The Co-operative Bank plc

Pillar 3 Disclosures

2015

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1. Overview

1.1 Background

This document sets out the Pillar 3 disclosures for The Co-operative Bank plc and its subsidiaries (the Bank) as at 31 December 2015. These disclosures have been prepared to give information on the basis of calculating capital requirements and on the management of risks faced by the Bank in accordance with the rules laid out in the Capital Requirements Regulation (Part 8), unless otherwise stated and should be read in conjunction with the Risk sections of the Bank's Annual Report and Accounts including the Risk Management section and the Principal risks and uncertainties section. These are available on the Investor Relations section of the Bank's website www.co-operativebank.co.uk/investorrelations/financialresults

The European Union Capital Requirements Directive (CRD) came into effect on 1 January 2007. Commonly referred to as Basel II, the legislative framework introduced capital adequacy standards and an associated supervisory framework in the European Union (EU). This was replaced by Capital Requirements Regulation (CRR) and Capital Requirements Directive (together collectively known as CRD IV) which came into force 1 January 2014. In the UK, implementation of the Directive has been through rules introduced by the Prudential Regulation Authority (PRA). These are known as Pillar 3 disclosures because they complement the minimum capital requirements in Pillar 1 and the supervisory review process in Pillar 2. The Pillar 3 disclosures are aimed at promoting market discipline by providing information on risk exposures and the management of those risks.

The Bank has a PRA waiver to use the Internal Ratings Based (IRB) approach to credit risk. This allows the Bank to calculate capital requirements for some of the Retail, Corporate and Treasury assets classes using internally developed models that reflect the credit quality of the assets. The Bank is in discussion with the PRA to remediate areas of non-compliance related to the use of IRB approaches. Please refer to the Bank's 2015 Annual Report and Accounts, Principal risks and uncertainties section, for further details of this issue.

The Bank currently has approval to use the following IRB approaches outlined below:

- Retail IRB - internal calculations of Probability of Default (PD), Loss Given Default (LGD) and credit conversion factors are used to model risk exposures;
- Foundation IRB – uses internal calculation of PD, but standardised regulatory defined LGD and credit conversion factors;
- Foundation IRB (slotting approach) – exposures are modelled and mapped to five supervisory categories from strong to default (slotting categories 1–5 respectively) with prescribed risk weights and expected losses;
- Foundation IRB (securitisation ratings based approach) – external credit ratings are used to map exposures to regulatory defined risk weights.

The table below illustrates the portfolios where the Bank has permission to use each of the IRB approaches:

Asset	Portfolio	IRB exposure classes	CRD approach
Retail	Mortgages (including Buy to Let Mortgages)	Retail – secured by immovable property	Retail IRB
	Credit cards/Overdrafts	Qualifying revolving retail exposures	Retail IRB
	Loans	Retail other non-SME	Retail IRB
Corporate	Corporate (total assets >£350k)	Corporates	Foundation IRB
	Business Banking	Corporates	Foundation IRB
	Registered social landlords (RSL)/housing associations	Corporates	Foundation IRB
	Specialised lending	Corporates	Foundation IRB (slotting approach)
Treasury	Financial institutions	Institutions	Foundation IRB
	Structured investments/credit trading funds	Corporates	Foundation IRB (securitisation ratings based method)
	Securitisation	Securitisation	Foundation IRB (securitisation ratings based method)

For other exposures and risk areas, the standardised approach is adopted, which uses capital risk weighting percentages set by CRD IV requirements.

1.2 Basis and frequency of disclosures

In meeting these disclosure requirements, the Bank has also considered recommendations made by the Enhanced Disclosure Task Force (EDTF) which seeks to give enhanced information above and beyond the minimum Pillar 3 disclosure requirements. These are set out in more detail in Section 2: Changes to disclosures.

Basel III was implemented in the UK from 1 January 2014, through both the European CRR and the Capital Requirements Directive (CRD IV) and through the PRA's policy statement PS7/13 www.bankofengland.co.uk/pra/Pages/publications/implemcrdiv.aspx. The term CRD IV is used throughout these disclosures as a collective term for CRD IV, CRR and the PRA's policy statement.

1.2 Basis and frequency of disclosures continued

These disclosures may differ from similar information in the 2015 Annual Report and Accounts prepared in accordance with International Financial Reporting Standards, with the information included in Pillar 3 being prepared in accordance with CRD IV; the information in these disclosures may therefore not be directly comparable with that information. All figures are as at 31 December 2015, the Bank's year end, unless otherwise stated.

Disclosures are issued on an annual basis and published on the same day as publication of the Annual Report and Accounts.

1.3 Location and verification

This report was prepared and approved in line with the Bank's Pillar 3 policy, which is approved on a yearly basis by the Audit Committee (AC). No significant changes have been made to the Pillar 3 policy compared to the prior year.

Business owners attest accuracy of their data and at the same time consistency checks and reconciliations were performed with the Bank's 2015 Annual Report and Accounts and regulatory returns where applicable. The disclosures have been subject to internal verification and reviewed by the Bank's Audit Committee (AC) and Risk Committee (RC) on behalf of the Board but have not been, and are not required to be subject to independent external audit. They are published on the Bank's website www.co-operativebank.co.uk/investorrelations/financialresults

1.4 Scope of disclosure

The Pillar 3 disclosures in this document relate to The Co-operative Bank plc (PRA firm reference number 121885). The principal subsidiary undertakings included within these disclosures are:

Operating company	Nature of business	Consolidated capital regulatory returns	Solo consolidated capital returns
The Co-operative Bank plc	Banking	Yes	Yes
Co-operative Commercial Limited	Investment company	Yes	No*
Britannia Treasury Services Limited	Holding company	Yes	Yes
Platform Funding Limited, Platform Home Loans Limited	Mortgage origination, Platform servicing company	Yes	No*
Platform Group Holdings Limited, Platform Consumer Services Limited	Holding companies	Yes	Yes
Platform Funding No.2 Limited, Platform Funding No.3 Limited, Platform Funding No.4 Limited, Platform Funding No.5 Limited, Platform Funding No.6 Limited	Dormant entities in liquidation	Yes	Yes
Mortgage Agency Services Number One, Two, Four, Five, Six Limited	Mortgage lending (acquired)	Yes	No*
First Roodhill Leasing, Second Roodhill Leasing, Third Roodhill Leasing, Fourth Roodhill Leasing, Roodhill Leasing Limited	Leasing	Yes	Yes
Britannia Asset Management Limited	Holding company	Yes	Yes
Britannia Development and Management Company Limited	Property Investments	Yes	Yes
Britannia Life Direct Limited	Financial Services	Yes	Yes
Moorland Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	Yes	No
Leek Finance (Number Seventeen, Eighteen, Nineteen) plc	Securitisation vehicles	Yes	No
Silk Road Finance Number Three plc	Securitisation vehicle	Yes	No
Meerbrook Finance Number Eight Limited	Securitisation vehicle	Yes	No
Calico Finance Number One Limited	Securitisation vehicle	Yes	No

* A capital deduction is made at a solo consolidated level to represent the equity investment in these companies. No equity investment is held in securitisation vehicles hence there is no capital deduction at a solo consolidated level.

All entities are fully consolidated (i.e. none are proportionally consolidated) and registered and operating in the UK.

Until its expiry in September 2014, the Bank had regulatory approval to operate with a 'solo-consolidation' permission, which allowed it to be regulated for prudential purposes as though the Bank and specified solo-consolidated subsidiaries formed a single legal entity. In March 2015, the Bank was granted a new permission to apply solo consolidation, though with respect to a smaller number of subsidiaries as per the table above. In addition the Bank has been granted regulatory approval for a Core UK Group permission to allow its exposures to those FCA-authorised subsidiaries no longer part of its solo-consolidation, to be exempt from large exposure thresholds. The scope of the Bank's prudential consolidation is the same as its consolidation for accounting purposes.

1.5 Non-disclosure

In accordance with European Banking Authority (EBA) guidelines on materiality, proprietary and confidentiality and on disclosure frequency, the Bank has not included the following disclosures on the grounds of immateriality:

- CRR Article 442(d),(h) split of geographical exposures. The Bank's exposures are predominately within the UK and therefore the geographical split has not been disclosed;
- CRR Article 447 regarding equity disclosures (Exposure At Default (EAD) of £60.5m as at 31 December 2015 and £8.1m as at 31 December 2014).

The Bank did not omit any disclosures on the grounds of proprietary or confidential information.

1.6 Pillar 3 requirements disclosed in the 2015 Annual Report and Accounts

1.6.1 Biographies of the Board

The number of directorships held by members of the management body, their actual knowledge, skills and expertise have been disclosed in the 2015 Annual Report and Accounts, Corporate Governance section, while the policy on diversity with regard to selection of members of management body and recruitment policy has been disclosed in the 2015 Annual Report and Accounts, Nomination Committee report. The 2015 Annual Report and Accounts are published on the Bank's website www.co-operativebank.co.uk/investorrelations/financialresults

1.6.2 Remuneration

In order to comply with the disclosure requirements of CRD IV and the PRA's Remuneration Code, the responsibilities and decision making process for determining remuneration policy, the link between pay and performance and the design and structure of remuneration, including performance pay plans, have been disclosed in the 2015 Annual Report and Accounts, Directors' Remuneration report. The 2015 Annual Report and Accounts are published on the Bank's website www.co-operativebank.co.uk/investorrelations/financialresults

1.7 Regulatory position

In December 2014, the Bank submitted a Revised Plan to the PRA. The Revised Plan was designed to help the Bank comply with Financial Conduct Authority (FCA) and PRA regulatory requirements and expectations. The Bank has an Updated Plan covering the period 2016-2020. The Board have reassessed the Optimum Portfolio and given current market conditions, expect to hold this portfolio for at least the short term future. However the Bank will continue to reassess this position, considering market conditions, over time. Please see 2015 Annual Report and Accounts, Principal risks and uncertainties, for further information regarding the Bank's regulatory position.

There are no current or foreseen material restrictions or legal impediments to the movement of capital or to the repayment of liabilities between UK based consolidated entities, with the exception of:

- securitisation vehicles and Covered Bond LLP with assets being ring-fenced within such entities.

1.8 Summary of key capital ratios

The Bank's key capital ratios are included below:

Table 1 CRD IV key capital ratios

	2015		2014	
	Transitional	**Fully Loaded**	Transitional	Fully Loaded
Common Equity Tier 1 ratio	**15.5%**	**15.5%**	12.7%	13.0%
Total Capital Ratio	**21.6%**	**21.6%**	14.9%	15.0%
Risk Weighted Assets (£m)	**7,422.9**	**7,422.9**	12,632.2	12,632.2
Leverage ratio		**3.8%**		4.2%

The Banks leverage ratio is calculated on a fully loaded basis in line with PRA guidance. Further details on the Bank's capital and leverage positions can be found in section 3 of this document.

2. Changes to disclosures

Basel III has been implemented in the EU through publication of CRR and a further iteration of CRD. Together this package of requirements is known as CRD IV and came into force 1 January 2014. The European Banking Authority is providing technical standards relating to CRD IV some of which are not yet finalised. CRD IV disclosures in this document are based on the Bank's interpretation of published rules. The Bank publishes its Pillar 3 disclosures on an annual basis; hence its 31 December 2014 Pillar 3 disclosures were the first to be fully disclosed on a CRD IV basis. Both the 2015 and 2014 comparatives included within these disclosures are reported on a CRD IV basis.

The Bank has continued to review its disclosures in line with EDTF recommendations and has made the following improvements to its EDTF disclosures:

- EDTF 19 – qualitative disclosure on the impact of encumbrance on business model;
- EDTF 20 – maturity split on tables 40 and 41;
- EDTF 31 – description of other risks (i.e. Fraud risk, Information and Data risk, Anti-Money Laundering risk, Technology risk, Legal risk, Insurance risk).

Further information regarding the EDTF recommendations can be found at www.fsb.org/2014/09/r_140930a/

Table 2 EDTF disclosure

The table below provides an index to the Bank's disclosures in accordance with the EDTF's recommendations either within its Annual Report and Accounts or Pillar 3 disclosures.

Type of risk	Recommendation	Disclosure	Section in Pillar 3	Section in Risk Management	Other sections of the accounts
General	1	Risks to which the business is exposed	5	Risk Management objectives and policies 3.1-3.6	Strategic review
	2	Definition of risk terminology, principles and appetite	5		
	3	Top and emerging risks and the changes during the reporting period	5		
	4	Analysis of future regulatory developments affecting our business model and the Bank's profitability	5		
Risk governance and risk management	5	The Bank's risk management organisation, process and key functions	4	Risk Management objectives and policies 3.1-3.6	Strategic review
	6	Risk culture and risk governance and ownership	4		
	7	Key risks, risk appetite and risk management	4, 5		
	8	Stress testing and the underlying assumptions	3	Capital Management	
Capital adequacy	9	Minimum Pillar 3 disclosure requirements	3	Capital Management	
	10	Reconciliation of accounting balance sheet to regulatory balance sheet	3		
	11	Flow statement of movements in regulatory capital since the previous reporting period including changes in Common Equity Tier 1, Tier 1 and Tier 2 Capital	3		
	12	Discussion of targeted level of capital and how this will be established	1,3,5		
	13	Analysis of Risk Weighted Assets	3		
	14	Analysis of capital requirements for each Basel asset class	3		
	15	Analysis of credit risk for each Basel asset class	3		
	16	Flow statements reconciling the movements in Risk Weighted Assets for each Risk Weighted Asset type	3		
	17	Discussion of Basel credit risk model performance	5		

2. Changes to disclosures continued

Type of risk	Recommendation	Disclosure	Section in Pillar 3	Section in Risk Management	Other sections of the accounts
Liquidity and funding	18	Analysis of the Bank's liquid asset buffer	5	Liquidity risk 2.4	
	19	Encumbered and unencumbered assets analysed by balance sheet category	5	Liquidity risk 2.6	
	20	Consolidated total assets, liabilities and off-balance sheet commitments analysed by remaining contract maturity at the balance sheet date	5	Liquidity risk 2.5	
	21	Analysis of the Bank's sources of funding	5	Liquidity risk 2.4	
Market risk	22	Relationship between the market risk measures for trading and non-trading portfolios and the balance sheet	5	Market risk 3.1	
	23	Discussion of significant trading and non-trading market risk factors	5	Market risk 3.4	
	24	VaR assumptions, limitations and validation	5	Market risk 3.1	
	25	Description of the primary risk management techniques employed by the Bank	5	Market risk 3.4	
Credit risk	26	Analysis of the aggregate credit risk exposures	5	Credit risk 1.1, 1.2, 1.3	Note 16: loans and advances to banks
	27	Describe the policies for identifying impaired and non-performing loans	5	Credit risk 1.1	Note 17: loans and advances to customers
	28	Reconciliation of the opening and closing balances of non-performing or impaired loans in the period	5	Credit risk 1.1	Note 18: investment securities
	29	Analysis of counterparty credit risk that arises from derivative transactions	5	Credit risk 1.2	Note 19: derivative financial instruments
	30	Discussion of credit risk mitigation, including collateral held for all sources of risk	5	Credit risk 1.1, 1.2, 1.3	
Other risks	31	Description of other risks	5	4-10	Note 32: Provisions for liabilities and charges
	32	Discussion of publicly known risk events	5	4-10	Note 35: Contingent liabilities and commitments

3. Capital adequacy

3.1 Assessing the adequacy of internal capital

Capital is held by the Bank to protect its depositors, to cover its inherent risks, to absorb unexpected losses and to support the development of the business. The Bank's objective is to achieve a capital base in excess of regulatory requirements.

Assessment of capital adequacy is made on a forward looking basis with reference to prevailing and forthcoming prudential rules including those under consultation. From 1 January 2014 the Bank has been subject to CRD IV which implemented Basel III within the European Union.

The Asset and Liability Committee (ALCO) is responsible for ensuring that the capital and solvency position of the Bank is managed in line with policy. The Capital Management Forum (CMF) is a sub-forum of ALCO and is responsible for oversight of all aspects of the Bank's capital risk management, monitoring and control including consideration of prudential regulations. CMF has specific responsibility as follows:

- review, challenge and monitor current and forecast capital adequacy with reference to regulatory requirements, Board risk appetite and financial plan;
- review and ratify the Bank's Internal Capital Adequacy Assessment Process (ICAAP) and capital adequacy stress testing;
- assess and report on risks and opportunities to plan and on capital management actions;
- review and monitor the Bank's capital management control standards; and
- report to and make recommendations to ALCO as appropriate.

The Bank's approach to assessing capital adequacy to support current and future requirements is conducted via the Bank's ICAAP, the financial planning process and through stress testing and scenario analysis. Stress testing is performed at least annually, with a formal ICAAP submission required to be submitted to the PRA at least once every two years. The Bank's ICAAP is constructed in two stages:

Stage 1 – initially assesses the capital adequacy of the Bank's Pillar 1 charge (credit, market and operational risks), and analyses and quantifies, where appropriate, additional Pillar 2 risks (including operational risk add-on, concentration risk, pension scheme risk, interest rate risk in the banking book, securitisation risk, resilience, reputational risk and contagion risk).

Stage 2 – models the Bank's five year plan earnings and balance sheet in order to ensure that its Pillar 1 and Pillar 2 capital requirements are met during a severe but plausible stressed environment over the plan period, utilising appropriate management actions. The Bank's most material risk is credit risk, making up 87.8% of its Risk Weighted Assets (RWAs). On this basis, the Bank's principal stress in determining its Pillar 2 capital is that of credit quality deterioration as a result of the Bank's chosen view of stress conditions.

Through most of 2015 the Bank was compliant with its Individual Capital Guidance (ICG), being the PRA's statement as to the regulatory capital it expects the Bank to hold. However, due to the Bank's ongoing losses, this position should be regarded as a temporary situation as the Bank is not expected to be sustainably compliant until the latter stages of the planning period. This unsustainable non-compliance relies on the PRA's continued acceptance of the Bank's Updated Plan (2016-2020). There is therefore a risk that the PRA may exercise any of its wide-ranging powers over the Bank, including the imposition of a special resolution procedure. The Bank met the Pillar 1 capital requirement throughout the year.

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

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

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

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

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

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

(1) Details of how the Bank of England's resolution powers operate under the Banking Act 2009 generally operate can be found set out in a document "The Bank of England's approach to resolution, October 2014" which can be found on its website at www.bankofengland.co.uk/financialstability/Documents/resolution/apr231014.pdf

(2) PRA CP 44/15 "The minimum requirements for own funds and eligible liabilities (MREL) Buffer and Threshold Conditions" was published on 11 December 2015 and sets out that PRA processes to adopt a policy that if a firm is in breach of its MREL requirement, it would not automatically mean that the PRA will consider the firm is failing, or likely to fail, to satisfy Threshold Conditions.

3.1 Assessing the adequacy of internal capital (continued)

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

The Bank's Updated Plan anticipates that the Bank will meet the 7% Common Equity Tier 1 (CET1) ratio throughout the planning period and will have sustainably met ICG by the latter stages of the planning period. The Updated Plan aims to build a sustainable Core Bank and is designed to create a capital buffer which would withstand a severe stress scenario equivalent to the 2014 Bank of England stress test by the latter stages of the planning period.

3.2 Capital stress testing

The Bank uses stress testing as part of its assessment of capital adequacy within its:

- Strategic Plan;
- ICAAP; and
- forecasting exercise.

Stress testing is embedded within the Bank's financial planning process, with stressed scenarios applied to the Bank's latest forecasts, at least on an annual basis or more frequent, where required. This enables the Bank's senior management and Board to assess the Plan under adverse scenarios to ensure the Plan remains within the risk appetite or that appropriate strategic decisions can be taken. Where outcomes fall outside of the risk appetite, they are either risk accepted or management actions are identified and embedded to return the position within the risk appetite.

Scenarios capture a multitude of macroeconomic variables including Gross Domestic Product (GDP), interest rates, unemployment, house prices and commercial real estate prices. An example scenario includes Euro sovereign debt concerns and weakening global economic activity, causing UK exports to recede. The Bank performs stress testing according to PRA's defined scenarios, as well as its own bespoke scenarios.

Individual business areas prepare business plans as part of the Strategic Planning process. Stress testing models are utilised to stress test business plans over a forward looking planning horizon.

Stress testing results are prepared on both a pre and post management action basis, and compared to both risk appetite and minimum regulatory requirements. Review and challenge of stress testing results are undertaken by the business and the second line of defence, as part of the Bank's Risk Management Framework (RMF).

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

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

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

As a result of the stress test, the Bank submitted a Revised Plan which was accepted by the PRA in December 2014. This Plan was designed to enable the Bank to withstand a severe stress by the end of the planning horizon.

Following the stress assessment, the Bank was not included in the 2015 Bank of England stress test since this test was designed to assess resilience to a deterioration in global economic conditions. The Bank was not included as a result of the size of the Bank's balance sheet, which is significantly smaller than the other banks which were included in the stress test; therefore the resilience of the Bank is unlikely to affect the resilience of the financial system as a whole.

Following the approval of the Bank's Updated Plan, the Bank's risk appetite is to ensure that the Bank is capital resilient and achieves Individual Capital Guidance (ICG) and PRA Buffer compliance by the end of the Plan.

The Bank's Updated Plan is complex and the execution risk is significant. Please see the Principal risks and uncertainties section of the 2015 Annual Report and Accounts for further details.

3.3 Capital adequacy

All CRD IV disclosures are shown on a transitional and fully loaded basis except for the leverage ratio which is only calculated on a fully loaded basis. Through its Policy Statement PS7/13, the PRA implemented CET1 deductions and prudential filters in full from 1 January 2014, with the exception of available for sale unrealised gains, which had a transitional provision for 2014 only. The Bank's fully loaded and transitional positions for Additional Tier 1 and Tier 2 capital were similar during 2014, however minority interests retained a transitional element. Given the Bank disposed of a 20.0% share in Unity Trust Bank (UTB), reducing it's shareholding to 6.7%, UTB is no longer a minority interest and is treated as an equity investment. Therefore the Bank no longer has any transitional provisions in December 2015.

During 2015 the Bank has continued to make progress towards improving its capital position and reducing its overall risk profile. The Bank closed its inaugural whole structure securitisation as part of its Non-core Optimum residential mortgages portfolio through the issuance of notes and residential certificates by Warwick Finance Residential Mortgages Number One plc (Warwick Finance One), followed by the securitisation of Warwick Finance Residential Mortgages Number Two plc (Warwick Finance Two) later in the period (collectively called Warwick Finance One & Two).

- Fully loaded Common Equity Tier 1 ratio has increased to 15.5% as at 31 December 2015 (2014: 13.0%). Further details can be found in the sub-section 3.4 Capital ratios.

3.3 Capital adequacy (continued)

- Fully loaded leverage ratio has decreased to 3.8% as at 31 December 2015 (2014: 4.2%). Further details can be found in the sub-section 3.8 Leverage ratio.
- the PRA issued PS27/15 in December 2015 to implement a UK leverage ratio framework. The framework as currently stands only applies to firms with greater than £50bn retail deposits. The UK framework will be reviewed by the Financial Policy Committee in 2017, and as part of this review, the PRA may extend the requirement to other firms including the Bank. Therefore at present, the Bank does not have a minimum leverage ratio requirement, however it continues to monitor framework developments and the leverage ratio is included within the Bank's Updated Plan and Risk Appetite as a key metric. The Bank's leverage ratio will be sustainably above 3.0% by the end of the planning period.

3.4 Capital ratios

The Bank's capital ratios are as follows:

Table 3 Capital ratios

	2015		2014	
	Transitional	Fully Loaded	Transitional	Fully Loaded
Common Equity Tier 1 ratio	**15.5%**	**15.5%**	12.7%	13.0%
Tier 1 ratio	**15.5%**	**15.5%**	12.9%	13.0%
Total Capital Ratio	**21.6%**	**21.6%**	14.9%	15.0%

The increase in CET1 ratio reflects a £5.2bn reduction of RWAs and a £161.5m reduction in the CET1 deduction for expected loss shortfall, which were more than offset by the £623.3m regulatory losses for the year. The £5.2bn reduction in RWAs is primarily due to the £4.4bn reduction in Non-core RWAs. The securitisation of £3.1bn of residential mortgages within the Optimum portfolio, the natural book run off and a £0.7bn reduction in the Optimum RWA temporary adjustment has resulted in a net £2.4bn reduction in RWAs after accounting for the £101.2m of Warwick Finance One & Two notes, which are held by the Bank. A further £1.8bn RWA reduction has been seen in Corporate Co-operative Asset Management (CoAM) business unit, driven by ongoing asset sales and deleveraging activity.

Warwick Finance One & Two comprised portfolios of £3.1bn of residential mortgages, issuing rated Residential Mortgage Backed Securities (RMBS) and residual certificates to investors. The transaction satisfies significant risk transfer requirements under CRR in relation to the securitised portfolio. In addition the Bank retained 65% of the Class A Notes on settlement of Warwick Finance One and 80% of the Class A notes on settlement of Warwick Finance Two. The Class A Note retention is the only position retained by the Bank within the Warwick Finance One & Two capital structures. The Bank retains 5% of the original mortgage pool which enables the Bank to meet CRR retention requirements for originators of securitisations. The Warwick Finance One & Two transactions have helped to drive an increase in the Bank's 2015 CET1 capital position which has risen by 2.5%, from 13.0% to 15.5%.

Within its Policy Statement PS7/13, the PRA implemented CET1 deductions and prudential filters in full. The 2015 minimum CET1 ratio is 4.5% and minimum Tier 1 ratio is 6.0%. As at 31 December 2015 the Bank's CET1 ratio of 15.5% is 11.0% higher than the 4.5% minimum CET1 ratio and the Bank's Tier 1 ratio of 15.5% is 9.5% higher than the 6.0% minimum Tier 1 ratio.

However, the PRA confirmed within its Supervisory Statement SS3/13 that it expects major UK banks and building societies, including The Co-operative Bank, to maintain a CET1 ratio of at least 7.0%. The PRA has amended this policy statement, effective 1 January 2016 such that it no longer references The Co-operative Bank, however the Bank expects to continue to be in excess of 7.0% CET1 throughout its plan.

3.5 Capital buffers

The Bank is not classified as a Global Systemically Important Institution (G-SII), and hence does not have a requirement to hold a G-SII buffer. The Bank is also not defined as an Other Systemically Important Institution (O-SII) by the PRA and hence does not have a requirement to hold a O-SII buffer; furthermore HM Treasury has also confirmed that it will set the UK O-SII buffer at 0%.

The capital conservation buffer to be introduced from 1 January 2016 includes a transitional requirement and increases by 0.625% per annum until the final requirement of 2.5% is reached from 1 January 2019. The capital conservation buffer was 0% as at 31 December 2015.

The Bank is required to calculate its institution specific countercyclical buffer dependent upon the geographic location of obligors. The European Commission published a Regulatory Technical Standard (EU Regulation No 1152/2014) in 2014 to define the location of obligor. Under this methodology, the Bank's exposures can all be classified as UK. The UK countercyclical buffer rate is therefore directly applicable to the Bank. The Financial Policy Committee confirmed in December 2015 that the UK countercyclical buffer rate remains at 0%.

3.6 Capital resources

The following table shows the capital resources of the Bank.

Table 4 Total capital resources

	2015		2014	
	Transitional £m	**Fully Loaded £m**	Transitional £m	Fully Loaded £m
Common Equity Tier 1 capital: instruments and reserves				
Permanent share capital and the related share premium account	**1,759.5**	**1,759.5**	1,759.5	1,759.5
Retained earnings	**(273.1)**	**(273.1)**	(36.7)	(36.7)
Available for sale and cash flow hedge reserves	**90.2**	**90.2**	83.6	83.6
Minority Interests	**–**	**–**	6.1	10.6
Other Reserves[1]	**410.0**	**410.0**	410.0	410.0
Common Equity Tier 1 (CET1) capital before regulatory adjustments	**1,986.6**	**1,986.6**	2,222.5	2,227.0
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
Prudent valuation	**(0.8)**	**(0.8)**	(0.4)	(0.4)
Intangible assets (net of related tax liability)	**(142.8)**	**(142.8)**	(103.7)	(103.7)
Deferred tax assets not arising from temporary differences	**(4.0)**	**(4.0)**	–	–
Cash flow hedge reserves	**(34.6)**	**(34.6)**	(59.0)	(59.0)
Expected loss shortfall	**(30.0)**	**(30.0)**	(191.5)	(191.5)
Losses for the year	**(623.3)**	**(623.3)**	(236.4)	(236.4)
Unrealised gains or losses on available for sale assets (revaluation reserve)	**–**	**–**	(24.6)	–
Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(835.5)**	**(835.5)**	(615.6)	(591.0)
Common Equity Tier 1 (CET1) capital	**1,151.1**	**1,151.1**	1,606.9	1,636.0
Additional Tier 1 (AT1) capital: instruments				
Minority interest	**–**	**–**	22.9	2.3
Additional Tier 1 (AT1) capital before regulatory adjustments	**–**	**–**	22.9	2.3
Total regulatory adjustments to AT1 capital	**–**	**–**	–	–
Tier 1 capital (T1 = CET1 + AT1)	**1,151.1**	**1,151.1**	1,629.8	1,638.3
Tier 2 (T2) capital: instruments and provisions				
Capital instruments	**448.4**	**448.4**	196.4	196.4
Minority interests	**–**	**–**	0.8	3.0
Credit risk adjustments	**–**	**–**	52.2	52.2
Tier 2 (T2) capital before regulatory adjustments	**448.4**	**448.4**	249.4	251.6
Total regulatory adjustments to Tier 2 (T2) capital	**–**	**–**	–	–
Tier 2 (T2) capital	**448.4**	**448.4**	249.4	251.6
Total capital (TC = T1 + T2)	**1,599.5**	**1,599.5**	1,879.2	1,889.9

(1) Other Reserves include the £410m capital redemption reserve created as a result of the Bank's Liability Management Exercise (LME) in 2013.

The reduction in Expected Loss (EL) shortfall is a result of both deleveraging of the Bank's Non-core assets and a revision to the method used to calculate EL shortfall following EBA guidance in relation to the Bank's interpretation of CRR Article 159. In 2014, the EL shortfall calculation resulted in a deduction from CET1 of £191.5m with add back in Tier 2 of £52.2m. The Bank now has a deduction to CET 1 only.

Following the reduction in the Bank's equity stake in Unity Trust Bank the Bank no longer consolidates UTB within its accounts as a Minority Interest. As a result, the Bank no longer allocates any Minority Interest across the tiers of capital which it previously held in 2014.

The Bank raised an additional £250m of subordinated debt which qualifies as Tier 2 capital during 2015. The additional increase is a result of changes in the Mark-to-Market Fair Value of the available funds.

3.6 Capital resources continued

Table 5 Movement in transitional capital resources during the year

The following table is a flow statement of movements in the Bank's available capital resources detailing the change between opening and closing position for the period.

	2015 £m	2014 £m
CET1 capital after regulatory adjustments at the beginning of the year	**1,606.9**	1,074.3
Permanent share capital	**–**	12.8
Retained earnings	**–**	–
Minority Interests	**(6.1)**	(0.8)
Losses for the period	**(623.3)**	(236.4)
Share premium account	**–**	687.4
Intangible assets	**(39.1)**	7.0
Available for Sale reserve	**55.6**	14.1
Capital Redemption Reserve	**–**	–
Expected loss shortfall	**161.5**	46.8
Prudent valuation	**(0.4)**	1.7
Unrealised gains or losses on available for sale assets (revaluation reserve)	**(4.0)**	–
CET1 capital after regulatory adjustments at the end of year	**1,151.1**	1,606.9
AT1 capital after regulatory adjustments at the beginning of the year	**22.9**	21.7
Minority Interest	**(22.9)**	1.2
AT1 capital after regulatory adjustments at the end of year	**–**	22.9
Total Tier 1 after regulatory adjustments at the end of year	**1,151.1**	1,629.8
T2 capital after regulatory adjustments at the beginning of the year	**249.4**	261.1
Paid up capital instruments and subordinated loans	**252.0**	0.1
Minority Interest	**(0.8)**	(0.1)
IRB Excess of provisions over expected losses eligible	**(52.2)**	(11.7)
T2 capital after regulatory adjustments at the end of year	**448.4**	249.4
Total capital resources at the end of year	**1,599.5**	1,879.2

An explanation of the key movements in capital during the course of the year have been noted below Table 4.

3.6 Capital resources continued

Table 6 Reconciliation of capital resources to statutory balance sheet

Item	Balance per accounts £m	Regulatory presentation	Regulatory balance treatment £m	Cash flow hedge reserve £m	Regulatory treatment of deferred tax assets £m	Expected Loss £m	Prudent valuation £m	Capital Resources £m
Equity								
Ordinary share capital	**22.6**	Paid up capital instruments	**22.6**	–	–	–	–	**22.6**
Share premium account	**1,736.9**	Share premium	**1,736.9**	–	–	–	–	**1,736.9**
Retained earnings	**(896.4)**	Retained earnings	**(273.1)**	–	–	–	–	**(273.1)**
		Regulatory losses for the period	**(623.3)**	–	–	–	–	**(623.3)**
Available for sale reserve	**55.6**	Available for sale reserve	**55.6**	–	–	–	–	**55.6**
Cash flow hedging reserve	**34.6**	Cash flow hedging reserve	**34.6**	**(34.6)**	–	–	–	–
Capital redemption reserve	**410.0**	Other reserves	**410.0**	–	–	–	–	**410.0**
		Total Equity	**1,363.3**	**(34.6)**	–	–	–	**1,328.7**
Non-Equity								
Other borrowed funds	**448.4**	Capital instruments	**448.4**	–	–	–	–	**448.4**
Intangible assets	**142.8**	Intangible assets (net of related tax liability)	**(142.8)**	–	–	–	–	**(142.8)**
Deferred tax assets	**7.6**	Deferred tax assets not arising from temporary differences	**7.6**	–	**(11.6)**	–	–	**(4.0)**
Impairment[1]	**(240.4)**	Expected loss shortfall	**240.4**	–	–	**(270.4)**	–	**(30.0)**
		Prudent valuation	–	–	–	–	**(0.8)**	**(0.8)**
		Total Non-Equity	**553.6**	–	**(11.6)**	**(270.4)**	**(0.8)**	**270.8**
		Total balances subject to own funds calculations	**1,916.9**	**(34.6)**	**(11.6)**	**(270.4)**	**(0.8)**	**1,599.5**

[1] Impairment is included within Loans and Advances to Customers in the Statutory Balance Sheet. Only impairment relating to exposures calculated under the IRB approach to credit risk are applicable for the calculation of Expected loss shortfall. Therefore the impairment number included in the table above relates to IRB exposures only, and is a subset of the Bank's total impairment.

The Bank's issued Capital resources defined in the above table comprise the following:

- Share Capital of 454m Ordinary shares of 5p each. The original issue date of 254m shares took place in December 2013 during the Bank's LME, where by all previous shares were cancelled. A further issuance of 200m shares took place during May 2014;
- The share premium of £1.7bn is attributable to the issuance of the Ordinary shares and reflects both the premium paid for the shares issued and the debt restructuring effected during the LME;
- Subordinated debt of £448.4m following two Tier 2 eligible debt issuances. During the LME, £206m was issued with an additional issuance of £250m during July 2015. The amount held as Tier 2 is the net amount excluding the cost of issuance to be amortised over the term.

Further details including any specific terms of the Ordinary Shares and Tier 2 instruments can be found in Appendix 2. Full details of the Terms & Conditions of the Ordinary Shares can be found in the Articles of the Association on the Bank's website: www.co-operativebank.co.uk/investorrelations

3.7 Pillar 1 capital requirements and Risk Weighted Assets

The following table analyses the Pillar 1 capital requirement by approach and exposure class. In the table below and throughout the document, unless otherwise stated, the documented exposures are reported as EAD (see Table 10). For IRB exposures EAD is defined as the amount estimated to be outstanding at the time of default, including the estimation of credit conversion factors to undrawn commitments. For standardised exposures EAD includes undrawn commitments post credit conversion factors defined in CRR Article 111 and is net of eligible provision.

In accordance with CRR Article 150 (Conditions for permanent partial use) the Bank has received permission from the regulator to exempt its exposures to certain counterparty classes, namely Central governments and central banks and Multilateral development banks from the IRB Approach for the purposes of the calculation of both risk-weighted exposure and expected loss amounts, instead applying the Standardised Approach for these exposures. The revised approach was implemented for the purposes of the Bank's regulatory reporting submissions as at 1 January 2014.

The exposure classes not applicable to the Bank and which haven't been presented in the tables disclosing exposures classes throughout this document, are as follows:

- IRB approach: Central government and central bank, Retail SME, Equity exposures and Other non-credit obligation assets; and
- Standardised approach: International organisations, Securitisation positions, Exposures associated with particularly high risks, Short term claims on institutions and corporates and Collective investment undertakings.

The following table analyses the capital requirements by approach and exposure class:

Table 7 Pillar 1 capital requirements

2015

IRB exposure class	Capital requirement £m	Risk weighted asset £m	Exposure at default £m	Average risk weight %	Average exposure at default £m
Institutions	17.6	220.5	836.0	26%	945.8
Corporates	48.6	606.9	1,152.2	53%	1,220.5
Retail secured by immovable property	159.0	1,987.5	15,563.6	13%	16,764.9
Qualifying revolving retail exposures	35.6	444.9	2,031.9	22%	2,075.8
Retail other non-SME	23.6	294.4	288.7	102%	350.9
Securitisation positions	52.7	658.2	3,038.0	22%	2,501.1
Total IRB	337.1	4,212.4	22,910.4	18%	23,859.0
Specialised lending	104.0	1,299.4	1,496.2	87%	2,085.7
Standardised exposure class					
Central government or central banks	–	–	5,465.4	0%	7,092.9
Regional governments or local authorities	0.1	1.0	5.0	20%	11.3
Public sector entities	0.3	4.0	20.0	20%	27.9
Multilateral development banks	–	–	500.9	0%	557.2
Institutions	8.6	107.7	72.8	148%	185.8
Corporates	25.6	320.1	320.1	100%	648.1
Retail exposures	4.6	58.1	77.4	75%	113.0
Secured by mortgages on immoveable property[(1)]	–	0.1	0.2	75%	28.4
Exposures in default	4.8	60.4	41.0	147%	50.2
Covered bonds	–	–	–	–	70.8
Equity exposures	5.4	67.8	60.5	112%	21.1
Other items[(2)]	30.9	386.6	461.8	84%	609.6
Total standardised	80.3	1,005.8	7,025.1	14%	9,416.3
Total credit risk	521.4	6,517.6	31,431.7	21%	35,361.0
Total market risk	–	–	N/A	N/A	N/A
Operational risk	72.4	905.3	N/A	N/A	N/A
Total Pillar 1	593.8	7,422.9	N/A	N/A	N/A

(1) The Standardised Secured by mortgages on immovable property class contains a small number of legacy mortgages not included within the IRB portfolio. The 75% RW% is accurate however due to the small level of exposure rounded values do not allow the arithmetic calculation in the table.

(2) Other items relate to accounting adjustment applied to customer balances and investments, and non-customer related assets on the balance sheet (e.g. Cash, Property Plant & Equipment, Tax). The varying Risk weights applied to these assets under CRR have resulted in a reduction in overall RWAs, in part related to the reduction in exposure amounts.

3.7 Pillar 1 capital requirements and Risk Weighted Assets continued

Counterparty risk arising from derivative exposures is reported within the appropriate exposure classes, dependent upon the counterparty classification.

Institutions calculated under the standardised approach include £83m of RWA's and £6.6m capital requirement relating to the calculation of Credit Valuation Adjustments for derivatives.

The deleveraging of the Bank has resulted in the following significant movements during 2015:

- the Warwick Finance One & Two transactions resulting in £3.1bn of Optimum mortgage assets being securitised, have reduced overall Risk Weight percentage (RW%) in Retail secured by immovable property by 10%;
- disposal of unrated Securitisations positions in favour of retention in the Warwick Finance One & Two issued notes have significantly reduced the RW% by 35%;
- following the reduced stake in UTB, RWA reduction within Standardised approach is as follows: Institutions (£33m), Corporates (£100.2m), Retail Exposures (£27.2m), Secured by mortgages on immovable property (£10.9m), Exposures in default (£4.7m), Covered bonds (£7.4m).

Increases in Equity exposures' RWA is a direct result of revaluation of the Bank's Visa Europe investment. The Bank's investment in Visa Europe has a 100% risk weight, while significant investments have a 250% risk weight in accordance with CRR Article 133. Therefore the increased proportion of Visa Europe investment in total Equity exposures led to a decrease of the RW% year on year.

The Bank does not have a trading book.

2014

IRB exposure class	Capital requirement £m	Risk weighted asset £m	Exposure at default £m	Average risk weight %	Average exposure at default £m
Central government and central bank	–	0.3	2.8	11%	1.5
Institutions	35.8	446.9	1,567.1	29%	1,770.5
Corporates	66.2	827.3	1,424.0	58%	1,696.6
Retail secured by immovable property	345.3	4,315.8	19,128.8	23%	19,862.9
Qualifying revolving retail exposures	40.2	503.0	2,162.9	23%	2,720.3
Retail other non-SME	37.7	471.7	434.5	109%	492.4
Securitisation positions	74.3	928.4	1,623.8	57%	1,692.2
Total IRB	599.5	7,493.4	26,343.9	28%	28,236.4
Specialised lending	170.7	2,133.5	3,067.4	70%	3,609.9
Standardised exposure class					
Central government or central banks	–	–	8,084.4	0%	8,395.2
Regional governments or local authorities	0.4	5.2	25.8	20%	53.1
Public sector entities	1.2	14.4	71.9	20%	54.7
Multilateral development banks	–	–	588.2	0%	632.5
Institutions	12.3	153.8	144.8	106%	190.0
Corporates	75.0	937.9	944.4	99%	1,088.1
Retail exposures	7.1	89.3	130.7	75%	125.8
Secured by mortgages on immoveable property	0.9	11.1	32.6	35%	27.6
Exposures in default	5.9	73.2	52.8	139%	51.6
Covered bonds	0.6	7.5	74.5	10%	40.5
Equity exposures	1.6	20.2	8.1	249%	3.5
Other items	44.9	560.9	959.9	58%	988.8
Total standardised	149.9	1,873.5	11,118.1	17%	11,651.4
Total credit risk	920.1	11,500.4	40,529.4	28%	43,497.7
Total market risk	–	–	N/A	N/A	N/A
Operational risk	90.5	1,131.8	N/A	N/A	N/A
Total Pillar 1	1,010.6	12,632.2	N/A	N/A	N/A

Institutions calculated under the Standardised approach include £145m of RWA's and £12m capital requirement relating to the calculation of Credit Valuation Adjustments for derivatives.

3.7 Pillar 1 capital requirements and Risk Weighted Assets continued

Table 8 Flow statement of Risk Weighted Assets

A flow statement for the movement in Credit risk RWAs during the year is set out in the table below:

	Corporate £m	Retail Unsecured £m	Retail Secured £m	Treasury £m	Total £m
Credit Risk RWAs as at 31 December 2014	4,384.0	1,076.7	4,315.9	1,723.8	11,500.4
Book size[1]	(1,467.1)	(233.8)	56.5	(172.2)	(1,816.6)
Book quality[2]	(165.4)	(5.5)	46.6	–	(124.3)
Model updates[3]	–	–	–	–	–
Methodology and policy[4]	–	–	–	(121.1)	(121.1)
Acquisitions and Disposals[5]	(461.6)	(38.0)	(2,462.6)	41.4	(2,920.8)
Credit Risk RWAs as at 31 December 2015	2,289.9	799.4	1,956.4	1,471.9	6,517.6

(1) Book size – organic changes in book size and composition (including new business, maturing loans and individual customer deleverage).

(2) Book quality – quality of book changes caused by experience such as underlying customer behaviour or demographics, including changes through model calibrations/realignments.

(3) Model updates – Model implementation, change in model scope or any change to address model malfunctions.

(4) Methodology and policy – methodology changes to the calculations including those driven by regulatory policy change, such as new regulation (e.g. CRD IV).

(5) Acquisitions and Disposals – significant acquisition or disposal of distinct portfolios.

Corporate RWAs have reduced by 48% during 2015, predominantly as a result of the decrease in book size (55% reduction in Standardised, 35% in Specialised Lending and 21% in other Foundation IRB portfolios), driven by the deleveraging activity within the Non-core portfolio. The key reductions in RWAs have been observed in Project Finance Initiatives (PFI) (£402m), Energy (£390m) and Commercial Real Estate (£318m) sectors.

The reduction in Retail Unsecured RWAs has largely been driven by a decrease in book size, with Loan exposure reducing by £150m in the period, resulting in £180m reduction in RWA. A reduction in Credit Card and Overdraft exposure also reduces RWA by £51m and £3m respectively.

Retail Secured RWAs reduced due to securitisation of Warwick Finance One & Two. An increase in RWA is observed in the remaining secured portfolios, driven by Platform new business (Net EAD increase of £1.8bn resulting in £309m increase in RWA), offset largely by amortisation/maturity of other portfolios (Net EAD decrease of £2.2bn resulting in £206m reduction in RWA).

The reduction in Treasury RWA's is primarily due to a decrease in exposures as the size of the Treasury book has reduced throughout the year. The acquisitions relate to the Warwick Finance One & Two securitisations, with the Bank retaining 65% and 80% of Class A notes respectively in each transaction.

Table 9 Reconciliation of statutory balance sheet to gross drawn credit risk exposure

The table below reconciles the statutory balance sheet included within the Annual Report and Accounts to gross drawn credit risk exposure.

	Balance Sheet Assets under the Regulatory Scope of Consolidation £m	Items Deducted from Own Funds £m	Provisions £m	Securitisations Adjustment £m	Other Adjustments £m	Gross Drawn Credit Risk Exposure £m
Cash and balances with central banks	2,678.5	–	–	–	(81.0)	2,597.5
Loans and advances to banks	871.0	–	–	–	(19.2)	851.8
Loans and advances to customers	19,784.4	–	245.2	(107.2)	(127.2)	19,795.2
AFS financial assets	4,296.8	–	–	–	–	4,296.8
Treasury bills/other eligible bills	597.4	–	–	–	–	597.4
Derivatives and SFTs (e.g. reverse repos)	370.1	–	–	–	–	370.1
Equity shares	55.6	–	–	–	–	55.6
Investments in group undertakings (e.g. insurance subs)	4.9	–	–	–	–	4.9
Intangible assets	142.8	(142.8)	–	–	–	–
Deferred tax assets	7.6	–	–	–	(1.9)	5.7
Other assets	219.2	–	–	–	236.9	456.1
Total balance sheet	29,028.3	(142.8)	245.2	(107.2)	7.6	29,031.1

Securitisations Adjustment represents the difference in regulatory treatment allowable under CRR rules on the Calico securitisation as a result of the Significant Risk Transfer (SRT) that has been established on the related mortgages.

3.7 Pillar 1 capital requirements and Risk Weighted Assets continued

Table 10 Reconciliation of gross drawn credit risk exposure to Exposures at Default

	Gross drawn exposure £m	Off-balance sheet items under regulatory scope £m	Gross exposure pre-CRM £m	Credit conversion factor £m	Credit risk mitigation £m	Net exposure post-CRM £m	Other regulatory adjustments £m	Exposure at default £m
IRB approach								
Central government and central bank	–	–	–	–	–	–	–	–
Institutions	1,047.5	220.5	1,268.0	0%	(432.0)	836.0	–	836.0
Corporates	2,538.5	195.5	2,734.0	75%	(28.1)	2,656.7	(8.3)	2,648.4
Retail secured by immovable property	14,727.3	514.1	15,241.4	91%	–	15,192.9	370.7	15,563.6
Qualifying revolving retail exposures	464.6	1,814.4	2,279.0	85%	–	2,010.3	21.6	2,031.9
Retail other non-SME	288.7	–	288.7	–	–	288.7	–	288.7
Securitisation positions	3,038.0	–	3,038.0	–	–	3,038.0	–	3,038.0
Total	22,104.6	2,744.5	24,849.1	–	(460.1)	24,022.6	384.0	24,406.6
Standardised approach								
Central government or central banks	5,393.9	–	5,393.9	–	71.5	5,465.4	–	5,465.4
Regional governments or local authorities	2.9	11.3	14.2	19%	–	5.0	–	5.0
Public sector entities	19.2	3.3	22.5	23%	–	20.0	–	20.0
Multilateral development banks	500.9	–	500.9	–	–	500.9	–	500.9
Institutions	53.6	537.0	590.6	0%	(517.8)	72.8	–	72.8
Corporates	308.5	44.8	353.3	30%	(2.5)	320.1	–	320.1
Retail exposures	77.4	–	77.4	–	–	77.4	–	77.4
Secured by mortgages on immoveable property	0.2	–	0.2	–	–	0.2	–	0.2
Exposures in default	47.6	9.2	56.8	49%	–	52.1	(11.1)	41.0
Equity exposures	60.5	–	60.5	–	–	60.5	–	60.5
Other items	461.8	–	461.8	–	–	461.8	–	461.8
Total	6,926.5	605.6	7,532.1	–	(448.8)	7,036.2	(11.1)	7,025.1
Overall total	29,031.1	3,350.1	32,381.2	–	(908.9)	31,058.8	372.9	31,431.7

The Off-balance sheet items include future commitments to lend subject to conversion factors and Repurchase Agreements (Repos) that are required under regulatory scope. Credit Conversion Factors (CCF) applicable under the Standardised approach per CRR Article 111 are 0%, 20%, 50% or 100% dependent upon the credit facility available. Where values differ in the table above this is a result of a mixed basis of credit facility within the given exposure class. CCF for IRB exposure classes relate specifically to Off-Balance sheet exposures calculated by the EAD model.

Credit Risk Mitigation (CRM) has been calculated in line with CRR regulation Part 3, Title II, Chapter 4. For IRB institutions, £153m of the CRM relates to pledged collateral against Repos, £75m relates to derivate collateral with the remaining £204m relating to drawn exposures. For Standardised Institutions the applicable CRM relates to pledged collateral against Repos.

Net exposure post-CRM is the sum of gross drawn exposures and Off-balance sheet items following the application of CCF and CRM. EAD is the final exposure value used in the calculation of capital following the application of Other regulatory adjustments.

Other regulatory adjustments in the IRB section relate specifically to the amount applied to drawn exposures calculated by the EAD model.

Other regulatory adjustments in the Standardised section relate specifically to the allocation of Provisions and relate to Corporate exposures within the Exposures in default asset class.

Refer to Table 15 for explanations of EAD movement within the period.

3.8 Leverage ratio

Table 11 Leverage ratio

	2015 £m	Restated[1] 2014 £m
Derivative exposures	**344.5**	509.1
Securities financing transactions	**86.1**	190.5
Other assets	**28,980.3**	37,557.3
Off-balance sheet items	**938.6**	957.0
Regulatory deductions and other adjustments	**(212.2)**	(354.6)
Total fully loaded leverage exposure	**30,137.3**	38,859.3
Fully-loaded CRD IV Tier 1 capital	**1,151.1**	1,638.3
Fully loaded leverage ratio	**3.8%**	4.2%

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

Note: The Bank received a waiver from the PRA in July 2014 to compute the leverage ratio on a point-in-time basis at the end of each quarter (i.e. 31 December 2015) as opposed the arithmetic mean of the 3 months within each quarterly period.

The leverage ratio (calculated as Tier 1 capital divided by adjusted balance sheet exposures) has decreased by 0.4% to 3.8% as at 31 December 2015 (2014: 4.2% restated). The result reflects a decrease in exposure of £8.7bn to £30.1bn impacted by the overall deleveraging strategy, partially offset by a £487.2m decrease in the Bank's Tier 1 position primarily as a result of the £623.3m regulatory losses for the year. The leverage ratio has been calculated in accordance with the European Commission delegated act.

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

Table 12 On Balance sheet exposure reconciliation

The table shows the reconciliation of EAD in Table 10 to the leverage measure of exposure.

	2015 £m
Total EAD Per Table 10	**31,431.7**
Derivative exposures	**(344.5)**
Securities financing transactions	**(86.1)**
Off-balance sheet items EAD[1]	**(2,178.1)**
IRB Provisions for On balance sheet items	**(188.9)**
Derivative collateral	**203.4**
Intangibles	**142.8**
Total Leverage 'Other Assets'	**28,980.3**

[1] Reflects Gross Off-balance sheet post application of CCF and CRM.

Table 13 Off-balance sheet exposure reconciliation

The table shows the reconciliation of Off-balance sheet exposures in Table 10 to the leverage measure of exposure.

	Off-balance sheet items under regulatory scope	Undrawn commitments post leverage CCF
Undrawn credit facilities unconditionally cancellable @10%	**1,837.9**	183.8
Medium/low risk trade related off-balance sheet items @20%	**–**	–
Medium risk trade related off-balance sheet items @50%	**–**	–
Other off-balance sheet items @100%	**754.8**	754.8
Securities financing transactions	**731.4**	N/A
Derivatives: Futures	**26.0**	N/A
Total Off-balance sheet items	**3,350.1**	938.6

4. Risk Management governance

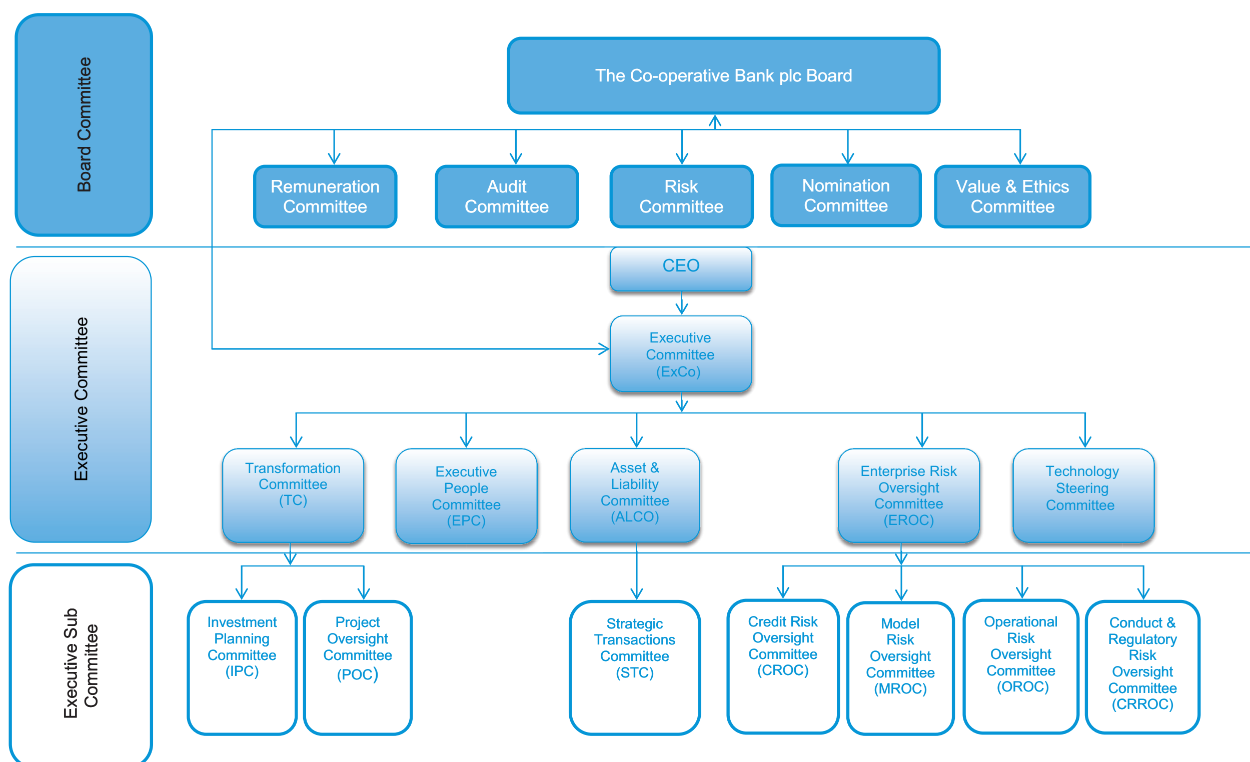
4.1 Overview

Responsibility for risk management resides at all levels of the Bank from the Board and the Executive Committee supported by senior management committees throughout the organisation to each business area subject to appropriate oversight.

The Enterprise Risk Oversight Committee (EROC) achieves some of its objectives through delegating responsibility to sub-committees, Model Risk, Conduct & Regulatory Risk, Operational Risk and Credit Risk Oversight Committees. The sub-committees will approve, discuss or note papers and escalate to the EROC where relevant or where required by governance. EROC will escalate where appropriate to the Board via the Risk Committee.

4.2 Risk governance structure

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



4.3 Board and sub-committees

The Bank's risk governance structure provides risk evaluation and management whilst ensuring the Bank manages the regulatory environment as efficiently as possible. The risk focus of these Committees is described below:

Committee	Risk focus
The Board	The Board has collective responsibility for the long term success of the Bank. Its role is to provide leadership of the Bank within a framework of prudent and effective controls which enable risk to be assessed and managed. It sets the Bank's values and standards and ensures that its obligations to its shareholders, customers and other stakeholders are understood and met. The Board sets the Bank's 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.
Remuneration Committee	The Remuneration Committee determines the remuneration for the Executive Directors and the Executive Committee of the Bank and it sets and recommends to the Board for approval, the overarching principles and parameters of the remuneration policy across the Bank to ensure an overall coherent approach to remuneration for all employees.
Audit Committee (AC)	The Audit Committee monitors, reviews and reports to the Board on the formal arrangements established by the Board in respect of the financial and narrative reporting of the Bank, the internal controls and the Risk Management Framework, and the internal/external audit process.
Risk Committee (RC)	The Risk Committee is responsible for the review and report of its conclusions to the Board in respect of the Bank's risk appetite and Risk Management Framework, taking a forward looking perspective and anticipating changes in business conditions.
Nomination Committee (NC)	The Nomination Committee reviews and makes recommendations on Board composition, succession planning for Executive Directors, Non-Executive Directors and certain Senior Executives, identifying and nominating candidates for Board vacancies and evaluation of candidates for the Board.
Values and Ethics Committee (V&E)	The Values and Ethics Committee recommends to the Board for its approval and adoption of the Co-operative Values and Ethical Policies of the Bank and to advise the Board of the Bank's conformity with such values and ethics in its operations and activities.

The Initial Public Offering (IPO) Committee is a special purpose Committee not considered part of the overall governance structure described above.

4.4 Executive and management committees

The Board has established Board Committees and senior management committees as well as appropriate forums to oversee the RMF, including identifying the key risks facing the Bank and assessing the effectiveness of planned management actions.

Committee	Risk focus
Executive Committee (ExCo)	The Executive Committee manages the business in line with the risk appetite statement, and in doing so ensures the implementation of the risk strategy set by the Bank's Board so as to deliver an effective risk management environment.
Transformation Committee (TC)	The Transformation Committee is responsible for ensuring the successful implementation, prioritisation and funding of projects across the Bank in line with the Board's strategic plan. As such the committee assists the Chief Administrative Officer in prioritising projects within available resources and agreed investment budgets, overseeing the Bank's transformation programme funding position, policies, processes and standards to effectively manage the Bank's transformation programme risk profile.
Executive People Committee (EPC)	The Executive People Committee is responsible for the review of key people data within the Bank such as headcount, retention, overseeing the hiring of senior roles and all remuneration policies below the Executive level.
Asset and Liability Committee (ALCO)	The Asset and Liability Committee is primarily responsible for overseeing the management of capital, market, liquidity and funding risks. Its responsibilities include identifying, managing and controlling the Bank's balance sheet risks in executing its chosen business strategy, ensuring that the capital and liquidity position of the Bank is managed in line with policy and that adequate capital is maintained at all times, overseeing and monitoring relevant risk control frameworks and recommending relevant principal risk policies, detailed risk appetite limits for approval and approval of all product pricing proposals.
Enterprise Risk Oversight Committee (EROC)	The Enterprise Risk Oversight Committee's purpose is to provide a mechanism to ensure all the Bank's risks are reviewed, challenged and approved in line with decisions made at EXCO (with escalation to the RC where required). EROC achieves some of its objectives through delegating responsibility to sub-committees: Model risk, Conduct & Regulatory risk, Operational risk and Credit Risk Oversight Committees. The sub-committees will approve, discuss or note papers and escalate to the EROC where relevant or where required by governance. EROC will escalate where appropriate to the Board via the Risk Committee.
Technology Steering Committee (TSC)	The Technology Steering Committee acts to support the Chief Information Officer in developing and executing the Bank's IT strategy. The TSC provides a forum for Executive input to strategic IT decisions, policy, planning and prioritisation, maintaining alignment between IT strategy and Business strategy. The TSC assesses potential risks and benefits from future technology changes.
Investment Planning Committee (IPC)	The Investment Planning Committee is responsible for overseeing and challenging the execution of all significant investments, divestments and major capital expenditure proposals. As such it ensures that all investments are being made in accordance with the Board's strategic plan and that the investment portfolio remains balanced when considering investment demands against available resources.
Project Oversight Committee (POC)	The Project Oversight Committee is responsible for overseeing and challenging the delivery of the Bank's Change Portfolio ensuring there is clarity of delivery outcomes, that benefits are delivered within agreed time, cost and quality thresholds, that sponsors have the necessary executive support to deliver successfully and that key risks and issues threatening delivery are being effectively managed.
Strategic Transactions Committee (STC)	The Strategic Transactions Committee reviews, challenges and approves (where permitted within the authority delegated to it) strategic transactions designed to achieve a deleveraging of the balance sheet in line with the strategy outlined by the Board for Non-core assets held within the Corporate CoAM business. In making its decisions it ensures that sanctioned deals are approved in line with delegated financial authorities and risk assessments are carried out by the Chief Risk Officer (CRO) or other directors in the Risk division.
Credit Risk Oversight Committee (CROC)	The Credit Risk Oversight Committee's purpose is to monitor significant credit risks and issues with the entire credit life cycle, the controls and management actions being taken to mitigate them and to hold to account the executives responsible for actions. This includes but not limited to proposing, monitoring and reviewing the credit risk appetite (current and emerging) of the Bank ensuring that key risk exposures are managed within risk appetite and reported to EROC, that appropriate mitigating actions are taken and that adherence to the RMF through a process of ongoing continuous improvement and review of the credit risk strategy is achieved while making recommendations to EROC as appropriate.
Model Risk Oversight Committee (MROC)	The Model Risk Oversight Committee is a sub-committee of EROC and the core objective is to provide oversight and challenge including independent validation of model governance.
Operational Risk Oversight Committee (OROC)	The Operational Risk Oversight Committee oversees the design and maintenance of the Bank's Operational Risk Framework and the risk control frameworks. In addition to this the OROC recommends to the Chief Executive Officer (CEO), CRO and the EROC relevant underlying policies and detailed risk appetite limits for approval.

4.4 Executive and management committees continued

Committee	Risk focus
Conduct and Regulatory Risk Oversight Committee (CRROC)	The Conduct and Regulatory Risk Oversight Committee provides oversight of the Bank's RMF in respect of regulatory, conduct, fraud, anti-money laundering and product risks.

A number of senior management committees are supported by either management forums or sub-committees. The purpose of these is to assist the senior management committees to exercise their respective mandate. They do not hold any delegated authorities or decision making powers as these are retained by the respective senior management committee. The key forums and sub-committees are:

Forums/Sub-committees	Risk focus
Liquidity and Market Risk Forum (LMRF)	The Liquidity and Market Risk Forum is a forum reporting to the ALCO. The role of the LMRF is to define the lower level governance requirements for liquidity and market risk across the Bank. The forum oversees and challenges all aspects of liquidity and market risk management and makes appropriate recommendations to ALCO as required.
Capital Management Forum (CMF)	The role of the CMF is to review, challenge and monitor the Bank's capital adequacy, in line with Capital policy and within risk appetite and review of capital adequacy stress testing. The CMF is responsible for making recommendations to ALCO as appropriate.
Secured Funding Review Forum (SFRF)	The primary monitoring of secured funding is via the forum and is responsible for making appropriate recommendations to ALCO as required.
Strategic Asset Review Committee (SAR)	The Strategic Asset Review (SAR) is a committee, established by CoAM Operating Committee for the strategic review of Corporate Performing and Non-performing assets within Corporate CoAM. Lending proposals presented to SAR are sanctioned within the Credit Discretion Matrix.
Treasury Credit Risk Management Forum (TCRMF)	The Treasury Credit Risk Management Forum is a management forum that supports the Treasury Risk Director in discharging his duties with regard to the approval and management of credit limits extended to Treasury counterparties. TCRMF oversees and challenges all aspects of credit risk management within the Bank in relation to Treasury activity defining the lower level governance requirements and making recommendations accordingly.
Impairment Charge Forum (ICF)	The purpose of the Impairment Charge Forum is to assure the CRO via the appropriate Delegated Authority that the monthly impairment charge has been determined accurately and consistent with the Impairment Control Standards prior to it being booked to Profit & Loss.
Impairment Adequacy Forum (IAF)	The purpose of the Impairment Adequacy Forum is to support the CRO in their assessment of the adequacy of impairment coverage across the Bank's Credit Risk portfolios. IAF is a management forum, held as a minimum prior to the interim and full year accounts, providing review and challenge across the process of determining and governing impairment adequacy.

4.5 Risk Committee (RC)

The Risk Committee met in total 10 times during the financial year. A sub-committee of the main Risk Committee was convened for the purpose of reviewing risk policies. The risk sub-committee met four times during the financial year. In performing its duties, the Risk Committee has access to the services of the Chief Risk Officer, the Chief Executive Officer, the Finance Director, the Director of Internal Audit and the General Counsel, as well as external professional advisors. To support the interplay between the role of the Risk Committee and the Audit Committee, the Chairman of the Audit Committee is a member of the Risk Committee. The Chairman of the Risk Committee is also a member of the Remuneration Committee to ensure that qualitative and quantitative advice is provided to the Remuneration Committee on risk weightings to be applied to performance objectives incorporated in executive remuneration.

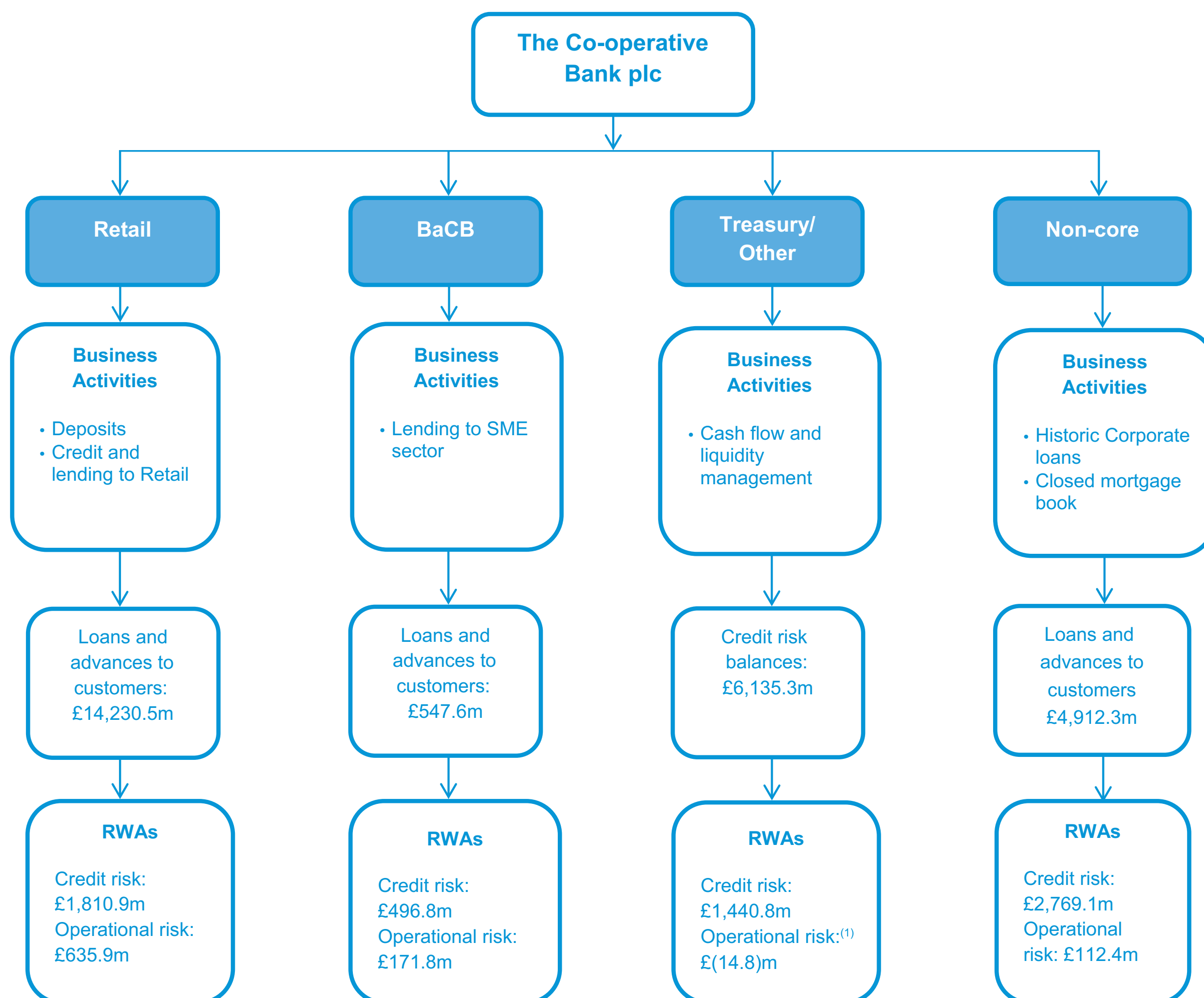
During 2015 the risk management structure continued to be overhauled alongside the roll-out of the cultural transformation programme across the Bank. The continued embedding of the Risk Management Framework is a key component in the transformation of culture in the organisation and progress has been made. The Committee has worked closely with the Audit Committee to monitor Risk Management and internal controls.

5. Risks and their management

5.1 Overview

Risk profile of the Bank

This diagram below shows the business activities of each of the divisions of the Bank and the RWAs which reside in each division.



(1) The capital requirement for Operational risk is calculated using prior years operating income; the reported Treasury income for 2014 was £(42.8m) resulting in a negative calculation of RWA. CRR allows for positive income values in business line activity to be offset by negative income providing the overall total is not less than zero.

5.2 Risk Management objectives and policies

The Bank has a formal structure for reporting, monitoring and managing risks across the Bank. This comprises, at its highest level, a Risk Appetite Statement which is set and approved by the Board and is supported by granular risk appetite measures across the Bank's principal risk categories. This is underpinned by a RMF which sets out the high level policy, standards, roles, responsibilities, governance and oversight for the management of all risks across the Bank.

During the year the Bank continued to review its RMF which focused on aligning roles and responsibilities between 1st and 2nd lines of defence, updating the Bank's policy framework and the Bank's committee structure. The Bank will continue to review and enhance its RMF with particular reference to these key areas in 2016.

Risks and issues, whether crystallised or emerging inclusive of those observed in relation to the RMF are detailed within the Principal risks and uncertainties section of the 2015 Annual Report and Accounts.

Responsibility for risk management resides at all levels of the Bank from the Board and the Executive Committee supported by senior management committees through the organisation to each business area subject to appropriate oversight. In line with this approach the Bank adopts the three lines of defence governance model which is outlined below:

5.2 Risk Management objectives and policies continued

- The Bank's business teams act as first line of defence and are responsible for identifying where a business area is exposed to risks, including from the development of new products, processes or other business change. They also manage the risks that reside within their business area on a day to day basis, implementing monitoring and control processes to ensure that the Bank's business profile is understood and maintained within Board defined risk appetite.
- The Bank's Risk Framework Owners act as the second line of defence. They oversee and challenge the implementation and monitoring of the RMF and consider current and emerging risks across the Bank. They also oversee the appropriate escalation of breaches of appetite, mitigating actions and report these to the mandated senior management committee.
- The Bank's Internal Audit function acts as the third line of defence. They are responsible for independently verifying that the RMF has been implemented as intended across the Bank, and independently challenge the overall management of the framework to provide assurance to the Audit Committee and senior management on the adequacy of both first and second lines.

5.3 Risk Management Strategy and Appetite

The Board has primary responsibility for identifying the key business risks facing the Bank, approving the Bank's Risk Management Strategy which includes setting the risk appetite which defines the type and amount of risk that the Bank is prepared to accept both qualitatively and quantitatively in pursuit of its strategic objectives. In addition the Board approves key regulatory documents including the Internal Liquidity Adequacy Assessment Process (ILAAP) and the Internal Capital Adequacy Assessment Process (ICAAP) which also includes appropriate stress testing, scenario analysis and contingency planning allowing it to understand the impact of potentially severe risks to ensure that it remains resilient to them.

The Bank's risk appetite is translated into specific risk measures that are tracked and monitored and reported to the appropriate Risk Committees and the Board. The Bank's Risk Appetite Framework has been designed to create clear links to the Bank's strategic plan, capital planning, stress testing and the RMF whereby appropriate metrics and limits for each risk category are clearly established and recalibrated in line with the planning process.

5.4 Principal Risks categories

The Bank's principal risks are categorised into Capital, Liquidity and Funding, Reputational and Operational risks with further sub categories of risk underpinning Capital including Credit, Model, Pension, Market, Strategic and Business. The Bank also assesses Operational risks at a more granular level which are considered within this principal risk type.

Subsets of the principal risks are currently categorised as most material to the Bank and these are denoted as such*.

Principal risks	Risk definitions
Capital risk	The risk that the Bank's regulatory capital resources are inadequate to cover its regulatory capital requirements.
Credit risk*	The risk to Bank's earnings and capital arising from a customer's failure to meet their legal and contractual obligations. The Bank currently has one principal Credit risk policy that is executed via the RMF through separate 2nd line accountability for Retail, Corporate and Treasury Credit Risk.
Model risk*	The risk of model failure or the inappropriate use of models resulting in potential loss, poor decision making and/or reputational damage.
Pension risk*	The risk to Bank Capital and company funds from exposure to defined benefit scheme liabilities (to the extent that liabilities are not matched by scheme assets) and risks inherent in the valuation of scheme liabilities and assets.
Market risk*	The risk of loss as a result of the value of financial assets or liabilities (including off-balance sheet instruments) being adversely affected by the movement in market prices, interest rates or exchange rates. This loss can be reflected in the near term earnings by changing net interest income, or in the longer term as a result of changes in the economic value of future cash flows.
Strategic and Business risk*	Any risk to a firm arising from changes in its business, including the acute risk to earnings posed by falling or volatile income and the broader risk of a firm's business model or strategy proving inappropriate due to macroeconomic, geographical, industry, regulatory or other factors.
Liquidity and Funding risk	The risk that the Bank is unable to meet its obligations as they fall due or can only do so at excessive cost.
Reputational risk	The risk of damage to how the Bank's reputation, brand or image are perceived by its internal or external stakeholders as a result of its conduct, performance, or the impact of operational failures or other external issues.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or external events.
Conduct risk*	The risk that the Bank's behaviours, offerings or interactions will result in unfair outcomes for customers.
Regulatory risk*	The risk that the Bank and its subsidiaries breach the letter and spirit of relevant laws, regulations, and codes of practice or standards of good market practice. Changes in the regulatory environment may adversely effect the Bank's ability to deliver its Updated Plan.
People risk*	The risk associated with inappropriate employee behaviour, inadequate resource (people, capability and frameworks), resulting in customer or financial detriment, and legal or regulatory censure.

5.4 Principal Risks categories continued

Principal risks	Risk definitions
Anti-Money Laundering risk*	The risk that the Bank may be used to facilitate the laundering of the proceeds of crime, the financing of terrorist activity or breach financial sanction legislation.
Fraud risk*	The risk that the Bank is exposed to uncontrolled levels of financial crime resulting in unplanned fraud losses, reduced customers confidence and reputational damage.
Product risk*	The risk that the Bank's products result in unfair outcomes to customers, significant compliance breaches, financial loss, or reputational damage.
Financial Reporting risk*	The risk of reputational damage resulting in loss of investor confidence, prejudicing the relationships with the regulatory authorities and/or financial loss caused by incorrect Financial Reporting arising from: the adoption of inappropriate accounting policies; ineffective controls over financial, regulatory, taxation and management reporting; failure to manage the associated risks of changes in financial, regulatory and taxation requirements; and failure to disclose accurate information about the Bank on a timely basis.
Information and Data risk*	The risk associated with theft, loss, or misuse of information or the processing of inaccurate information, resulting in customer or financial detriment, and legal or regulatory censure.
Payment risk*	The risk of failure to correctly make or receive customer payments, respond to customer payment instructions when requested or rectify payment errors for customers, as outlined in terms and conditions, regulatory requirements and payment scheme rules resulting in poor customer outcomes, financial loss to the Bank or customer and/or potential regulatory or scheme fines.
Legal risk*	Legal risk is defined as the risk that the Bank is not compliant with the applicable laws and that contractual arrangements with customers, suppliers or other third parties are not enforceable as intended, are enforced against the Bank in an unexpected way or do not operate as expected. Legal risk may occur when the Bank's assets are not legally protected (e.g. intellectual property, real estate property) or when litigation by or against the Bank is not appropriately managed to protect the Bank's reputation and achieve the best outcome or the Bank mismanages relationships with competition, authorities and breeches competition laws. In each of the legal risks cases identified above, the result being that the Bank is exposed to legal and/or regulatory censure, financial loss, and/or reputational damage.
Technology risk*	The risk of financial and non-financial impacts resulting from the lack of effective IT systems operability.
Change risk*	The risk of change not being delivered successfully (Delivery risks) and/or that the change deliverables adversely impact the Banks risk profile (Associated Risks of Change). This definition covers all change activities including Transformation, Projects and business funded change activities.
Third Party Supplier risk*	The risk of reputational, financial and non-financial loss associated with all third parties relied upon to provide services and or products which support the operations and performance of the Bank.
Physical Assets risk*	The risk associated with internal and external threats, either deliberate or accidental, against physical assets, colleagues, and customers that could cause financial and/or non-financial losses, damage to or non-availability of the Bank's assets.
Insurance risk*	The risk that financial exposures caused by an insured event, will not be payable by our insurance, or events occur where self insurance or external insurance was not available, could cause losses of an unforeseen magnitude.
Business Continuity risk*	Business Continuity risk is defined as the risk associated with the inability of the Bank to continue delivery of products or services at acceptable predefined levels following a disruptive incident.

5.5 Credit risk

Credit risk is the risk that borrowers will fail to repay what they have borrowed. The risk to the Bank includes the amounts lent not being repaid, loan interest not being received, cash flows being received later than expected and increased collection costs. This results in the need to set aside provisions and capital to provide for future losses.

5.5.1 Management of Credit risk

Credit risk is one of the principal risks set out in the RMF and is an integral part of the Bank's business activities. It is inherent in both traditional banking products (loans, commitments to lend and contingent liabilities such as letters of credit) and in 'traded products' (derivative contracts such as forwards, swaps and options, repurchase agreements, securities borrowing and lending transactions).

All authority to take credit risk derives from the Board. This authority is delegated to the CEO and CRO who may then sub-delegate to defined role holders, to use at an individual level or in their capacity as Chair at the appropriate committee. The level of credit risk authority delegated depends on seniority and experience.

The Bank's overarching credit risk policy is approved annually by the Risk Committee and this is underpinned by supporting control standards and principles for the effective management of credit risk throughout the Bank's divisions.

Credit risk management is an essential element of the Bank's operations. As with all principal risks, the Board requires that the credit business is managed in line with the risk strategy and risk appetite set by the Board. Risk measurement is based on a set of metrics, which are aligned with the Board agreed risk appetite and support the limits framework. These metrics undergo periodic review to assure that they are fit for purpose (i.e. are able to recognise both emerging and current risks). Credit risk models are subject to annual review by the Model Risk Oversight Committee (MROC).

Corporate lending discretion was undertaken in 2015 via key individual lending discretions, which were approved in December 2014.

The Credit Risk Oversight Committee (CROC) (formerly known as Retail and Corporate Credit Risk Management Forums) considers key management information to support the oversight and challenge of the credit risk embedded in each division and across the credit risk life cycle. This includes appropriate benchmarking information from similar portfolios in the market and is key to calibrating risk appetite.

The CROC is supported by an additional four forums that exist to support the CRO in discharging the second line mandate:

- Credit Impairment & Default Group, which reviews and approves provisions, write offs and provision releases and reviews the impairment charge against forecast;
- Impairment Charge Forum, which was designed to ensure that the credit risk impairment standard is being implemented effectively and that there is sufficient evidence to support the credit risk impairment stock;
- Impairment Adequacy Forum, which acts as a mechanism for approving and reviewing the refresh of impairment parameters and post model adjustments;
- Treasury Credit Risk Management Forum, which provides day-to-day oversight of the credit risk exposure in the Treasury division.

The Retail division of the Core Bank uses both application and behavioural scoring techniques to rank a customer's risk of default with this, in common with other retail banks, being embedded in the business. The Non-core division, which includes corporate lending, includes a number of specialist models to reflect the embedded credit risk of sectors such as Private Finance Initiatives (PFI) and commercial property. The performance of all rating systems is governed by the Model Working Group with oversight from the MROC.

5.5.2 Credit risk control

The CROC review credit risk management information (MI) in depth, for example by risk pool, campaign or key risk splits. In addition, the credit risk second line receives and reviews credit risk MI on a regular basis split by campaign or key sector characteristic. The CROC MI is produced on a monthly basis with different MI produced for each asset class. The regular MI covers a broader scope than that provided to the EROC. Reports include:

- performance against agreed risk appetite limits and tolerances;
- sector and obligor concentrations and risk segmentation;
- monitoring of exposures at risk and in arrears and impairment levels;
- monitoring of loans under forbearance.

Early warning indicators are provided where appropriate, and any exceptions highlighted and escalated as necessary.

5.5 Credit risk continued

Retail credit policy

Credit approval and individual limit setting

The Bank's policy on retail secured and unsecured credit is to establish credit criteria that determine the balance between volume growth (generating higher income) and higher arrears and losses, so as to ensure the return is commensurate with the Bank's risk appetite, strategic objectives and enables sustainable growth. Retail credit risk related decisions are based on a combination of defined lending policy, made up of The Principal Credit Risk Policy, supporting Control Standards and Lending Criteria, along with the use of bespoke scorecards derived from historical data. Monthly reporting on the performance of portfolios is provided to senior management and presented to the Bank's CROC.

Unsecured lending

Application and behavioural scorecards are used to support new lending decisions and ongoing portfolio management. These scores are used, in combination with information from the Credit Reference Agencies, policy criteria and an assessment of affordability, to determine whether we will lend to an individual borrower and to set individual limits on the amount we will lend. Application scorecards are used to determine lending decisions to those customers with no or limited existing relationship with the Bank. The characteristics of existing customers are assessed on a monthly basis using behavioural scorecards and the resulting scores are used to make lending decisions for existing customers, including credit limit increases/decreases, authorisation decisions and card reissue. Decisions are generally fully automated with manual intervention only required in the event of referrals being triggered or customer appeal. The application and behavioural scorecards used for lending decisions and customer management actions form the main components of the IRB models.

Mortgage lending (credit approval)

Scorecards are also used to assess new mortgage applications. The application models are integral in the assigning of IRB risk weights. The models have all been developed based on the profile of mortgage applicants received by the specific asset class. Each model uses a combination of external credit reference data and information collected as part of the application process. The calculation of the application scores is fully automated within the application processing system. The score is used in association with lending policy and affordability checks to make a decision on whether an application will be approved. More complex higher risk applications or those outside of standard lending policy are reviewed by more senior underwriters to ensure compliance with policy and to allow expert judgment within agreed levels of authority.

Individual and portfolio limit setting

Portfolio limits are in place for specific lending sectors based on an overall assessment of our appetite for exposure to that sector. This includes an assessment of risk based on the capital requirement of each sector based on the IRB models.

Retail pricing and profitability

The IRB models, or the underlying credit risk models upon which the IRB models are based, are used as inputs to pricing/profitability models across the Retail secured portfolios.

Corporate credit policy

The Bank's policy on new Corporate lending is to consider relatively low risk and senior (not subordinated) exposures from UK customers provided they meet the criteria contained in the corresponding sector strategy, while avoiding excess single name or sector concentrations. During 2015 very little new Corporate lending was undertaken. Individual cases which show signs of unsatisfactory performance are managed through the Strategic Asset Review (SAR). The CROC and EROC (and by exception the RC) receive regular reports on the performance of the portfolio.

Corporate lending and credit approval

Corporate exposures are managed through two distinct divisions. The Business and Commercial Banking (BaCB) division represents activity consistent with the strategy and risk appetite of the Bank. The Non-core Corporate CoAM division is managed for value and targeted for run down or exit.

First line relationship managers submit recommendations for any new money to be lent which are risk assessed by the second line corporate credit risk underwriting team (CCRU) which is independent from income generation. BaCB lending discretions for new money are made by named role holders predominately within CCRU. Facilities that exceed CCRU role holder delegated lending authority are referred to a higher sanctioning authority in accordance with the approved delegated lending discretions matrix. The Corporate CoAM strategy is executed through higher risk (default and watch list) and performing Strategic Asset Review (SAR) groups comprising of first and second line business including CCRU representatives where the majority of decisions are taken to set run-off or exit strategies but occasionally the customers may require additional lending to protect value in the work out of a particular asset. Where the levels of exposure and/or new money exceeds the delegated lending authority of the most senior CCRU representative in attendance, the SAR groups make recommendations to a higher sanctioning authority in accordance with the approved delegated lending discretions matrix to confirm the decision.

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

5.5 Credit risk continued

5.5.3 Models used

5.5.3.1 Retail models residential mortgages

Probability of Default (PD) models

Underlying scorecards are calibrated to a definition of default to provide a PD for each loan. The definition of default for secured exposures is taken as six months in arrears, but also includes the relevant unlikeliness to pay elements such as bankruptcy and litigation. The application credit score is used for new lending to determine PD up until sufficient internal account performance data is available, at which time the behaviour score will be used to determine PD. The ratings philosophy of the PD models is deemed to be hybrid with the point-in-time score mapped to a long run average PD grade. The long run grades have been determined using historical data and an assessment of PD performance over an economic cycle.

Loss Given Default (LGD) models

The key components of the LGD models are the Probability of Possession given Default (PPD) and expected shortfall, calibrated to reflect a downturn environment. Any post sale recoveries are excluded from the loss estimate. The expected shortfall calculation uses an estimate of house price at sale, a forced sale discount, projected balances (EAD) and costs, along with time to possession and sale parameters and standard discounting principles.

5.5.3.2 Qualifying revolving and other retail exposures

Probability of Default (PD) models

Underlying business scorecards are calibrated to a definition of default to provide a PD for each loan. The definition of default for unsecured exposures is taken as 90 days past due and includes some relevant unlikeliness to pay elements such as bankruptcy. The application credit score is used for new lending to determine PD up until sufficient internal account performance data is available, at which time the behaviour score will be used to determine PD. The ratings philosophy of the PD models is deemed to be predominantly a point-in-time and therefore changes in the quality of the portfolio will be reflected via a movement in ratings.

Loss Given Default (LGD) models

These models estimate the average loss percentage of snapshot balances over a 36 month recovery period for the three population segments: default, non-default and charge off. The 36 month LGD is then discounted (using standard discounting principles) and adjusted for recoveries between 36-48 months, cost of collections and downturn stress.

This LGD measure is then used to set the downturn LGD value based on the worst (highest) LGD observed during the development window, which in turn is used to determine capital requirements.

Exposure at Default (EAD)

For credit cards and current accounts, EAD is based on current drawn exposure plus an adjustment for future drawn exposure and fees. Accounts are segmented into risk pools which are used to determine the level of adjustment (increase in EAD) applied. For loan accounts, the EAD is set at 100%, in line with the guidance set out by the regulatory requirements.

5.5.3.3 Corporate models

A single definition of default is applied across the whole Corporate portfolio (foundation IRB, specialised lending and standardised). This definition is taken as being one or more of the following:

- where the Bank considers that the borrower is unlikely to repay its credit obligations without recourse by the Bank to actions such as realising security (if held);
- the borrower is past due more than 90 days on any material credit obligation; and/or
- the borrower has committed an act of default (i.e. bankruptcy, filing for administration, liquidation etc). An additional Watchlist marker, which is broken down into three stages, is applied to help identify where a situation has not reached the point of default but is one that the SAR groups have decided merits closer management.

Probability of Default (PD) models

There are four PD models in use for grading and monitoring exposures to corporates. Two of them (CreditEdge and RiskCalc) are external vendor models which are used industry-wide to rate general corporates. The other two are internally developed and are used to rate Registered Social Landlords (i.e. Housing Associations) and Business Banking customers. The ratings philosophy of these PD models is defined as 'near point-in-time models'. The output of all PD models is mapped to the 13 grades of the internally calibrated Master Grading Scale (with a 14th grade indicating default).

Loss Given Default (LGD) models

Capital for customers rated with a PD model is calculated under the foundation IRB approach and therefore regulatory prescribed LGD rates apply (from 35% for senior exposures fully secured by real estate collateral to 45% for senior unsecured exposures).

5.5 Credit risk continued

Supervisory slotting approach

Supervisory slotting criteria are used to analyse and monitor the specialised lending exposures to PFIs and commercial real estate. The PFI and property investment and development 'slotting models' are based on regulatory approaches and their output is mapped to four supervisory categories from strong to weak (slotting categories 1–4 respectively) or default with prescribed risk and expected loss weights.

Overrides

The PD and slotting grades can be overridden by exception in line with policy to ensure that the grades fully reflect all available information.

Standardised approach

Capital for customers not rated with a PD or slotting model is calculated under the standardised approach using regulatory prescribed risk weights.

Exposure at Default (EAD)

EAD across the whole Corporate portfolio is calculated by applying regulatory prescribed Credit Conversion Factors (CCFs).

5.5.3.4 Wholesale model

Under Foundation IRB we use modelled PD for Treasury counterparties and regulatory defined LGD. The quantitative assessment is based upon bond default statistics. Credit ratings are derived from a variety of information sources including External Credit Assessment Institutions's (ECAI) (Moody's and Fitch) based on fundamental credit analysis to assign an appropriate Internal Rating Grade (IRG) 1–9. More conservative, qualitative overlays to counterparties IRG (downward overrides) may be applied with the supporting credit rationale clearly stated in the appropriate credit review.

Treasury counterparty limit matrix

<table>
<tr><th></th><th></th><th colspan="4">External Credit Rating</th></tr>
<tr><th></th><th></th><th colspan="2">Long term</th><th colspan="2">Short term</th></tr>
<tr><th>Internal Rating Grade</th><th>PD Band %</th><th>Fitch</th><th>Moody's</th><th>Fitch</th><th>Moody's</th></tr>
<tr><td>IRG 1</td><td>0.03%</td><td>AAA/AA+</td><td>Aaa Aa1</td><td rowspan="2">F1+</td><td rowspan="5">P-1</td></tr>
<tr><td>IRG 2</td><td>0.03%</td><td>AA</td><td>Aa2</td></tr>
<tr><td>IRG 3</td><td>0.05%</td><td>AA-</td><td>Aa3</td><td rowspan="2">F1</td></tr>
<tr><td>IRG 4</td><td>0.08%</td><td>A+</td><td>A1</td></tr>
<tr><td>IRG 5</td><td>0.12%</td><td>A</td><td>A2</td><td>F1</td></tr>
<tr><td>IRG 6</td><td>0.28%</td><td>A-/BBB+</td><td>A3/Baa1</td><td rowspan="2">F2</td><td rowspan="2">P-2/P-3</td></tr>
<tr><td>IRG 7</td><td>0.66%</td><td>BBB/BBB-</td><td>Baa2/Baa3</td></tr>
<tr><td>IRG 8</td><td>2.04%</td><td>BB+/BB/BB-</td><td>Ba1/Ba2/Ba3</td><td>B</td><td>NP</td></tr>
<tr><td>IRG 9</td><td>7.43%</td><td>B+/B/B-/CCC</td><td>B1/B2/B3/Caa</td><td>C</td><td>NP</td></tr>
</table>

5.5.3.5 Model performance and back testing

This section provides analysis of the performance of IRB models over 2014 and 2015.

The table outlines the estimated and actual performance for PD, EAD and LGD by exposure class. All figures reported are taken from the regulatory capital models.

For PD and EAD the calculation shown assesses the non-defaulted portfolio at the start of the period and measures the default emergence over the following year. These are measured on an account weighted basis. For LGD, the calculation shown assesses the losses of the defaulted population, with actuals measured at the end of the period. The estimates are taken from 4 years previous for unsecured (to allow time for recoveries) and 2 years previous for secured (to allow time for the default to progress to sale).

To ensure fair comparisons can be made over the period in regards to Retail secured by immovable property, exposures now securitised through Warwick Finance One & Two transactions are removed from all estimated and actual performance.

5.5 Credit risk continued

Table 14 Model performance

	PD				EAD	
Exposure Class	**Long run Estimate at 2015 %**	**Actual 2015 %**	Long run Estimate at 2014 %	Actual 2014 %	**Estimate to Actual Ratio 2015 %**	Estimate to Actual Ratio 2014 %
Retail						
– Retail secured by immovable property	**1.4%**	**0.5%**	1.4%	0.7%	**101.5%**	101.6%
– Qualifying revolving retail exposures	**0.9%**	**0.5%**	1.0%	0.5%	**128.6%**	132.5%
– Retail other non-SME	**4.5%**	**2.2%**	4.8%	3.2%	**116.0%**	113.3%
Corporate	**1.1%**	**1.1%**	1.1%	1.3%	**–**	–

Note: The Corporate portfolio operates under the Foundation IRB Approach under which EADs and LGDs are not modelled.

	LGD			
Exposure Class	**Downturn Estimate at 2015 %**	**Actual 2015 %**	Downturn Estimate at 2014 %	Actual 2014 %
Retail				
– Retail secured by immovable property	**16.8%**	**3.2%**	17.3%	4.7%
– Qualifying revolving retail exposures	**81.6%**	**76.1%**	76.0%	73.3%
– Retail other non-SME	**81.4%**	**71.7%**	78.0%	69.7%
– Unsecured charged-off	**91.1%**	**92.4%**	88.7%	87.0%

Retail unsecured (Qualifying revolving retail exposures and Retail other non-SME)

Note that a small proportion of the Retail unsecured portfolio is excluded from these comparisons. This covers immaterial products from a capital perspective such as basic bank accounts (approximately 0.36% of Retail unsecured non-default RWA is excluded as at 31 December 2015).

There are a number of factors that influence the metrics shown, including:

- the conservatism within the estimates in line with regulatory calculations, for example the Retail unsecured PD models are hybrid models but are predominantly 'point-in-time' requiring a conservative add-on to the estimates. Hence the actual default rates are significantly lower than estimates;
- retail unsecured EAD models are similar to the above with substantial layers of conservatism included, especially for Qualifying revolving retail exposures;
- movements in portfolio risk over time. General improvements in risk are seen across the Retail business;
- regular realignments of the Retail unsecured PD models to reflect the above; and
- The LGD models are generally performing better than expected. This is predominantly due to changes in the underlying performance of the portfolio due to a mix of portfolio and strategy changes and debt sale activity, that haven't yet been reflected in the model. The only exception is the 'unsecured charged-off' model, where the actual for 2015 is exceeding the estimate. However, this under-estimation is within tolerance and reflects a breach of the point-in-time estimate, not the downturn estimate (94.1%) used to determine capital.

Retail secured by immovable property

As with Retail unsecured, the actual outcomes for the secured portfolio are lower than the estimates for all metrics:

- the Retail secured PDs used within the regulatory capital models are based on long-run averages. Hence the actual default rates are significantly lower than estimates due to the continued low interest rate environment and reducing unemployment;
- actual and modelled EADs tend to be very stable, which is demonstrated in the above table;
- the actual LGDs are significantly lower than estimates. They are currently measured 24 months after default, and so actual losses will continue to materialise afterwards. However extending the measurement to 36 months only increases the 2014 actual from 4.7% to 4.9%. Please note, 36 months performance is not available for 2015 actual as this represents performance of defaults in 2013. The LGD model predicts losses in a downturn environment and therefore assumes a fall in property values. However, over the last 2 years, house prices have increased by 18% nationally, thus leading to reduced losses; and
- the above table shows the secured LGD estimates from the current LGD model. Due to proposed methodology changes when estimating downturn possession rates, there is an additional overlay applied to the final capital figures. This overlay is not reflected in the above metrics.

5.5 Credit risk continued

Corporate

The Income Producing Real Estate (IPRE) and PFI models use the Foreign Investment Review Board (FIRB) Specialised Lending (slotting) methodology which assigns prescribed risk weights and EL weights and as such are not shown. The table also excludes those sectors where the standardised approach is adopted, typically due to low volumes or a low default history of a particular sector.

Overall, corporate year on year actual defaults have reduced. Actual default rates for 2015 exceed estimated PDs. This is predominantly driven by the low exposure, high volume Business Banking portfolio, which although they represent the highest proportion of actual defaults, in terms of volumes, represents only 3.5% of exposures within the portfolios covered by FIRB PD models. The Bank has recalibrated the Business Banking PD model during 2015 to address the underestimation.

5.5.4 Approach to validation

Model governance standards apply to ratings models to ensure that principal risks faced by the Bank are appropriately managed under the RMF. All model developments and material adjustments are subject to assessment against this framework, which incorporates relevant requirements from CRR. Model governance standards are set in the Model Risk Control Standards and governed by the Model Risk Oversight Committee. The coordination of all model risk resides with the MROC reporting directly to EROC.

The Model Risk Control Standards require that:

- the materiality of any given model is measured based on the potential impact of the risk being modelled;
- expected performance standards should be set for the new model against which its actual performance can be benchmarked;
- results and methods should be fully documented;
- data used must comply with the overarching Bank Data Standards;
- an independent review is required prior to approval;
- models must undergo a post-implementation review;
- models must be approved through the appropriate approval governance process, both at inception and throughout their life cycle;
- a monitoring frequency is agreed; and
- models must be logged on the Bank's Model Inventory.

Model development, re-calibration and monitoring requirements in line with these control standards are governed through the Model Working Group reporting up to the MROC.

A review by the PRA took place in 2015 for compliance with IRB related CRR articles and identified areas of non-compliance and inadequate procedures relating to use of the IRB approach and a remediation plan commenced in accordance with supervisory guidance. This review and remediation plan was a key focus in 2015 and areas of improvement identified are being addressed in 2016. Model Risk Policy and Model Risk Control Standards and a Model Inventory have been redesigned. Work continues in 2016 to strengthen the control environment: model risk monitoring, enhancement of KPIs, Policy/Control Standards and Model Inventory. Resource continues to be reassessed to meet ongoing priorities.

5.5 Credit risk continued

5.5.5 Credit risk exposures

The following table represents the Bank's EAD analysed by approach, exposure class and contractual maturity.

Table 15 Analysis of EAD by residual contractual maturity

2015

Exposure class	Repayable on demand/ undated £m	Up to 1 year £m	1-5 years £m	5-10 years £m	10-20 years £m	>20 years £m	Total £m
IRB							
Institutions	–	678.4	115.9	40.3	1.4	–	836.0
Corporates	–	61.6	224.6	270.4	276.8	318.8	1,152.2
Retail secured by immovable property	–	173.7	709.0	1,842.9	6,917.5	5,920.5	15,563.6
Qualifying revolving retail exposures	2,031.9	–	–	–	–	–	2,031.9
Retail other non-SME	51.1	21.0	203.5	13.1	–	–	288.7
Securitisation positions	–	–	–	1,423.2	–	1,614.8	3,038.0
Total IRB	2,083.0	934.7	1,253.0	3,589.9	7,195.7	7,854.1	22,910.4
Specialised lending	–	213.2	320.6	178.5	374.5	409.4	1,496.2
Standardised							
Central government or central banks	–	2,947.0	1,387.3	1,060.8	70.3	–	5,465.4
Regional governments or local authorities	–	0.1	2.5	–	–	2.4	5.0
Public sector entities	–	0.1	2.9	2.4	13.1	1.5	20.0
Multilateral development banks	–	69.2	344.5	87.2	–	–	500.9
Institutions	–	56.2	16.6	–	–	–	72.8
Corporates	–	17.3	99.8	79.7	94.5	28.8	320.1
Retail exposures	0.5	3.0	58.8	15.1	–	–	77.4
Secured by mortgages on immoveable property	–	–	0.2	–	–	–	0.2
Exposures in default	–	19.1	21.4	0.2	0.2	0.1	41.0
Covered bonds	–	–	–	–	–	–	–
Equity exposures	60.5	–	–	–	–	–	60.5
Other items	165.2	25.4	147.7	69.8	51.7	2.0	461.8
Total standardised	226.2	3,137.4	2,081.7	1,315.2	229.8	34.8	7,025.1
Total credit risk exposures	2,309.2	4,285.3	3,655.3	5,083.6	7,800.0	8,298.3	31,431.7

Deleverage of Non-core assets results in IRB portfolios, Corporates and Specialised Lending reducing by 19% and 51% respectively. Retail secured by immovable property reduced by 19% driven by securitisation of Warwick Finance One & Two.

5.5 Credit risk continued

2014

Exposure class	Repayable on demand/ undated £m	Up to 1 year £m	1-5 years £m	5-10 years £m	10-20 years £m	>20 years £m	Total £m
IRB							
Central government and central bank	–	2.8	–	–	–	–	2.8
Institutions	–	1,269.6	249.0	48.4	0.1	–	1,567.1
Corporates	–	264.8	168.3	206.1	288.4	496.4	1,424.0
Retail secured by immovable property	–	167.6	984.4	2,334.6	10,104.5	5,537.7	19,128.8
Qualifying revolving retail exposures	2,162.9	–	–	–	–	–	2,162.9
Retail other non-SME	32.4	42.6	326.2	33.2	0.1	–	434.5
Securitisation positions	–	1.5	6.0	1,568.9	47.4	–	1,623.8
Total IRB	2,195.3	1,748.9	1,733.9	4,191.2	10,440.5	6,034.1	26,343.9
Specialised lending	–	408.1	994.1	320.8	671.4	673.0	3,067.4
Standardised							
Central government or central banks	–	4,507.7	2,333.5	1,171.2	72.0	–	8,084.4
Regional governments or local authorities	–	19.5	1.0	–	2.9	2.4	25.8
Public sector entities	–	15.9	5.4	14.4	34.7	1.5	71.9
Multilateral development banks	–	68.5	461.3	52.7	5.7	–	588.2
Institutions	–	69.9	74.9	–	–	–	144.8
Corporates	–	202.0	137.1	251.6	324.9	28.8	944.4
Retail exposures	3.2	6.9	84.6	32.5	3.3	0.2	130.7
Secured by mortgages on immoveable property	8.0	1.6	3.5	13.9	1.8	3.8	32.6
Exposures in default	0.2	10.8	30.8	1.6	9.4	–	52.8
Covered bonds	74.5	–	–	–	–	–	74.5
Equity exposures	8.1	–	–	–	–	–	8.1
Other items	316.2	170.3	236.7	154.1	79.5	3.1	959.9
Total standardised	410.2	5,073.1	3,368.8	1,692.0	534.2	39.8	11,118.1
Total credit risk exposures	2,605.5	7,230.1	6,096.8	6,204.0	11,646.1	6,746.9	40,529.4

Movement in EAD by Maturity Profile 2014 to 2015:

- Foundation IRB Corporates: Reduction in EAD is due to deleverage of the Corporate Non-core CoAM portfolio.
- Retail secured by immovable property: Reduction in EAD due to Warwick Finance One & Two securitisation. The Core mortgage book exposure has remained circa £13bn over the year where new advances, largely acquired on Platform, have been offset by maturities/amortisations.
- Qualifying revolving retail exposures: A 6% reduction in EAD, all repayable on demand. This is driven by a reduction in credit card exposure, due to a combination of customer management limit strategies and balance attrition.
- Retail other non-SME: Reduction largely driven by a reduction in loan assets due to amortisation and low volumes of new business during 2015. EAD over the period reduced by 34% from £435m to £289m.
- Specialised lending: Reduction in EAD was driven largely by deleverage of IPRE and PFI assets.
- Standardised Corporates: EAD reduction primarily due to the sale of Renewable Energy assets (circa £300m) along with deleverage of other individual assets.

5.5 Credit risk continued

5.5.6 Impaired and past due exposures

The following table represents the Bank's EAD, impaired and past due exposures and impairment analysed by approach and exposure class.

Table 16 Analysis of impaired and past due exposures

2015

Exposure class	Exposure at default £m	Of which: Impaired exposures £m	Of which: Past due exposures not impaired £m	Specific and general credit risk adjustments £m	Charges for specific and general credit risk adjustments during the reporting period £m
IRB					
Institutions	**836.0**	**–**	**–**	**–**	**–**
Corporates	**1,152.2**	**49.6**	**–**	**17.9**	**(3.7)**
Retail secured by immovable property	**15,563.6**	**369.2**	**–**	**17.0**	**(45.6)**
Qualifying revolving retail exposures	**2,031.9**	**44.3**	**–**	**30.8**	**9.0**
Retail other non-SME	**288.7**	**84.6**	**–**	**69.7**	**(3.2)**
Securitisation positions	**3,038.0**	**–**	**–**	**–**	**–**
Total IRB	**22,910.4**	**547.7**	**–**	**135.4**	**(43.5)**
Specialised lending	**1,496.2**	**275.5**	**–**	**97.5**	**17.3**
Standardised approach					
Central government or central banks	**5,465.4**	**–**	**–**	**–**	**–**
Regional governments or local authorities	**5.0**	**–**	**–**	**–**	**–**
Public sector entities	**20.0**	**0.5**	**–**	**–**	**–**
Multilateral development banks	**500.9**	**–**	**–**	**–**	**–**
Institutions	**72.8**	**–**	**–**	**–**	**–**
Corporates	**320.1**	**21.3**	**–**	**1.1**	**(5.3)**
Retail exposures	**77.4**	**0.7**	**–**	**–**	**–**
Secured by mortgages on immoveable property	**0.2**	**–**	**–**	**–**	**–**
Exposures in default	**41.0**	**41.0**	**–**	**11.2**	**(6.2)**
Covered bonds	**–**	**–**	**–**	**–**	**–**
Equity exposures	**60.5**	**–**	**–**	**–**	**–**
Other items	**461.8**	**–**	**–**	**–**	**–**
Total standardised	**7,025.1**	**63.5**	**–**	**12.3**	**(11.5)**
Total credit risk exposures	**31,431.7**	**886.7**	**–**	**245.2**	**(37.7)**

The period to 31 December 2015 has seen an overall reduction in exposures at default, notably for Retail secured by immovable property, driven by the securitisation of Warwick Finance One & Two as well as for Corporate and Specialised lending asset classes, in line with of the Bank's strategy to deleverage Non-core assets. All specific and general credit risk adjustments are disclosed on a statutory basis.

5.5 Credit risk continued

2014

Exposure class	Exposure at default £m	Of which: Impaired exposures £m	Of which: Past due exposures not impaired £m	Specific and general credit risk adjustments £m	Charges for specific and general credit risk adjustments during the reporting period £m
IRB					
Central government and central bank	2.8	–	–	–	–
Institutions	1,567.1	–	–	–	–
Corporates	1,424.0	101.1	0.2	46.6	(13.6)
Retail secured by immovable property	19,128.8	953.7	–	24.4	(17.2)
Qualifying revolving retail exposures	2,162.9	44.6	1.3	27.4	(4.9)
Retail other non-SME	434.5	97.8	4.7	78.3	5.3
Securitisation positions	1,623.8	–	–	–	–
Total IRB	26,343.9	1,197.2	6.2	176.7	(30.4)
Specialised lending	3,067.4	1,039.7	–	325.7	(117.4)
Standardised approach					
Central government or central banks	8,084.4	–	–	–	–
Regional governments or local authorities	25.8	–	–	–	–
Public sector entities	71.9	–	–	–	–
Multilateral development banks	588.2	–	–	–	–
Institutions	144.8	–	–	–	–
Corporates	944.4	52.8	–	6.4	(9.7)
Retail exposures	130.7	–	–	–	–
Secured by mortgages on immoveable property	32.6	–	–	–	–
Exposures in default	52.8	53.3	–	31.1	(14.9)
Covered bonds	74.5	–	–	–	–
Equity exposures	8.1	–	–	–	–
Other items	959.9	–	–	–	–
Total standardised	11,118.1	106.1	–	37.5	(24.6)
Total credit risk exposures	40,529.4	2,343.0	6.2	539.9	(172.4)

5.5 Credit risk continued

5.5.7 Analysis of Corporate exposures impaired and past due

The following table represents, for Corporate assets (excluding Securitisations), the Bank's EAD, impaired exposures and impairment analysed by approach and exposure class:

Table 17 Analysis of Corporate EAD by sector

2015

Sector	Exposure at default £m	Of which: Impaired exposures £m	Specific and general credit risk adjustments £m	Charges for specific and general credit risk adjustments during the reporting period £m
Accommodation, Food & Licenced Services	126.4	36.6	11.7	(2.1)
Care	120.2	32.6	6.5	2.1
Education	70.3	3.0	0.2	(0.2)
Financial Services	36.9	3.0	0.2	–
Football clubs	16.7	1.0	0.9	0.1
Housing associations	719.1	0.3	0.1	(0.3)
Manufacturing	13.2	1.2	0.2	(0.5)
Motor Trade/Garages	5.1	0.9	–	(0.7)
PFI	698.4	18.0	13.0	9.8
Professional Services	14.4	1.5	0.9	(0.1)
Property and Construction				
Commercial investment	552.7	167.9	50.8	9.6
Residential investment	125.2	34.0	2.9	(8.6)
Commercial development	75.3	58.8	31.6	7.8
Residential development	10.7	3.0	0.2	(0.5)
Public sector entities	5.1	–	–	–
Renewable energy	122.4	–	0.6	(8.2)
Retail/Wholesale Trade	166.4	9.1	2.3	(0.2)
Services	95.3	13.2	3.7	(6.6)
Transport, storage & communication	9.1	0.7	0.2	(0.4)
Utilities	6.0	0.8	1.2	0.8
Other	43.8	0.5	0.5	0.3
Total	3,032.7	386.1	127.7	2.1
IRB corporates	1,152.2	49.6	17.9	(3.7)
Specialised lending	1,496.2	275.5	97.5	17.3
Standardised corporates	345.1	21.8	1.1	(5.3)
Standardised past due corporates	39.2	39.2	11.2	(6.2)
Total	3,032.7	386.1	127.7	2.1

The year to 31 December 2015 has seen a significant reduction in impaired exposures (from £1,239.9m in 2014 to £386.1m in 2015) and specific and general credit risk adjustments (from £409.8m in 2014 to £127.7m in 2015), most notably for Commercial Investments (£602.7m reduction in impaired exposures and £209.3m reduction in specific and general credit adjustments). This is reflective of the Bank's strategy to deleverage Non-core assets.

Past due and impaired exposures are monitored via a Watchlist status that contains specific triggers that when met result in the customer being classed as Watchlist. These triggers include cash flow pressures, failure to pay interest when it falls due, potential insolvency event & unsatisfactory account operation.

5.5 Credit risk continued

2014

Sector	Exposure at default £m	Of which: Impaired exposures £m	Specific and general credit risk adjustments £m	Charges for specific and general credit risk adjustments during the reporting period £m
Accommodation, Food & Licenced Services	254.8	123.2	11.9	(43.6)
Care	134.0	52.0	6.5	(2.6)
Education	72.9	2.9	0.4	(0.3)
Financial Services	63.7	2.5	2.3	(1.0)
Football clubs	17.4	1.1	0.9	(2.1)
Housing associations	895.5	0.6	0.3	(4.6)
Manufacturing	26.2	3.3	1.1	(0.8)
Motor Trade/Garages	20.4	3.0	0.8	(1.4)
PFI	1,156.7	–	3.2	(5.7)
Professional Services	37.5	3.6	1.5	(0.3)
Property and Construction				
Commercial investment	1,375.7	770.6	260.1	(87.9)
Residential investment	228.1	100.1	36.3	8.3
Commercial development	172.1	102.1	40.9	(2.3)
Residential development	19.8	10.5	3.2	(1.6)
Public sector entities	–	–	–	(0.1)
Renewable energy	501.0	7.7	12.7	(1.6)
Retail/Wholesale Trade	163.1	9.4	5.6	(3.4)
Services	160.5	38.4	18.0	(4.3)
Transport, storage & communication	14.5	4.2	2.5	0.1
Utilities	11.6	3.2	1.0	(0.1)
Other	156.6	1.5	0.6	(0.3)
Total	5,482.1	1,239.9	409.8	(155.6)
IRB corporates	1,424.0	101.1	46.6	(13.6)
Specialised lending	3,067.4	1,039.7	325.7	(117.4)
Standardised corporates	944.4	52.8	6.4	(9.7)
Standardised past due corporates	46.3	46.3	31.1	(14.9)
Total	5,482.1	1,239.9	409.8	(155.6)

5.5 Credit risk continued

5.5.8 IRB approach

Foundation

Foundation IRB uses modelled PD and regulatory defined amounts for LGD. Credit ratings are derived from a variety of information sources including ECAI's Moody's and Fitch based on fundamental credit analysis to assign an appropriate IRG 1–9. More conservative, qualitative overlays to counterparties IRG (downward overrides) may be applied with the supporting credit rationale clearly stated in the appropriate credit review.

The table below analyses EAD for each IRB exposure class by PD band and discloses average risk weight percentage for exposures subject to the foundation IRB approach.

Table 18 Foundation IRB EAD by PD band
2015

Internal grades	PD range %	Exposure value pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m	Mapped external rating
2015								
Institutions								
1/2	0.000 to 0.040	25.8	25.8	0.030%	45.0%	10.9%	2.8	AAA to AA
3	0.040 to 0.060	404.9	335.8	0.050%	45.0%	21.2%	71.2	AA-
4	0.060 to 0.080	–	–	–	–	–	–	A+
5	0.080 to 0.200	491.8	364.8	0.099%	45.0%	27.0%	98.4	A
6	0.200 to 0.300	345.3	109.3	0.280%	45.0%	43.8%	47.9	A- to BBB+
7	0.300 to 1.000	0.2	0.2	0.660%	45.0%	50.0%	0.1	BBB to BBB-
8	1.000 to 5.000	0.1	0.1	2.040%	45.0%	100.0%	0.1	BB+ to BB-
9	5.000 to 99.999	–	–	–	–	–	–	B+ to C
10	100.0	–	–	–	–	–	–	Default
Total institutions		1,268.1	836.0	0.101%	45.0%	26.4%	220.5	
Central governments and central banks								
1/2	0.000 to 0.040	–	–	–	–	–	–	AAA to AA
3	0.040 to 0.060	–	–	–	–	–	–	AA-
4	0.060 to 0.080	–	–	–	–	–	–	A+
5	0.080 to 0.200	–	–	–	–	–	–	A
6	0.200 to 0.300	–	–	–	–	–	–	A- to BBB+
7	0.300 to 1.000	–	–	–	–	–	–	BBB to BBB-
8	1.000 to 5.000	–	–	–	–	–	–	BB+ to BB-
9	5.000 to 99.999	–	–	–	–	–	–	B+ to C
10	100.0	–	–	–	–	–	–	Default
Total central governments and banks		–	–	–	–	–	–	
Corporates								
1	0.000 to 0.030	–	–	–	–	–	–	A
2	0.030 to 0.060	–	–	–	–	–	–	A-
3	0.060 to 0.160	605.1	571.9	0.140%	35.9%	42.5%	243.0	BBB+
4	0.160 to 0.260	290.0	280.8	0.220%	37.3%	52.6%	147.8	BBB
5	0.260 to 0.400	171.2	154.0	0.330%	43.5%	68.5%	105.5	BBB-
6	0.400 to 0.650	26.3	24.6	0.510%	38.1%	59.3%	14.6	BBB-
7	0.650 to 1.100	27.6	26.0	0.850%	41.4%	74.6%	19.4	BB+
8	1.100 to 1.900	21.3	19.9	1.500%	42.8%	114.6%	22.8	BB
9	1.900 to 3.300	9.5	9.0	3.000%	40.1%	100.0%	9.0	BB-
10	3.300 to 10.000	30.9	29.6	6.000%	39.2%	125.0%	37.0	B
11	10.000 to 15.000	3.1	3.1	13.000%	44.9%	206.5%	6.4	B-
12	15.000 to 20.000	0.1	0.1	18.000%	45.0%	200.0%	0.2	CCC+
13	20.000 to 99.999	0.6	0.6	22.000%	37.8%	200.0%	1.2	CCC
14	100.0	32.9	32.6	100.000%	40.4%	–	–	Default
Total corporates		1,218.6	1,152.2	3.279%	37.8%	52.7%	606.9	

5.5 Credit risk continued

In accordance with CRR Article 150 (Conditions for permanent partial use) the Bank has received permission from the regulator to exempt its exposures to certain counterparty classes, namely central governments (sovereigns) and central banks and multilateral development banks, from the IRB Approach for the purposes of the calculation of both risk-weighted exposure and expected loss amounts instead applying the standardised approach for these exposures.

Corporate IRB exposures decreased by 19% driven by deleverage of Non-core assets. RW% has reduced during the period owing to an improvement in PD grade associated to a small number of high exposure customers.

2014

Internal grades	PD range %	Exposure value pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m	Mapped external rating
2014								
Institutions								
1/2	0.000 to 0.040	–	–	–	–	–	–	AAA to AA
3	0.040 to 0.060	725.5	725.5	0.050%	45%	18%	128.1	AA-
4	0.060 to 0.080	287.2	287.2	0.080%	45%	30%	87.6	A+
5	0.080 to 0.200	331.8	318.7	0.120%	45%	32%	103.3	A
6	0.200 to 0.300	815.3	235.7	0.280%	45%	54%	127.9	A- to BBB+
7	0.300 to 1.000	–	–	–	–	–	–	BBB to BBB-
8	1.000 to 5.000	–	–	–	–	–	–	BB+ to BB-
9	5.000 to 99.999	–	–	–	–	–	–	B+ to C
10	100.0	–	–	–	–	–	–	Default
Total institutions		2,159.8	1,567.1	0.100%	45%	29%	446.9	
Central governments and central banks								
1/2	0.000 to 0.040	–	–	–	–	–	–	AAA to AA
3	0.040 to 0.060	2.8	2.8	0.100%	45%	12%	0.3	AA-
4	0.060 to 0.080	–	–	–	–	–	–	A+
5	0.080 to 0.200	–	–	–	–	–	–	A
6	0.200 to 0.300	–	–	–	–	–	–	A- to BBB+
7	0.300 to 1.000	–	–	–	–	–	–	BBB to BBB-
8	1.000 to 5.000	–	–	–	–	–	–	BB+ to BB-
9	5.000 to 99.999	–	–	–	–	–	–	B+ to C
10	100.0	–	–	–	–	–	–	Default
Total central governments and banks		2.8	2.8	0.100%	45%	12%	0.3	
Corporates								
1	0.000 to 0.030	–	–	–	–	–	–	A
2	0.030 to 0.060	20.5	17.4	0.053%	45%	30%	5.3	A-
3	0.060 to 0.160	489.4	480.8	0.140%	39%	44%	209.2	BBB+
4	0.160 to 0.260	480.2	467.6	0.220%	38%	56%	260.2	BBB
5	0.260 to 0.400	123.8	119.7	0.330%	36%	62%	74.1	BBB-
6	0.400 to 0.650	57.1	54.1	0.510%	39%	71%	38.7	BBB-
7	0.650 to 1.100	28.9	27.3	0.850%	41%	71%	19.4	BB+
8	1.100 to 1.900	12.5	10.3	1.500%	42%	82%	8.5	BB
9	1.900 to 3.300	159.2	139.9	3.000%	43%	115%	160.9	BB-
10	3.300 to 10.000	42.6	38.3	6.000%	40%	127%	48.6	B
11	10.000 to 15.000	0.9	0.8	13.000%	42%	164%	1.2	B-
12	15.000 to 20.000	0.2	0.1	18.000%	40%	208%	0.1	CCC+
13	20.000 to 99.999	0.6	0.5	22.000%	37%	171%	1.1	CCC
14	100.0	68.0	67.2	100.000%	38%	–	–	Default
Total corporates		1,483.9	1,424.0	5.385%	39%	58%	827.3	

5.5 Credit risk continued

IRB approach: EAD analysed by Expected Loss (EL) grades

The table below analyses each retail IRB exposure class by EL grade, calculated as expected loss as a percentage of EAD.

Table 19 Retail IRB EAD by EL grade

2015

	EL grade 1 £m	EL grade 2 £m	EL grade 3 £m	EL grade 4 £m	EL grade 5 £m	EL grade 6 £m	Default £m	Total £m
IRB Exposures class								
Retail secured by immovable property	**10,676.9**	**1,179.1**	**2,035.6**	**644.4**	**549.3**	**247.3**	**231.0**	**15,563.6**
Qualifying revolving retail exposures	**419.2**	**550.8**	**266.4**	**191.1**	**374.3**	**203.2**	**26.9**	**2,031.9**
Retail other non-SME	**–**	**–**	**–**	**2.4**	**154.6**	**62.0**	**69.7**	**288.7**
Total retail IRB	**11,096.1**	**1,729.9**	**2,302.0**	**837.9**	**1,078.2**	**512.5**	**327.6**	**17,884.2**

2014

	EL grade 1 £m	EL grade 2 £m	EL grade 3 £m	EL grade 4 £m	EL grade 5 £m	EL grade 6 £m	Default £m	Total £m
IRB Exposures class								
Retail secured by immovable property	12,795.0	1,133.0	2,152.5	820.0	994.7	574.4	659.2	19,128.8
Qualifying revolving retail exposures	435.7	608.5	301.4	112.6	420.4	261.0	23.3	2,162.9
Retail other non-SME	–	–	–	58.5	187.5	112.9	75.6	434.5
Total retail IRB	13,230.7	1,741.5	2,453.9	991.1	1,602.6	948.3	758.1	21,726.2

Definition in grading for expected loss grade

EL grade 1	EL% < 0.05%
EL grade 2	0.05% =< EL% < 0.07%
EL grade 3	0.07% =< EL% < 0.20%
EL grade 4	0.20% =< EL% < 0.40%
EL grade 5	0.40% =< EL% < 2.00%
EL grade 6	2.00% =< EL% < 100.00%

Retail secured by immovable property reduced by 19% overall. Securitisation of part of the Non-core Optimum portfolio through Warwick Finance One & Two has led to a reduction in particular within the higher risk EL grades and Default class.

5.5 Credit risk continued

Table 20 Retail IRB RWA by PD grade

The table below analyses each retail IRB exposure class by PD grade.

2015

Internal grades	PD range %	Exposure value pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m
Retail secured by immovable property							
1	0.000 to 0.040	2,668.4	2,739.4	0.035%	7.3%	0.8%	22.4
2	0.040 to 0.070	3,517.6	3,606.4	0.064%	9.8%	1.8%	65.7
3	0.070 to 0.310	2,567.2	2,630.8	0.159%	10.7%	3.9%	102.6
4	0.310 to 1.000	3,660.3	3,751.0	0.532%	11.3%	10.1%	380.1
5	1.000 to 3.000	1,664.6	1,705.6	1.570%	12.4%	25.8%	439.7
6	3.000 to 15.320	312.8	320.8	7.279%	15.5%	74.1%	237.7
7	15.320 to 99.999	619.3	578.6	57.719%	8.4%	31.1%	179.8
8	100.0	231.0	231.0	100.000%	17.9%	242.2%	559.4
Total Retail secured by immovable property		15,241.2	15,563.6	4.129%	10.3%	12.8%	1,987.4
Qualifying revolving retail exposures							
1	0.000 to 0.040	91.0	419.2	0.040%	74.5%	2.2%	9.2
2	0.040 to 0.070	–	–	–	–	–	–
3	0.070 to 0.120	719.9	562.0	0.085%	80.8%	4.5%	25.2
4	0.120 to 0.310	509.8	255.3	0.222%	80.1%	9.9%	25.2
5	0.310 to 0.500	378.4	300.7	0.436%	78.0%	16.5%	49.7
6	0.500 to 1.000	143.4	94.5	0.660%	83.3%	24.2%	22.9
7	1.000 to 5.000	309.1	278.3	2.305%	79.8%	59.2%	164.8
8	5.000 to 10.000	79.4	76.3	6.155%	82.7%	120.7%	92.1
9	10.000 to 20.000	14.3	11.9	13.149%	80.9%	184.9%	22.0
10	20.000 to 50.000	5.0	4.9	40.961%	79.1%	255.1%	12.5
11	50.000 to 99.999	1.9	1.9	60.580%	79.3%	210.5%	4.0
12	100.0	26.9	26.9	100.000%	89.4%	63.9%	17.2
Total Qualifying revolving retail exposures		2,279.1	2,031.9	2.257%	79.1%	21.9%	444.8
Retail other non-SME							
1	0.000 to 0.040	–	–	–	–	–	–
2	0.040 to 0.070	–	–	–	–	–	–
3	0.070 to 0.120	–	–	–	–	–	–
4	0.120 to 0.310	0.7	0.7	0.270%	81.2%	42.9%	0.3
5	0.310 to 0.500	1.7	1.7	0.390%	81.2%	52.9%	0.9
6	0.500 to 1.000	–	–	–	–	–	–
7	1.000 to 5.000	196.3	196.3	1.768%	79.9%	96.7%	189.8
8	5.000 to 10.000	10.0	10.0	9.029%	79.7%	138.0%	13.8
9	10.000 to 20.000	0.9	0.9	17.548%	80.6%	177.8%	1.6
10	20.000 to 50.000	9.0	9.0	36.399%	79.5%	220.0%	19.8
11	50.000 to 99.999	0.4	0.4	62.789%	79.3%	225.0%	0.9
12	100.0	69.7	69.7	100.000%	89.3%	96.6%	67.3
Total Retail other non-SME		288.7	288.7	26.946%	82.2%	102.0%	294.4

The Retail secured by immovable property includes an RWA temporary adjustment of £258m in relation to the Optimum portfolio. For further details, please refer to the Detailed financial review and Capital Management section of the 2015 Annual Report and Accounts.

5.5 Credit risk continued

2014

Internal grades	PD range %	Exposure value pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m
Retail secured by immovable property							
1	0.000 to 0.040	3,312.5	3,402.8	0.040%	7%	1%	28.2
2	0.040 to 0.070	4,253.4	4,368.5	0.060%	11%	2%	85.3
3	0.070 to 0.310	2,569.3	2,641.2	0.160%	10%	4%	98.7
4	0.310 to 1.000	3,704.3	3,808.0	0.560%	10%	10%	390.3
5	1.000 to 3.000	2,716.5	2,786.0	1.610%	13%	36%	1,006.4
6	3.000 to 15.320	667.1	684.7	6.750%	18%	93%	636.6
7	15.320 to 99.999	785.0	772.0	43.200%	14%	87%	669.8
8	100.0	665.5	665.6	100.000%	19%	210%	1,400.5
Total Retail secured by immovable property		18,673.6	19,128.8	5.852%	11%	23%	4,315.8

Internal grades	PD range %	Exposure value pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m
Qualifying revolving retail exposures							
1	0.000 to 0.040	98.8	435.7	0.040%	74%	2%	9.5
2	0.040 to 0.070	–	–	–	–	–	–
3	0.070 to 0.120	831.8	624.6	0.080%	81%	5%	28.1
4	0.120 to 0.310	578.2	285.9	0.220%	80%	10%	28.4
5	0.310 to 0.500	414.8	245.2	0.450%	80%	17%	42.4
6	0.500 to 1.000	82.4	68.5	0.720%	80%	25%	17.1
7	1.000 to 5.000	355.2	352.2	1.970%	79%	52%	183.9
8	5.000 to 10.000	104.3	104.1	6.170%	82%	120%	124.8
9	10.000 to 20.000	17.6	15.2	13.330%	80%	184%	28.1
10	20.000 to 50.000	5.7	5.7	37.070%	80%	249%	14.3
11	50.000 to 99.999	2.4	2.5	60.350%	79%	221%	5.5
12	100.0	23.3	23.3	100.000%	90%	90%	20.9
Total Qualifying revolving retail exposures		2,514.5	2,162.9	2.092%	79%	23%	503.0

Internal grades	PD range %	Exposure value pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m
Retail other non-SME							
1	0.000 to 0.040	–	–	–	–	–	–
2	0.040 to 0.070	–	–	–	–	–	–
3	0.070 to 0.120	–	–	–	–	–	–
4	0.120 to 0.310	3.1	3.1	0.270%	82%	43%	1.3
5	0.310 to 0.500	55.4	55.4	0.409%	82%	55%	30.6
6	0.500 to 1.000	–	–	–	–	–	–
7	1.000 to 5.000	229.8	229.8	2.111%	79%	103%	236.1
8	5.000 to 10.000	56.3	56.3	9.167%	78%	136%	76.3
9	10.000 to 20.000	2.3	2.3	16.287%	80%	174%	4.0
10	20.000 to 50.000	6.9	6.9	37.340%	80%	223%	15.3
11	50.000 to 99.999	5.2	5.2	62.895%	79%	190%	9.8
12	100.0	75.5	75.5	100.000%	89%	130%	98.3
Total Retail other non-SME		434.5	434.5	21.161%	81%	109%	471.7

5.5 Credit risk continued

5.5.9 Standardised approach

Analysis of exposures calculated in accordance with the standardised approach

For standardised exposures that are rated the nominated ECAI is Moody's. The Bank complies with the credit quality assessments scale in allocating external credit ratings to the credit quality steps as defined by the PRA.

The table analyses exposures post CCF and net of provisions subject to the standardised approach by associated credit quality step.

The Bank complies with the credit quality assessments scale in allocating external credit ratings to the credit quality steps as defined by the PRA within Supervisory Statement 10/13: www.bankofengland.co.uk/pra/Documents/publications/policy/2013/standardappr1013.pdf

Table 21 EAD post CRM calculated under the standardised approach

2015

	Credit Quality Step							
	1 £m	2 £m	3 £m	4 £m	5 £m	6 £m	Unrated £m	Total £m
Central government or central banks	**5,465.4**	**–**	**–**	**–**	**–**	**–**	**–**	**5,465.4**
Regional governments or local authorities	**–**	**–**	**–**	**–**	**–**	**–**	**5.0**	**5.0**
Public sector entities	**–**	**–**	**–**	**–**	**–**	**–**	**20.0**	**20.0**
Multilateral development banks	**500.9**	**–**	**–**	**–**	**–**	**–**	**–**	**500.9**
Institutions	**–**	**–**	**–**	**–**	**–**	**–**	**72.8**	**72.8**
Corporates	**–**	**–**	**–**	**–**	**–**	**–**	**320.1**	**320.1**
Retail exposures	**–**	**–**	**–**	**–**	**–**	**–**	**77.4**	**77.4**
Secured by mortgages on immoveable property	**–**	**–**	**–**	**–**	**–**	**–**	**0.2**	**0.2**
Exposures in default	**–**	**–**	**–**	**–**	**–**	**–**	**41.0**	**41.0**
Covered bonds	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Equity exposures	**–**	**–**	**–**	**–**	**–**	**–**	**60.5**	**60.5**
Other items	**–**	**–**	**–**	**–**	**–**	**–**	**461.8**	**461.8**
Total standardised approach	**5,966.3**	**–**	**–**	**–**	**–**	**–**	**1,058.8**	**7,025.1**

Central Governments or central banks include £71.5m of CRM, as detailed in Table 10.

2014

	Credit Quality Step							
	1 £m	2 £m	3 £m	4 £m	5 £m	6 £m	Unrated £m	Total £m
Central government or central banks	8,084.4	–	–	–	–	–	–	8,084.4
Regional governments or local authorities	–	–	–	–	–	–	25.8	25.8
Public sector entities	–	–	–	–	–	–	71.9	71.9
Multilateral development banks	588.2	–	–	–	–	–	–	588.2
Institutions	–	–	–	–	–	–	144.8	144.8
Corporates	–	–	–	–	–	–	944.4	944.4
Retail exposures	–	–	–	–	–	–	130.7	130.7
Secured by mortgages on immoveable property	–	–	–	–	–	–	32.6	32.6
Exposures in default	–	–	–	–	–	–	52.8	52.8
Covered bonds	74.4	–	0.1	–	–	–	–	74.5
Equity exposures	–	–	–	–	–	–	8.1	8.1
Other items	–	–	–	–	–	–	959.9	959.9
Total standardised approach	8,747.0	–	0.1	–	–	–	2,371.0	11,118.1

Note: Unrated includes exposures where customers individual credit rating does not impact RWAs under the standardised approach.

Corporate standardised exposures have decreased compared to last year as the Bank continues with its deleveraging strategy.

5.5 Credit risk continued

5.5.10 Supervisory slotting approach

The Corporate sector includes a specialised lending portfolio, consisting of lending to PFIs and property investment and development. For the specialised lending portfolio, the supervisory slotting approach is used. The table analyses EAD (including undrawn commitments post CCF) by slotting category.

Table 22 Specialised lending by slotting category

	2015 £m	2014 £m
Slotting category		
Strong	**72.4**	104.0
Good	**1,063.8**	1,844.8
Satisfactory	**80.1**	106.1
Weak	**93.0**	140.4
Default	**186.9**	872.1
Total	**1,496.2**	3,067.4

Slotting models are used to analyse and monitor specialised lending exposures to property which are assigned to PRA supervisory categories with predefined risk weights. The exposures have reduced since last year, reflective of the Bank's Non-Core deleveraging strategy.

5.5.11 Credit risk mitigation

5.5.11.1 Retail and Corporate

Collateral

The Bank uses various forms of collateral to mitigate credit risk. Collateral is regularly reviewed to ensure continued effectiveness as part of the credit review process. Property collateral for corporate lending is categorised as security for property development or investment customers (i.e. 'property' lending) or owner occupied premises to secure mainstream loan and overdraft facilities. For general lending, in addition to taking charges over property assets owned by the customer, other security is taken in modest proportion to the total portfolio. This includes debentures, floating charges and guarantees (often supported by tangible security, where appropriate, including property, life policies and stocks & shares) and cash cover.

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

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

Valuations are performed under Bank instruction by an approved panel of external valuers. When cases are placed into the Recoveries team and an LPA (Law of Property Act) Receiver is appointed then the valuation used will be an Expected Outcome Statement (EOS).

Property valuations are obtained when the facility is first approved and lending procedures typically require collateral to be revalued every two years or more frequently in higher risk situations (typically annually or when a material change has occurred that is likely to affect the value and/or recoverability of the debt). For sectors such as Housing Associations, which have exhibited zero defaults historically, revaluations would be required every three years. In certain circumstances, such as syndicates, the multi bank facility letter may preclude revaluations at the customer's expense of all the assets as frequently as this and a decision is required by all banks involved to decide if they require the updates more frequently.

In addition, the values held in the Bank's systems are indexed for risk assessment and capital calculation using appropriate regional and asset type indices where available, otherwise the national average index is applied.

Single name concentration risk

Single name concentration risk is the concentration in exposures to single counterparties.

During 2015, the Bank has reduced its single name concentration risk:

- as at 31 December 2014, 14 customers existed on book with individual exposure greater than £50m. This totalled £1,005m (18% of total Corporate portfolio), of which £371m was categorised as default.
- as at 31 December 2015, only six customers were on book with individual exposure exceeding £50m, totalling £455m (15% of total Corporate portfolio). All customers performing with five of the six assets categorised in the low risk Housing Association sector.

5.5 Credit risk continued

5.5.11.2 Treasury

Treasury credit risks are managed in accordance with limits and asset quality measures which are set out in the Credit Risk Policy and more specifically in the Treasury Credit Risk Control Standard which govern the types of wholesale related exposure that the Bank can take. A Delegated Lending Discretion (DLD) framework, detailing maximum lending limits at individual role holder level for the granting of initial and further advances of credit, credit related write-offs/write-backs and for approving impairment provisions has been established. Within this DLD framework, Treasury Counterparty limits are approved by the CRO, or in his absence the CEO. Additionally, the CRO has delegated discretion to the Treasury Risk Director, upon the advisement of EROC and RC in accordance with the Treasury Credit Discretion Matrix.

The Treasury Risk function monitors both the counterparties and assets held against a Board approved matrix of risk tolerance and associated indicators. Rating actions, market events and financial results are continually monitored in order to assess any change in risk status and possible escalation requiring management actions and inclusion on the Watchlist. A risk based approach is followed in allocating credit assessment priority, taking into account the potential for credit loss, exposure (sector concentrations, if appropriate), bond pricing, rating actions, country of risk and any potential management actions. Reviews are undertaken on the following basis:

- Investment Grade (ECAI Rated) Counterparties – these are continuously monitored for any change in rating or significant commentary and are subject to credit reviews on a rolling basis. Furthermore, a Watchlist update is provided to Treasury Credit Risk Management Forum (TCRMF) monthly. An annual impairment review is undertaken in conjunction with other related parties.
- ECAI Unrated Treasury names – exposures for these counterparties are subject to continual monitoring and annual review.

To provide an independent monthly view of Delegated Lending Authority utilisation across Treasury portfolios, TCRMF, EROC and RC will be advised of all new, increased and/or renewed credit limits sanctioned by the CRO/CEO.

Table 23 IRB exposures covered by collateral

	2015		2014	
	Exposure value covered by collateral after haircut £m	**Exposure value covered by guarantee after haircut £m**	Exposure value covered by collateral after haircut £m	Exposure value covered by guarantee after haircut £m
Central governments and central banks	**–**	**–**	–	2.8
Institutions	**169.3**	**–**	623.3	–
Totals	**169.3**	**–**	623.3	2.8

Collateral held represents the value of cash collateral held in relation to repurchase agreement (repo) activity and cash and debt securities held in relation to derivative activity after the application of applicable regulatory haircuts as prescribed under CRR Articles 223 and 224 (Financial Collateral Comprehensive Method).

The significant decrease in the Bank's collateralised exposures observed between 2014 and 2015, primarily results from the maturity of two term funding repo transactions during 2015, these having previously been cash collateralised at the aggregated level of £598m as at 31 December 2014.

The Bank also utilises a number of methods to reduce the credit risks associated with its activities. The form and scope of credit risk mitigation will vary dependent upon factors such as the counterparty and underlying transaction type amongst others. These mitigation methods are summarised below:

Netting policies and processes

The Bank documents its derivative activity through the use of bilateral netting master agreements (typically industry standard International Swaps and Derivatives Association (ISDA) agreements) allowing close out netting with a single net settlement of all derivative contracts covered under each agreement concluded with the same legal counterparty in the event of default. This is achieved through the offsetting of all positive and negative market values under the derivative contracts outstanding with the given counterparty. Such agreements effectively serve to eliminate the counterparty credit risk associated with favourable contracts such that unfavourable contracts with the same legal counterparty are not settled before favourable contracts.

Collateral management and valuation policies and processes for derivatives

The forms of collateral acceptable to the Bank are determined in accordance with strict policies governing issuer type, credit rating and debt seniority. Collateral must also meet the eligibility criteria established by the regulator in order that risk mitigation of the Bank's credit exposures may be recognised.

In conjunction with the execution of each ISDA Master Agreement a collateral agreement known as a Credit Support Annex (CSA) will typically be established in order to further mitigate credit risk associated with derivative activity. These agreements govern the collateral amounts to be posted or received by the Bank during the contract term. The terms of each CSA may vary according to each party's view of the other party's creditworthiness. Some agreements are linked to external credit ratings such that in the event of a deterioration of a party's (the Bank or a counterparty) external rating, it may be required to lodge collateral.

In the case of repurchase transactions documentation takes the form of the Global Master Repurchase Agreement (GMRA), with collateral valuations calculated by reference to the market prices associated with the underlying debt security.

5.5 Credit risk continued

Transactions subject to collateral agreements are marked-to-market periodically (usually daily) and the parameters defined in the collateral agreement are applied in order to derive the rebalancing amount of collateral (usually cash) to be called from, or returned to, the transactional counterparty such that variation tolerances set out within the collateral agreement are adhered to.

The Bank only accepts cash and government bonds as collateral. To mitigate any market risk impact from holding fixed rate government bonds a daily mark-to-market is undertaken and additional collateral requested as appropriate.

The Bank's collateralised exposures as at 31 December 2015 was £752.4m (31 December 2014: £847.5m). Collateral lodged with the Bank comprised of cash held in connection with repurchase agreement activity of £671.3m (31 December 2014: £755.2m), cash held in connection with derivative activity of £9.6m (31 December 2014: £13.3m) and government debt securities held in connection with derivative activity of £71.5m (31 December 2014: £79.0m). The credit risk mitigation effect of all collateral held will reflect any reduction in value resulting from the application of prescribed regulatory haircuts.

Guarantees

Guarantees issued by national or regional governments have historically been available in relation to certain assets within Bank's investment security portfolio, primarily debt securities issued by European special purpose banks operating in the public sector. These guarantees may serve to enhance the credit profile of the exposure and provide security in the event of issuer default. Such exposures will consequently qualify for the application of a lower risk weighting for the purposes of calculating the associated regulatory capital requirement. As at 31 December 2015, total exposure benefiting from guarantees is nil (£32.8m as at 31 December 2014).

Wrong Way risk

This type of risk occurs when exposure to counterparty is adversely correlated with the credit quality of that counterparty. The Bank ensures that the issuer of collateral is neither the same nor connected to the counterparty to a transaction.

5.5.12 Derivative credit exposure

The Bank enters into a variety of derivative contracts primarily for the purposes of hedging its market risk exposures such as interest rate and foreign exchange risks.

Counterparty Credit risk

Counterparty credit risk in derivative transactions arises from the risk of counterparty default prior to the settlement date of derivative contracts with the counterparty unable to fulfil present and future contractual payment obligations. The amount at risk may change over time as a function of the underlying market parameters up to the positive value of the contract in favour of the Bank.

A key difference between derivatives and other asset types is that whereas the credit risk of other financial assets is generally represented by the principal amount net of any applicable allowance for credit losses, the counterparty credit risk associated with derivative instruments will ordinarily represent an amount significantly lower than the notional amount of the derivative instrument.

Except where such are settled via central counterparties, the counterparty credit risk associated with over-the-counter derivative instruments will usually be greater than with those traded through recognised exchanges given the more formal regulation and centralised management of the latter contracts.

Gross credit risk exposure is comprised of the estimated replacement cost, or positive fair value for all contracts plus an add-on for potential future exposure (PFE). The add-on amount is based upon the formula prescribed within Article 274 (Mark-to-Market Method) of the CRR.

The following tables summarise the gross credit exposure associated with the Bank's derivative financial instruments and underlying Mark-to-Market (MtM) and PFE values.

The table below provides an overview of the aggregate notional amounts under the Bank's outstanding derivative contracts by underlying product. The notional amounts shown represent the reference amount to which a rate or price is applied in order to determine the cash flows to be exchanged during the life of the underlying transactions and are not in themselves a measure of potential credit or market risk, rather they provide an illustration of transactional volumes outstanding.

5.5 Credit risk continued

Table 24 Mark-to-Market and Potential Future Exposures

	2015				2014			
	Notional Amount £m	PFE £m	Positive MtM £m	Negative MtM £m	Notional Amount £m	PFE £m	Positive MtM £m	Negative MtM £m
Interest Rate Contracts								
Exchange-traded								
Futures	(1,095.5)	15.7	10.2	28.8	6,070.5	35.5	9.9	31.5
Options	–	–	–	–	–	–	–	–
	(1,095.5)	15.7	10.2	28.8	6,070.5	35.5	9.9	31.5
Over-the-Counter								
Interest Rate Swaps	11,823.3	76.1	50.6	305.0	16,172.2	99.2	78.5	536.7
Currency Interest Rate Swaps	948.4	22.5	160.2	0.3	1,463.2	55.5	182.3	14.8
Collars	–	–	–	–	2.4	–	–	–
Caps	80.0	0.3	0.2	–	255.0	0.4	–	–
	12,851.7	98.9	211.0	305.3	17,892.8	155.1	260.8	551.5
Over-the-Counter (settled via CCP)								
Interest Rate Swaps	4,475.7	25.3	17.4	44.3	3.0	–	–	–
Currency Interest Rate Swaps	–	–	–	–	–	–	–	–
Collars	–	–	–	–	–	–	–	–
	4,475.7	25.3	17.4	44.3	3.0	–	–	–
Total Interest Rate Contracts	16,231.9	139.9	238.6	378.4	23,966.3	190.6	270.7	583.0
Foreign Exchange Contracts								
Exchange-traded								
Futures	–	–	–	–	–	–	–	–
Options	–	–	–	–	–	–	–	–
Over-the-Counter								
Foreign Exchange Swaps	9.9	0.1	–	0.1	18.9	0.2	0.4	0.1
Spot Foreign Exchange	2.2	0.0	–	–	1.5	–	–	–
Forward Foreign Exchange	44.5	0.4	0.1	1.8	6.5	0.1	0.1	0.1
	56.6	0.5	0.1	1.9	26.9	0.3	0.5	0.2
Over-the-Counter (settled via CCP)								
Foreign Exchange Swaps	–	–	–	–	–	–	–	–
Spot Foreign Exchange	–	–	–	–	–	–	–	–
Forward Foreign Exchange	–	–	–	–	–	–	–	–
Total Foreign Exchange Contracts	56.6	0.5	0.1	1.9	26.9	0.3	0.5	0.2
Other Derivative Contracts								
Exchange-traded								
Equity Swaps	–	–	–	–	–	–	–	–
Credit Default Swaps	–	–	–	–	–	–	–	–
Over-the-Counter								
Equity Swaps	60.5	3.8	18.6	–	216.8	14.2	50.8	–
Credit Default Swaps	–	–	–	–	–	–	–	–
	60.5	3.8	18.6	–	216.8	14.2	50.8	–
Over-the-Counter (settled via CCP)								
Equity Swaps	–	–	–	–	–	–	–	–
Credit Default Swaps	–	–	–	–	–	–	–	–
Total Other Derivative Contracts	60.5	3.8	18.6	–	216.8	14.2	50.8	–
Total Derivative Notional, PFE and MtM	16,349.0	144.2	257.3	380.3	24,210.0	205.1	322.0	583.2

5.5 Credit risk continued

The notional amount on the exchange traded interest rate futures in the above table is negative as the overall position is short futures contracts. Reduction in Over-the-Counter (OTC) interest rate swaps and increase in OTC (settled via Central Clearing Counterparty (CCP)) interest rate futures reflects the maturing of existing derivative non CCP trades and the vast majority of new derivative trades through a CCP. Reduction in OTC equity swaps over 2015 reflects maturing equity swaps within the year and no new trades within the year.

Table 25 Derivative contracts Credit risk exposures

	2015		2014	
	Notional Amount £m	**Gross Credit risk exposure[1] £m**	Notional Amount £m	Gross Credit risk exposure[1] £m
Interest Rate Contracts				
Exchange-traded				
Futures	**(1,095.5)**	**26.0**	6,070.5	45.5
Options	**–**	**–**	–	–
	(1,095.5)	**26.0**	6,070.5	45.5
Over-the-Counter				
Interest Rate Swaps	**11,823.3**	**126.7**	16,172.2	177.6
Currency Interest Rate Swaps	**948.4**	**117.2**	1,463.2	237.9
Collars	**–**	**–**	2.4	–
Caps	**80.0**	**0.5**	255.0	0.4
	12,851.7	**244.4**	17,892.8	415.9
Over-the-Counter (settled via CCP)				
Interest Rate Swaps	**4,475.7**	**42.7**	3.0	–
Currency Interest Rate Swaps	**–**	**–**	–	–
Collars	**–**	**–**	–	–
	4,475.7	**42.7**	3.0	–
Total Interest Rate Contracts	**16,231.9**	**313.1**	23,966.3	461.4
Foreign Exchange Contracts				
Exchange-traded				
Futures	**–**	**–**	–	–
Options	**–**	**–**	–	–
	–	**–**	–	–
Over-the-Counter				
Foreign Exchange Swaps	**9.9**	**0.1**	18.9	0.6
Spot Foreign Exchange	**2.2**	**–**	1.5	–
Forward Foreign Exchange	**44.5**	**0.6**	6.5	0.1
	56.6	**0.7**	26.9	0.7
Over-the-Counter (settled via CCP)				
Foreign Exchange Swaps	**–**	**–**		
Spot Foreign Exchange	**–**	**–**	–	–
Forward Foreign Exchange	**–**	**–**	–	–
Total Foreign Exchange Contracts	**56.6**	**0.7**	26.9	0.7
Other Derivative Contracts				
Exchange-traded				
Equity Swaps	**–**	**–**	–	–
Credit Default Swaps	**–**	**–**	–	–
	–	**–**	–	–

5.5 Credit risk continued

	2015		2014	
	Notional Amount £m	Gross Credit risk exposure[1] £m	Notional Amount £m	Gross Credit risk exposure[1] £m
Over-the-Counter				
Equity Swaps	60.5	22.4	216.8	65.0
Credit Default Swaps	–	–	–	–
	60.5	22.4	216.8	65.0
Over-the-Counter (settled via CCP)				
Equity Swaps	–	–	–	–
Credit Default Swaps	–	–	–	–
	–	–	–	–
Total Other Derivative Contracts	60.5	22.4	216.8	65.0
Total Notional and Gross Credit Risk	16,349.0	336.2	24,210.0	527.1
Netting Benefit[2]		(121.7)		(148.4)
Credit Risk post Netting		214.5		378.7
Collateral Held[3]		(9.6)		(92.2)
Net Credit Risk Exposure		204.9		286.5

(1) Credit risk prior to the application of netting benefit and credit risk mitigation via collateral held.

(2) Netting benefit includes both Mark-to-Market and Potential Future Credit Exposure impacts.

(3) Collateral Held comprises cash and debt securities as valued post the application of regulatory haircuts.

The net credit risk exposure figure at the foot of the above table represents the Bank's credit exposure through derivative transactions after recognition of legally enforceable netting agreements and the application of eligible financial collateral held.

Table 26 Derivative Credit risk exposure maturity

The table below analyses OTC derivatives by maturity.

2015

	< 1 year £m	≥ 1 year to < 5 years £m	≥ 5 years to < 10 years £m	≥ 10 years to < 20 years £m	≥20 years £m	Total £m
Interest Rate Contracts						
Interest Rate Swaps	3,801.5	8,606.5	3,194.9	389.5	306.6	16,299.0
Currency Interest Rate Swaps	622.6	325.8	–	–	–	948.4
Collars	–	–	–	–	–	–
Caps	50.8	13.5	5.1	10.6	–	80.0
Total Interest Rate Contracts	4,474.9	8,945.8	3,200.0	400.1	306.6	17,327.4
Foreign Exchange Contracts						
Foreign Exchange Swaps	9.9	–	–	–	–	9.9
Spot Foreign Exchange	2.2	–	–	–	–	2.2
Forward Foreign Exchange	44.5	–	–	–	–	44.5
Total Foreign Exchange Contracts	56.6	–	–	–	–	56.6
Other Derivative Contracts						
Equity Swaps	51.1	9.4	–	–	–	60.5
Credit Default Swaps	–	–	–	–	–	0.0
Total Other Derivative Contracts	51.1	9.4	–	–	–	60.5
Total Derivative Notional Amounts	4,582.6	8,955.2	3,200.0	400.1	306.6	17,444.5

5.5 Credit risk continued

2014

	< 1 year £m	≥ 1 year to < 5 years £m	≥ 5 years to < 10 years £m	≥ 10 years to < 20 years £m	≥20 years £m	Total £m
Interest Rate Contracts						
Interest Rate Swaps	4,455.9	7,664.6	3,106.9	560.4	387.4	16,175.2
Currency Interest Rate Swaps	440.3	1,022.9	–	–	–	1,463.2
Collars	–	2.4	–	–	–	2.4
Caps	183.5	69.1	1.2	1.2	–	255.0
Total Interest Rate Contracts	5,079.7	8,759.0	3,108.1	561.6	387.4	17,895.8
Foreign Exchange Contracts						
Foreign Exchange Swaps	18.9	–	–	–	–	18.9
Spot Foreign Exchange	1.5	–	–	–	–	1.5
Forward Foreign Exchange	6.5	–	–	–	–	6.5
Total Foreign Exchange Contracts	26.9	–	–	–	–	26.9
Other Derivative Contracts						
Equity Swaps	156.3	60.5	–	–	–	216.8
Credit Default Swaps	–	–	–	–	–	–
Total Other Derivative Contracts	156.3	60.5	–	–	–	216.8
Total Derivative Notional Amounts	5,262.9	8,819.5	3,108.1	561.6	387.4	18,139.5

Table 27 Counterparty Credit risk by sector

	2015		2014	
	Credit risk post application of CRM £m	**% of portfolio**	Credit risk post application of CRM £m	% of portfolio
Sector				
Credit Institutions	**178.5**	**94.6**	240.5	99.8
Other Financial Corporations	**–**	**–**	0.4	0.2
Sovereigns	**–**	**–**	–	–
Corporates	**–**	**–**	–	–
Central Counterparties	**10.1**	**5.4**	–	–
Total	**188.6**	**100.0**	240.9	100.0

The counterparty credit risk to Central counterparties is exposure to the London Clearing House.

Table 28 Counterparty Credit risk by rating

	2015		2014	
	Credit risk post application of CRM £m	**% of portfolio**	Credit risk post application of CRM £m	% of portfolio
Credit Rating				
AAA	**–**	**–**	–	–
AA+	**–**	**–**	–	–
AA	**–**	**–**	–	–
AA-	**158.5**	**84.0**	36.8	15.3
A+	**4.1**	**2.2**	163.7	68.0
A	**12.8**	**6.8**	29.1	12.1
A-	**0.2**	**0.1**	0.6	0.2
BBB+	**2.9**	**1.5**	10.7	4.4
Unrated	**10.1**	**5.4**	–	–
Total	**188.6**	**100.0**	240.9	100.0

5.5 Credit risk continued

As at 31 December 2015, 86.2% of counterparty credit risk exposure post application of credit risk mitigation is to counterparties rated AA- and above.

The unrated exposure in the table above relates to the exposure to Central Counterparties as per Table 27.

Table 29 Counterparty Credit risk by country

	2015		2014	
	Credit risk post application of CRM £m	% of portfolio	Credit risk post application of CRM £m	% of portfolio
Country of Incorporation				
Australia	0.5	0.3	0.8	0.3
Canada	0.4	0.2	0.4	0.2
Denmark	0.1	0.1	0.1	0.0
France	4.9	2.6	6.0	2.5
Germany	0.2	0.1	0.2	0.1
Switzerland	–	–	2.0	0.9
United Kingdom	56.7	30.1	69.9	29.0
USA	125.8	66.6	161.5	67.0
Total	188.6	100.0	240.9	100.0

Net counterparty credit risk exposure associated with OTC derivative transactions are concentrated primarily with counterparties incorporated in the USA and UK at 67% and 30% of total exposure respectively.

Table 30 Encumbered and non-encumbered assets by balance sheet category

2015

	Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
Equity instruments	–	–	55.6	55.6
Debt securities	1,791.5	1,791.5	3,102.7	3,102.7
Other assets	5,334.0		18,744.5	
Assets of the reporting institution	7,125.5		21,902.8	

	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
Carrying amount of selected financial liabilities	3,299.7	7,125.5

2014

	Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
Equity instruments	–	–	2.8	2.8
Debt securities	1,644.5	1,644.5	2,778.0	2,778.0
Other assets	8,118.7		25,038.9	
Assets of the reporting institution	9,763.2		27,819.7	

	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
Carrying amount of selected financial liabilities	3,931.7	9,763.2

5.5 Credit risk continued

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

The 2015 encumbered assets captured above relate to median values over the last 12 months, whilst the 2014 comparatives are presented on a point-in-time basis.

The point-in-time encumbered asset ratio as at 31 December 2015 is 21.8% (25.9% as at 31 December 2014).

Going forward, a median based encumbrance ratio will be utilised (24.5% as at 31 December 2015).

A stress-test to calculate the amount of additional assets required in the event of a 30% decrease in GBP value of the existing encumbered assets has been completed. Due to the structure and content of the Bank's various encumbered asset pools, £284m worth of appropriate assets would be required to maintain contractual responsibilities and current credit ratings.

On a median value basis 58% of the encumbered assets are mortgage pools; 25% are debt securities.

5.5.13 Impairment

Allowance for impairments relating to loans and advances to customers

The policy on impairment is described in the Risk Management section of the 2015 Annual Report and Accounts.

The provisions within the Corporate portfolio are spread over the Corporate exposure classes for foundation IRB and Standardised approach. The provisions for Retail exposures relate to Retail secured by immovable property and the unsecured exposures within the Qualifying revolving retail exposures and Retail other non-SME exposure classes. With the exception of a small portfolio of personal career development loans, all retail exposures are treated under the Retail IRB approach. Reductions in the specific corporate impairments are a result of asset deleveraging in the Non-core portfolio and collateral revaluations.

Following on from the implementation of CRD IV, all provisions are now classified as specific.

The EBA Credit Risk Adjustments Regulatory Technical Standard (RTS) specifies the criteria that need to be met for a provision to be treated as a 'general provision'. In particular, provisions need to cover 'credit risk losses that have not yet materialised' and for which there is 'currently no evidence that a loss event has occurred'. However, under IAS 39 banks are not permitted to book (individually assessed or collective) loss provisions unless there is 'objective evidence that a loss event has occurred'. Therefore, all of the Bank's provisions are classified as specific.

Table 31 Allowance for impairment

2015

	Specific Retail £m	Specific Corporate £m	Total £m
At the beginning of the year	**130.2**	**409.7**	**539.9**
Adjustment to treatment of balances with debt collection agencies	**–**	**–**	**–**
Disposal of UTB	**–**	**(2.6)**	**(2.6)**
Charge/(Release) against profits	**(39.8)**	**2.1**	**(37.7)**
Amounts written off	**29.4**	**(280.0)**	**(250.6)**
Unwind of discount allowance	**(2.3)**	**(1.5)**	**(3.8)**
Interest charged on impaired loans	**–**	**–**	**–**
At the end of the year	**117.5**	**127.7**	**245.2**

2014

	Specific Retail £m	Specific Corporate £m	Total £m
At the beginning of the year	200.2	752.2	952.4
Adjustment to treatment of balances with debt collection agencies[1]	39.6	–	39.6
Charge/(Release) against profits	(16.7)	(155.7)	(172.4)
Amounts written off	(88.7)	(180.2)	(268.9)
Unwind of discount allowance	(4.2)	(6.7)	(10.9)
Interest charged on impaired loans	–	0.1	0.1
At the end of the year	130.2	409.7	539.9

[1] In 2014, the Bank reviewed its relationship with debt collection agencies and concluded the Bank had substantially retained all the risks and rewards associated with such relationships. The Bank recognised gross receivables of £41.6m and an associated allowance of £39.6m in 2014.

The Specific Retail amount written off in 2015 is impacted by fair value reversals of £43.9m for Retail secured by immovable property.

5.5 Credit risk continued

Allowance for impairment relating to debt securities

The provisions within the Treasury portfolio relate to exposures to institutions and investment in securitisations. During the year there has been no additional impairment recognised.

The following table represents the movement in allowance for impairments relating to debt securities:

Table 32 Allowance for impairment relating to debt securities

	2015 £m	2014 £m
At the beginning of the year	–	20.0
Release against profits	–	(1.1)
Utilised	–	(18.9)
Other	–	–
At the end of the year	–	–

A number of securities that had previously been fully provided for in 2014 were sold during the period. Cash proceeds of £1.1m were received, resulting utilisation of the remaining £18.9m.

In 2015, the result of the impairment review for debt securities showed no sign of impairment.

Comparison of expected losses to accounting impairment losses

The following table compares expected losses on non-defaulted assets as at 31 December 2014 to the actual impairment charge/releases incurred during the subsequent year ending 31 December 2015.

Expected losses for exposures on the IRB approach are derived from underlying IRB models and are a function of PD, LGD and EAD estimates. Expected losses for specialised lending are determined using pre-defined expected loss rates for each of the five PRA supervisory categories. Expected loss is not calculated for exposures on the standardised approach.

IRB models were developed following Basel III requirements and are not directly comparable with accounting impairment losses. In particular expected loss calculations are based on long run estimates of PD and use economic downturn estimates of LGD. In addition, LGD represents the loss expectation until finalisation of the workout period while account impairment losses correspond to a single year.

Table 33 Comparison of expected losses to impairment losses

2015

	Expected losses on non-defaulted assets as at 31 December 2014 £m	Impairment losses/(releases) for 2015 £m
Exposure class		
IRB		
Institutions	–	–
Corporates	3.9	(3.7)
Retail secured by immovable property	55.8	(45.6)
Qualifying revolving retail exposures	17.6	9.0
Retail other non-SME	12.9	(3.2)
Equity exposures	–	–
Total IRB	90.2	(43.5)
Specialised lending	27.9	17.3
Total	118.1	(26.2)
Impairment losses on standardised portfolios		(11.5)
Net charge (credit) to the income statements (loans and advances to customers and banks)		(37.7)

5.5 Credit risk continued

2014

	Expected losses on non-defaulted assets as at 31 December 2013 £m	Impairment losses/(releases) for 2014 £m
Exposure class		
IRB		
Institutions	1.1	–
Corporates	10.1	(13.6)
Retail secured by immovable property	91.6	(17.2)
Qualifying revolving retail exposures	22.7	(4.9)
Retail other non-SME	18.8	5.3
Equity exposures	–	–
Total IRB	144.3	(30.4)
Specialised lending	66.2	(117.4)
Total	210.5	(147.8)
Impairment losses on standardised portfolios		(24.6)
Net charge (credit) to the income statements (loans and advances to customers and banks)		(172.4)

An impairment charge of £17.3m is reported for Specialised lending compared to a release of £117.4m in 2014, which was driven largely by the workout approach relating to a number of large Commercial Real Estate customers.

The impairment release of £45.6m reported in 2015 for Retail secured by immovable property was largely driven by the securitisation of Warwick Finance One & Two.

Qualifying revolving retail exposures charge of £9.0m in 2015 was primarily driven by credit card write-offs (£4.3m) and provision movements relating to both credit cards and overdrafts (£3.3m). A release of £4.9m was reported in 2014 due to debt sale.

A release of £3.2m is reported for Retail other non-SME exposures. This is largely driven by the significant reduction in loan balance resulting in a provision release of £8.2m, offset by £4.0m of write offs.

5.5.14 Securitisations

Securitisations can take the form of traditional or synthetic. Traditional Securitisation is the process by which a group of assets, usually mortgage loans, are aggregated into a pool and the beneficial ownership is sold to bankruptcy remote Special Purpose Entities (SPEs). The pool of mortgage loans is used to back the issuance of new securities, allowing the credit rating of the securities to be separated from the credit rating of the sponsor company. In a Synthetic securitisation the Bank retains beneficial ownership of the underlying assets and transfers some or all of the credit risk to a SPE through a credit derivative. The underlying referenced asset portfolio will be divided into different credit tranches and the Bank may only transfer the credit risk of some tranches and may retain the credit risk of others.

The Bank acts as an investor, originator, sponsor, cash manager, servicer/administrator, subordinated loan provider and the liquidity facility provider in Securitisation Transactions.

Investments in securitisations

All of the Bank's Securitisation exposures are to UK residential mortgages and primarily reflects the retained elements of securitisations of mortgages either originated or acquired by the Bank. Out of the current total exposure of £3.0bn (£1.5bn in 2014), £1.4bn reflects the synthetic securitisation exposure from the Calico Finance Number One Limited (Calico) transaction referred to below. The increase from 2014 relates to retained holdings of Residential Mortgage Backed Securities (RMBS) issued by the Warwick Finance One & Two SPEs detailed below.

The Bank does not run an active trading book in RMBS. However these assets may be sold or used as collateral for short term borrowing (repos) in response to needs for liquidity or changes in interest rates. Given that the Bank does not seek to actively transact in this type of asset each purchase is individually agreed by ALCO and a maximum notional limit set.

RMBS positions held by the Bank may give rise to Credit risk and Market risk. Credit risk is the risk that the SPE's will fail to meet interest and principal payment obligations as and when they fall due. SPEs will service the securities using the cash flows generated by underlying mortgages. Given the majority of the Bank's securitisation investments are in senior, highly rated securitisation positions, this risk is largely mitigated. Market risk is the risk of losses the Bank may suffer due to fluctuations in credit spreads, interest rates, foreign currency rates and any other market implied volatility.

5.5 Credit risk continued

The Treasury Risk function acts as a second line of defence in monitoring changes in the credit and market risk profile of the Bank's RMBS exposure, with external market analysis being supplemented by discussions with the portfolio manager (Treasury – first line of defence). Monthly updates are provided to senior management detailing both changes in the valuations of the bonds and the performance of the underlying assets including delinquency rates, cumulative losses, Constant Prepayment Rates (CPR) and Loan To Value (LTVs). RMBSs are assessed using the ratings based approach, under foundation IRB, where risk weight percentages are applied to each deal depending on the external rating, seniority and granularity of the instrument. Notwithstanding the risk banding allocation, all transactions where no value adjustment is held continue to meet their payment obligations. There were no securitised revolving exposures held during the reporting period.

Capital requirements for all of the Bank's exposures to securitisations are calculated using the external ratings based method. The following table shows the exposure at default and capital requirement broken down by external ratings grade. Capital requirement is shown gross of any provision offsets.

The Bank does not have any exposures to re-securitisations and does not hedge any securitisation position.

Table 34 Securitisation exposure by rating grade

2015

		Senior and granular		Non senior and granular		Non senior and non granular	
	Credit quality step	Exposure £m	Capital Requirement £m	Exposure £m	Capital Requirement £m	Exposure £m	Capital Requirement £m
AAA or A1/P1	1	2,587.2	15.4	17.9	0.2	–	–
AA	2	7.0	–	156.5	2.0	–	–
A+	3	–	–	–	–	–	–
A or A2/P2	4	–	–	142.2	2.4	–	–
A-	5	–	–	–	–	–	–
BBB+	6	–	–	–	–	–	–
BBB	7	–	–	71.6	4.6	–	–
BBB-	8	–	–	22.4	1.9	–	–
BB+	9	–	–	–	–	–	–
BB	10	–	–	–	–	–	–
BB-	11	–	–	–	–	–	–
Rated below BB- or A3/P3	12	–	–	33.2	26.2	–	–
Total		2,594.2	15.4	443.8	37.3	–	–

2014

		Senior and granular		Non senior and granular		Non senior and non granular	
	Credit quality step	Exposure £m	Capital Requirement £m	Exposure £m	Capital Requirement £m	Exposure £m	Capital Requirement £m
AAA or A1/P1	1	1,094.9	6.5	17.9	0.2	–	–
AA	2	7.0	–	156.6	2.0	–	–
A+	3	–	–	–	–	–	–
A or A2/P2	4	–	–	143.5	2.4	–	–
A-	5	–	–	–	–	–	–
BBB+	6	–	–	–	–	–	–
BBB	7	–	–	71.6	4.6	–	–
BBB-	8	–	–	22.4	1.9	24.1	1.1
BB+	9	–	–	–	–	–	–
BB	10	–	–	–	–	24.2	8.7
BB-	11	–	–	–	–	–	–
Rated below BB- or A3/P3	12	–	–	34.3	25.2	27.3	21.7
Total		1,101.9	6.5	446.3	36.3	75.6	31.5

Ratings are based upon the lower of Fitch and Moody's assigned counterparty credit ratings and mapped on an equivalency basis.

5.5 Credit risk continued

The Bank risk weights securitisation positions within credit quality step 12 at 1,250% rather than deducting from capital. CRD IV allows either treatment.

Currently the Bank has no outstanding assets awaiting securitisation.

The increase in AAA exposure in 2015 compared to 2014 in senior and granular exposure is due to Warwick Finance One & Two retained holdings of an aggregate £1.5bn (as at 31 December 2015).

The decrease in Non senior and non granular exposure relates to the disposal of Non-core positions during the year.

There were no impaired/past due/losses on securitisation positions during 2015.

Originated securitisations

The Bank has established traditional securitisation structures as part of its funding and Optimum (Non-core residential mortgages) deleveraging activities, using residential mortgage loans as the underlying asset pools.

Securitisation funding transactions (Leek Finance and Silk Road RMBS programmes) provide funding diversity for the Bank. However, the majority of the risks and rewards in respect of the underlying mortgage loan pools are retained by the Bank in its funding securitisation structures. For such structures where risks and rewards of the underlying mortgages are retained by the Bank, the corresponding SPEs are included as subsidiaries in the consolidated financial statements, with the Bank continuing to recognise securitised assets as loans and advances to customers on the balance sheet, and income from the securitised assets being recognised as income.

The Bank has only acted as mortgage originator, sponsor, servicing and administration agent, cash manager, subordinated loan provider and liquidity facility provider in respect of its own traditional, funding securitisations. The Bank does not provide bridging loans nor does it act as underwriter or dealer in its securitisations. All transactions are approved at Board level and benefit from relevant accounting and legal advice to ensure compliance with regulatory and statutory requirements.

Furthermore, the Bank does not provide implicit support for its securitisations, including Calico.

The table overleaf shows the initial funded amount and value, at the balance sheet date, of the first loss pieces and liquidity facilities in respect of funding securitisations sold to third party investors, subject to the qualifications documented in the following paragraphs.

This table discloses 'first loss pieces' (general reserve fund) which represent subordinated loans advanced by the Bank (in respect of Leek Finance Number Seventeen, Leek Finance Number Eighteen and Leek Finance Number Nineteen), or variable funding notes subscribed to by the Bank (in respect of Silk Road Finance Number Three):

Table 35 Originated on balance sheet securitisation exposures

	Retained notes initial percentage	Initial funded amount £m	**2015 Value £m**	2014 Value £m
First Loss Piece				
Leek Finance Number Seventeen plc	–	23.0	**27.6**	27.6
Leek Finance Number Eighteen plc	–	23.0	**26.9**	26.9
Leek Finance Number Nineteen plc	–	18.0	**17.9**	17.9
Silk Road Finance Number One plc	45%	116.0	**–**	116.0
Silk Road Finance Number Three plc	–	19.0	**19.0**	19.0
Liquidity Facilities				
Leek Finance Number Eighteen plc	–	–	**13.5**	14.4
Leek Finance Number Nineteen plc	–	–	**13.1**	14.0
Total		199.0	**118.0**	235.8

The table below shows the value of securitised notes sold to third party investors issued and outstanding:

5.5 Credit risk continued

Table 36 Securitised notes sold to third party investors

	Total notes issued £m	Date of issuance	**2015 Notes outstanding £m**	2014 Notes outstanding £m
SPE Company				
Leek Finance Number Seventeen plc	1,168.4	01 April 2006	**370.2**	404.1
Leek Finance Number Eighteen plc	1,048.2	01 October 2006	**448.6**	481.9
Leek Finance Number Nineteen plc	833.2	01 April 2007	**435.6**	466.9
Silk Road Finance Number One plc	1,375.0	01 February 2010	**–**	400.7
Silk Road Finance Number Three plc	650.0	01 August 2012	**277.5**	351.7
Calico Finance Number One Limited	116.5	01 January 2013	**116.5**	116.5
Total	5,191.3		**1,648.4**	2,221.8

Where relevant, the 2015 and 2014 notes outstanding figures are based on multiplying outstanding foreign currency note balances outstanding by the foreign exchange rates specified under corresponding cross currency swap agreements.

The Bank redeemed Silk Road Finance Number One plc in March 2015. During 2015 the Bank also redeemed all the fully retained securitisation transactions: Leek Finance Number Twenty plc (Leek 20), Leek Finance Number Twenty One plc (Leek 21), Leek Finance Number Twenty Two plc (Leek 22) and Cambric Finance Number One plc (Cambric 1). Detailed disclosures around each remaining active securitisation listed in the above tables are published each quarter on the Bank's website www.co-operativebank.co.uk/investorrelations

In January 2013, the Bank transferred a portion of the risk in its portfolio of Platform originated (predominantly Optimum) mortgages to third party investors via the issuance of £116.5m of funded notes issued by Calico. The Bank received funded credit protection from third party investors up to £116.5m on a residential mortgage portfolio of approximately £1.8bn at inception. The structure conforms to all relevant provisions of CRR for significant risk transfer. A capital improvement is generated from a reduction in the total calculated RWAs as a result of the mezzanine securitisation tranche risk transfer. Other than in respect of Calico, no outstanding funding securitisation (Leek Finance/Silk Road Finance) affords the Bank regulatory capital relief.

During 2015, the Bank completed two whole structure securitisation transactions (Warwick Finance One & Two) which enabled the Bank to deleverage an aggregate £3.1bn of Non-core, Optimum residential mortgage assets. Warwick Finance One & Two generated £1.4bn of net funding with the Bank retaining 65% and 80% of Class A notes respectively in each transaction. The risk and rewards of the underlying mortgages were transferred to external investors in both structures and the SPEs are therefore not consolidated within the Bank's financial statements. Given that the SPEs are not consolidated within Bank's financial statements, Warwick Finance One & Two have been excluded from Tables 35 and 36 and investment in Class A notes are listed under Table 34.

5.6 Liquidity and funding risk

5.6.1 Overview

The Bank's management of liquidity and funding risk aims to ensure that at all times there are sufficient liquid resources, both as to amount and quality to cover cash flow mismatches and fluctuations in the Bank's funding profile in order to meet financial obligations as they fall due even during periods of stress. This is achieved through the management and stress testing of the Bank's cash flows and the setting of appropriate risk limits to maintain a prudent funding mix, maturity profile and level of high quality liquid assets.

To manage its liquidity and funding risk the Bank monitors the following:

- funding and cash flow profile;
- maturity concentrations;
- total liquid asset portfolio;
- asset encumbrance;
- stress testing the Bank's liquidity position to ensure it can withstand various stress scenarios;
- assessing market conditions for early signs of stress;
- contingency planning for unexpected events to ensure continued access to liquidity in the event of market disruption or specific events impacting the Bank.

The Bank has a strong funding base which continues to be predominantly funded by retail and corporate deposits. Over the course of the year the Bank continued to actively manage its liquidity position, maintaining a regulatory liquidity buffer, and restructuring existing exposures to further improve the funding profile and ensure its financial obligations as and when they fall due. As at 31 December 2015, the Bank's liquid asset ratio was 15.6% (2014: 17.4%).

5.6 Liquidity and funding risk continued

5.6.2 Liquidity risk management framework

The Board determines and approves the Liquidity Risk Appetite (LRA) of the Bank. It also reviews and approves the Bank's Liquidity and Funding Risk Management Policy (LFRMP) framework and delegates to ALCO the responsibility for complying with the framework which in turn delegates to the Liquidity and Market Risk Forum (LMRF) which oversees the management of liquidity and funding risks. Treasury are responsible for ensuring that all liquidity and funding risk measures are managed within policy and risk appetite. The Treasury Risk team provides review and challenge of policies and procedures relating to liquidity and funding risk.

The Bank sets formal limits within the LFRMP to maintain liquid assets within the LRA set by the Board. The LRA requires the Bank to maintain sufficient liquid assets to survive a defined stress scenario selected from a range of scenarios over a 90 day period, the severity of which is set in relation to both the external environment it operates in and the Bank's business activities. On 1 October 2015 the Liquidity Coverage Ratio (LCR) became the PRA's primary regulatory standard for liquidity, replacing the previous BIPRU 12 regime. The LCR measures the amount of high quality liquid assets relative to estimated net stressed cash outflows within a 30 day period. The PRA has set a minimum requirement of 80% from October 2015, rising thereafter to 100% from 1 January 2018. As at 31 December 2015 the Bank's LCR was in excess of 100%.

The Basel Committee on Banking Supervision published its final recommendations for the implementation of the Net Stable Funding Ratio (NSFR) in October 2014, proposing an implementation date of 1 January 2018, by which time banks are expected to meet an NSFR ratio of 100% from this point onwards. As at 31 December 2015 the Bank's NSFR exceeds 100%.

Liquidity management information is provided on a regular basis to the LMRF, ALCO and the Board, which details the Bank's compliance with its core liquidity risk metrics, which include:

- customer loan/deposit ratio, 98.5% (2014: 96.6%) – the ratio of customer loans to customer deposits;
- encumbrance ratio, 21.8% (2014: 25.9%) – Per the EBA definition, Asset Encumbrance ratio = (Carrying amount of encumbered assets and collateral)/(Total assets and collateral) where an asset is considered as encumbered if it has been pledged or if it is subject to any form of arrangement to secure, collateralise or credit enhance any transaction from which it cannot be freely withdrawn.

  To allow comparison with 2014 the encumbrance ratio above is calculated on a point-in-time basis. The median based encumbrance ratio is 24.5% and this measure will be utilised going forward; and
- internal liquidity stress tests – the survival period of the Bank under an applicable stress scenario.

LMRF oversees the operational liquidity management and convenes at least once a month. A range of indicators, details of cash flows and media coverage are monitored to attempt to detect early signs of liquidity stress either in the market or events that are specific to the Bank. The LMRF, ALCO and the Board discuss the actual liquidity position and projected position incorporating business plans. More frequent meetings are held if necessary, i.e. when the markets have a heightened period of stress or liquidity shortage.

The Bank maintains a Contingency Funding Plan (CFP) approved by ALCO and the Board, which details the procedures and a range of available actions that the Bank could deploy in the event of a liquidity or funding stress, thereby allowing adequate liquidity resources to be maintained. The CFP is reviewed every six months and tested at least annually. In the event that the CFP is deployed following endorsement from ALCO then the CEO will convene the Crisis Management Team (CMT) which will become the main management committee that assumes responsibility for delivering the CFP, engaging other business areas of the Bank and third parties. The Bank also has a recovery plan which describes potential actions that could be used in a more stressful scenario.

5.6.3 Liquidity risk policies

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

The Bank also monitors the adequacy of its controls to provide assurance that liquidity risk is being appropriately managed, and regularly assesses its funding position. The Bank's Liquidity Management Framework is designed in line with FCA, PRA and EBA regulations and industry guidelines. This will continue to be updated to reflect evolving regulatory change.

Liquid asset portfolios

Total liquidity resources as at 31 December 2015 were £11,402.8m (2014: £12,120.4m). The table below analyses the Bank's liquidity portfolio by product and unencumbered liquidity value. The Bank categorises its liquidity portfolio into primary and other liquid assets. Primary liquid assets includes cash and balances at central banks, gilts and other high quality government bonds and all other liquid assets including self issued retained securitisations (contingent liquidity portfolio).

5.6 Liquidity and funding risk continued

Table 37 Bank's Liquidity portfolio

	31 December 2015 £m	31 December 2014 £m
Operational balances with central banks	2,329.3	4,487.4
Gilts	1,450.2	1,246.7
Central government and multilateral development bank bonds	760.2	819.5
Total primary liquid assets	4,539.7	6,553.6
Other liquid assets	1,386.6	14.3
Contingent liquidity	5,476.5	5,552.5
Total liquidity	11,402.8	12,120.4
Average balance	11,203.9	12,015.8

The Bank uses any combination of these asset pools to manage liquidity, with primary liquidity used predominantly for short term cash flow movements, while other liquidity is used for creating longer term liquidity. Regular realisation through repo transactions and outright sales provide assurance that these asset pools remain sufficiently liquid. The overall quantum of liquid assets fell slightly in 2015 following an increase in 2014 due to an injection of cash through the capital raising in May 2014. The secondary liquidity portfolio reflects own assets eligible for discounting at central banks, which has increased in 2015.

Funding and liquidity strategy focuses on maintaining a high percentage of liquid assets that are eligible to be included in the Liquid asset buffer (LAB).

The table below shows in addition to the liquid assets listed above, other non-liquid assets. In 2015 the remaining two bonds have matured to leave the balance at nil.

Table 38 Non-buffer assets

	31 December 2015 £m	31 December 2014 £m
Short term deposits	–	–
Other public sector securities	–	2.5
Floating rate notes	–	31.0
Fixed rate notes	–	–
Other securities and commodities	–	–
Total non-buffer assets	–	33.5

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

Table 39 Long term wholesale funding sources

	31 December 2015 £m	31 December 2014 £m
Preference shares and subordinated debt	457.0	196.4
Secured funding	2,091.0	2,521.8
Repos	671.3	500.6
Market borrowing	10.9	46.0
MTNs	404.9	832.9
Total wholesale funding	3,635.1	4,097.7

The reduction of the wholesale funding reflects the repayment of a number of secured funding liabilities in 2015, alongside Medium Term Notes (MTNs). This is offset by a £250m Tier 2 subordinated debt issuance during the year. The Bank has £511.0m of Gilt repos within the Repos line.

5.6 Liquidity and funding risk continued

The following table sets out the Bank's contractual wholesale funding by maturity, with the Leek notes being disclosed based on call dates:

Table 40 Contractual wholesale funding by maturity

	31 December 2015 £m	31 December 2014 £m
Repayable in less than 1 month	**522.5**	84.8
Repayable between 1 and 3 months	**159.7**	334.4
Repayable between 3 and 6 months	**352.4**	–
Repayable between 6 and 9 months	**243.3**	–
Repayable between 9 and 12 months	**433.0**	389.8
Repayable between 1 and 2 years	**746.9**	1,028.1
Repayable between 2 and 5 years	**259.0**	942.1
Repayable in more than 5 years	**918.3**	1,318.5
Total external funding	**3,635.1**	4,097.7

Liquidity gap

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

Gross cash flows include interest and other revenue cash flows. The table for 2015 has enhanced disclosures by increasing the number of time maturities, with more analysis of the shorter maturity periods. The following table is an analysis of gross undiscounted contractual cash flows of financial assets and liabilities held at the balance sheet date.

5.6 Liquidity and funding risk continued

Table 41 Contractual cash flows

2015

	Carrying value £m	Gross nominal flow £m	Less than 1 month £m	1-3 months £m	3-6 months £m	6-9 months £m	9-12 months £m	1-2 years £m	2-5 years £m	Over 5 years £m
Assets										
Cash and balances at central banks	2,678.5	2,678.5	2,678.5	–	–	–	–	–	–	–
Loans and advances to banks	871.0	871.0	520.0	351.0	–	–	–	–	–	–
Loans and advances to customers	19,784.4	31,203.9	602.2	311.5	398.6	395.3	442.7	1,636.7	4,854.8	22,562.1
Investment securities										
Loans and receivables	15.0	18.4	–	–	–	–	–	0.2	0.5	17.7
Available for sale	4,296.8	5,515.2	9.1	233.0	24.7	159.7	21.8	253.0	1,140.1	3,673.8
Fair value through profit or loss	582.4	590.0	3.3	1.3	1.9	2.0	30.7	11.2	515.6	24.0
Derivative financial instruments	370.1	666.7	8.1	11.0	40.3	14.7	79.1	123.3	137.1	253.1
Other assets	430.1	–	–	–	–	–	–	–	–	–
Total recognised assets	29,028.3	41,543.7	3,821.2	907.8	465.5	571.7	574.3	2,024.4	6,648.1	26,530.7
Liabilities										
Deposits by banks	725.9	725.9	566.2	159.7	–	–	–	–	–	–
Customer accounts	22,732.0	22,836.6	15,938.3	1,473.6	975.4	1,644.4	870.2	1,322.4	448.0	164.3
Customer accounts – capital bonds	77.4	59.1	–	13.2	17.0	9.5	10.1	9.3	–	–
Debt securities in issue	2,554.3	2,866.3	10.4	18.6	385.1	262.2	473.1	827.6	129.4	759.9
Derivative financial instruments	346.9	766.1	9.8	19.1	29.1	29.0	26.9	94.9	192.1	365.2
Other borrowed funds	459.9	743.9	3.6	7.8	10.9	21.8	10.9	44.0	371.3	273.6
Other liabilities	768.6	–	–	–	–	–	–	–	–	–
Total recognised liabilities	27,665.0	27,997.9	16,528.3	1,692.0	1,417.5	1,966.9	1,391.2	2,298.2	1,140.8	1,563.0
Unrecognised loan commitments	2,710.2	2,710.2	2,375.4	334.8	–	–	–	–	–	–
Total liabilities	30,375.2	30,708.1	18,903.7	2,026.8	1,417.5	1,966.9	1,391.2	2,298.2	1,140.8	1,563.0
Total recognised liabilities, of which:										
Secured borrowings:	2,091.0									
Unsecured borrowings:	25,117.0									
Subordinated borrowings:	457.0									

5.6 Liquidity and funding risk continued

2014

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

5.7 Market risk

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

The main source of market risk within the Bank is driven by mismatches between the repricing profiles of asset and liability customer products and certain characteristics embedded within these products and basis risk. The Bank does not have a trading book although the Treasury function does create both market risk and currency risk through its various portfolio management activities and employs risk management strategies designed to ensure stability of earnings.

The Bank's only Pillar 1 market risk requirement is in relation to net currency positions, however it is below a threshold such that the Bank is not required to calculate Pillar 1 RWAs in respect of this. The Bank is however subject to market risk requirements under the PRA's Pillar 2 framework, which is captured as part of its ICG requirement.

5.7.1 Market risk management framework

The Treasurer is the Risk Owner for market risk and is accountable for the management of market risk in line with the Bank's policy, control standard and risk appetite. Day-to-day responsibility is delegated to the Head of Treasury Dealing who manages the Bank's liquidity portfolio and carries out hedging activities to minimise interest rate risk across the whole balance sheet. All market risk is transferred to the Treasury Dealing function to ensure risk is contained and managed effectively. Hedging strategies primarily involve the use of interest rate swaps although assets and liabilities are netted where risk can be effectively managed.

The Treasury Risk Director is the Risk Framework Owner for market risk and as such is responsible for setting the framework and policy by which the Treasurer manages the risk. A second line oversight function supports the Treasury Risk Director by monitoring the management of market risk to ensure compliance with the Bank's policy, control standard and risk appetite. A second line reporting function provides independent reporting and analysis of the Bank's exposures.

Responsibility for monitoring key market risk metrics and ensuring that the market risk profile is aligned to the Board risk appetite rests with the Bank's ALCO which meets on a monthly basis. The Committee also approves all behavioural assumptions used in the management of market risk. The LMRF supports the ALCO by reviewing current and potential future market risk position, identifying emerging market risks and required management actions. It also oversees the technical approaches to managing the Bank's market risks including any changes to methodologies, models and systems/infrastructure.

5.7 Market risk continued

5.7.2 Market risk appetite

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

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

5.7.3 Primary risk metrics and sources of market risk

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

5.7.3.1 Interest rate risk

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

To supplement the gapped and overall PV01 limits noted above, stress testing of exposures against historical yield curve shifts is undertaken on a monthly basis. This assesses the sensitivity to the most extreme curve steepening and curve flattening movements to a 99% confidence, seen over a 1 month period during the previous five years.

A key aspect in the management and measurement of interest rate risk is the behaviouralisation of certain elements of the Bank's balance sheet. Behavioural assumptions are limited to the treatment of non-interest bearing balances and expectations with regard to customer prepayments within the Bank's residential mortgage and unsecured loan portfolios. The Bank periodically analyses its current account portfolio in order to identify a stable, non-interest bearing 'core' element compared to the more volatile, rate sensitive and transitory balances. A behavioural duration is applied to the former while the latter are assumed to reprice within one month. Other non-maturity deposits are not subject to a behavioural adjustment and are assumed to reprice within one month. Similar assumptions are made for other non-interest bearing balance sheet items such as non-dated capital all of which are reviewed and approved by the ALCO on a semi-annual basis.

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

5.7.3.2 Basis risk

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

Basis risk is managed using earnings at risk based metric, focusing in detail on the sensitivity of changes in interest rates on net interest income over a one year period. The assumed potential loss of earnings reflects the downside risk comparing the prevailing relevant spreads against their historical extremes. The estimated earnings at risk is then expressed as a percentage of the forecasted net interest income over the next twelve months.

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

5.7.3.3 Sovereign Swap spread risk

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

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

5.7.3.4 Foreign exchange risk

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

Where the Bank has originated non-sterling debt securities or short term borrowings both currency and interest rate risk is mitigated using off setting assets or derivative instruments such as cross currency swaps.

5.7 Market risk continued

Table 42 Balance sheet by currency

	31 December 2015					31 December 2014				
	£ £m	$ £m	€ £m	Other £m	Total £m	£ £m	$ £m	€ £m	Other £m	Total £m
Assets										
Cash and balances at central bank	**2,678.5**	**–**	**–**	**–**	**2,678.5**	4,765.3	–	–	–	4,765.3
Loans and advances to banks	**805.8**	**34.4**	**29.6**	**1.2**	**871.0**	1,550.2	31.2	26.0	1.0	1,608.4
Loans and advances to customers	**19,643.7**	**27.1**	**19.5**	**0.1**	**19,690.4**	25,631.6	22.3	36.2	10.7	25,700.8
Fair Value adjustments for hedged risk	**94.0**	**–**	**–**	**–**	**94.0**	148.5	–	–	–	148.5
Investment securities										
Loans and receivables	**15.0**	**–**	**–**	**–**	**15.0**	18.1	–	–	–	18.1
Available for sale	**4,296.8**	**–**	**–**	**–**	**4,296.8**	3,166.7	0.8	–	–	3,167.5
Fair value through profit or loss	**582.4**	**–**	**–**	**–**	**582.4**	1,236.9	–	–	–	1,236.9
Derivative financial instruments	**370.1**	**–**	**–**	**–**	**370.1**	470.7	–	–	–	470.7
Other assets	**430.1**	**–**	**–**	**–**	**430.1**	466.4	–	0.3	–	466.7
Total assets	**28,916.4**	**61.5**	**49.1**	**1.3**	**29,028.3**	37,454.4	54.3	62.5	11.7	37,582.9
Liabilities										
Deposits by banks	**715.4**	**–**	**10.5**	**–**	**725.9**	601.0	–	14.4	–	615.4
Customer accounts	**22,684.0**	**17.6**	**28.8**	**1.6**	**22,732.0**	29,571.2	16.8	25.0	1.0	29,614.0
Customer accounts – capital bonds	**77.4**	**–**	**–**	**–**	**77.4**	263.8	–	–	–	263.8
Debt securities in issue	**1,466.4**	**549.6**	**538.3**	**–**	**2,554.3**	1,809.5	603.2	1,030.9	–	3,443.6
Derivative financial instruments	**346.9**	**–**	**–**	**–**	**346.9**	550.5	–	1.2	–	551.7
Other borrowed funds	**459.9**	**–**	**–**	**–**	**459.9**	196.4	–	–	–	196.4
Other liabilties	**770.3**	**0.4**	**(2.1)**	**–**	**768.6**	883.5	–	–	–	883.5
Total liabilities	**26,520.3**	**567.6**	**575.5**	**1.6**	**27,665.0**	33,875.9	620.0	1,071.5	1.0	35,568.4
Net Assets	**2,396.1**	**(506.1)**	**(526.4)**	**(0.3)**	**1,363.3**	3,578.5	(565.7)	(1,009.0)	10.7	2,014.5

In 2014 the loan and advances to customers included assets held for sale of £323.4m (see Note 17 of 2015 Annual Report and Accounts for further details).

The debt securities are shown gross of the Fair Value Adjustment for the Dollar and Euro values.

As at 31 December 2015, the Bank's open currency position was £(0.7)m (2014: £(0.6)m) (see Table 43). The Bank manages its currency positions against both an overall limit and individual currency limits.

5.7.3.5 Credit spread risk

Credit spread risk is defined as the risk of loss from changes in the credit spread on wholesale assets.

The Bank's non-sovereign term exposures are primarily to holdings of mortgage backed securities issued by Warwick Finance One & Two which reflect the retained elements from the deleveraging of the Bank's Non-core assets. Given that the Bank does not seek to actively transact in this type of asset, each purchase is individually agreed by ALCO and a maximum notional limit set. The potential risk from these holdings is assessed against historical spread movements of similar securitisation transactions.

5.7.3.6 Other sources of market risk

Other sources of market risk include:

- Directional risk – The sensitivity to the overall direction of interest rate movements;
- Yield curve risk – The sensitivity to the relative movement of interest rates at different maturities on the yield curve;
- Prepayment risk – The risk that an asset or liability repays more quickly or slowly than anticipated, resulting in a mismatch between the asset, liability and associated hedge;
- Pipeline risk – The risk that the sales profile for new fixed rate products do not match hedging assumptions, resulting in a mismatch between amount of product sold and that hedged, which can result in a hedge rebalancing cost;
- Explicit option risk – The sensitivity to overall direction of interest rates, speed of change of interest rates and market prices for positions which contain explicit options (e.g. caps, floors, swaptions);
- Repricing and implicit optionality in products – The risk that options embedded or implied within retail or commercial products have an impact on market value or earnings with changing interest rates;
- Illiquidity risk – The Bank's risk appetite for market risk considers any illiquidity risk which is reflected in the assumed holding period it uses to assess its capital requirements for market risk.

5.7 Market risk continued

Table 43 PV01, Basis risk, Swap spreads and FX risk metrics on the Bank's balances

	31 December 2015	31 December 2014
Total PV01 (£k)	**76.0**	(141.4)
Average PV01 for the year (£k)	**(94.2)**	17.6
Largest Positive PV01 for the period (£k)	**128.0**	167.8
Largest Negative PV01 for the period (£k)	**(348.2)**	(141.4)
Average Basis Risk (% of annual NII)	**3.4%**	4.4%
Swap Spread PV01 (£k)	**(1,043.0)**	(1,235.4)
Average of Swap Spread PV01 (£k)	**(1,014.1)**	(1,256.3)
MBS Holding (£m)	**1,614.0**	16.2
Average MBS Holding (£m)	**857.2**	16.2
FX Notional (£m)	**(0.7)**	(0.6)
Average FX Notional (£m)	**(0.7)**	(0.1)

The table illustrates the PV01, Basis risk, Swap spread and FX risk metrics on the Bank's balances. The PV01 is primarily driven by the non-sensitive balances offset by corresponding asset or derivative positions. During 2015 the largest PV01 of £(348)k reflected a timing mismatch between agreement and completion of the disposal of £323m of corporate assets and associated hedges. Given that a price had been fixed for the sale of the derivatives the Bank unwound the opposing derivatives to protect its economic position. Excluding this transaction the Bank's PV01 ranged from £133k to £(149)k.

The Bank's basis risk exposure in terms of potential earnings at risk has remained relatively unchanged year on year. However, during 2015 the deleveraging of the Bank's non-conforming mortgage portfolio and subsequent purchase of LIBOR linked Mortgage Backed Securities (MBS) has seen a net base rate asset/LIBOR liability position transition into a net LIBOR asset/base rate liability. Swap spread risk has reduced through 2015 due to lower absolute holdings. MBS holdings have increased markedly due to the purchase of Warwick Finance One & Two securities noted above.

5.8 Operational risk

Operational risk is the risk of loss resulting from inadequate and failed processes, people or systems within the Bank or from external events.

Operational risk processes have been embedded within the Bank, however Operational risk levels remain elevated due to the manual processes, legacy systems and processes for which remediation continues. Further information can be found in the Risk Management and Principal risks and uncertainties sections of the 2015 Annual Report and Accounts.

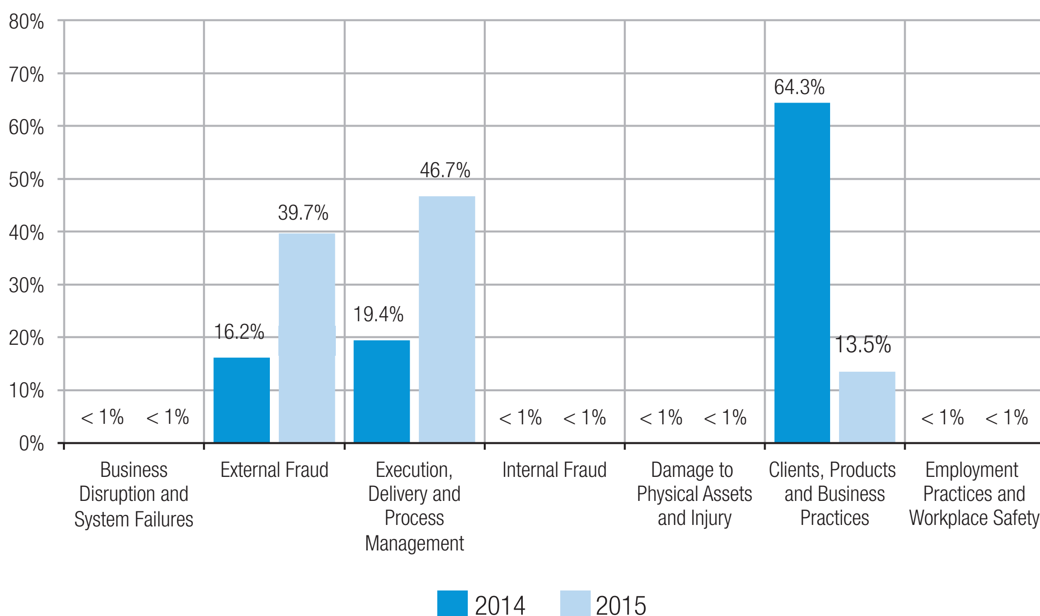
Operational Risk Framework

The management of Operational risk is designed to assist the Bank in understanding its operations in the context of a Board approved risk appetite, particularly with regard to reducing capital requirements, meeting regulatory expectations and reducing operational losses. The approved Operational Risk Framework has remained stable since early 2013 and continues to be embedded in line with good practice and regulatory guidance. This framework is designed to provide assurance over the system of risk management and internal control. Methods and approaches continue to be embedded within the business and there is significant focus on this activity. This is supported by the implementation of a revised Operational Risk Management System which is currently being implemented and will be finalised by mid 2016.

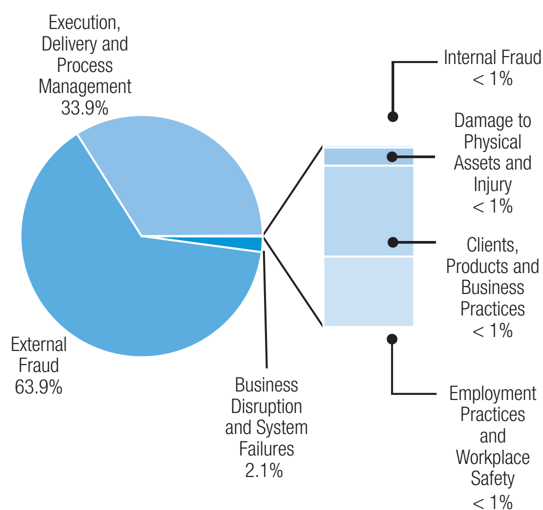
Operational risks are identified, managed and mitigated through ongoing risk management practices including material Bank level risk assessments, risk event reporting, operational loss data analysis, a detailed risk and control self assessment process, a consistently applied risk acceptance process, monitoring of key metrics, scenario analysis and continuous training. Material Operational risks are reported through an appropriate governance structure with regular meetings to monitor the development and effectiveness of the Operational risk processes and material risks within the Bank.

5.8 Operational risk continued

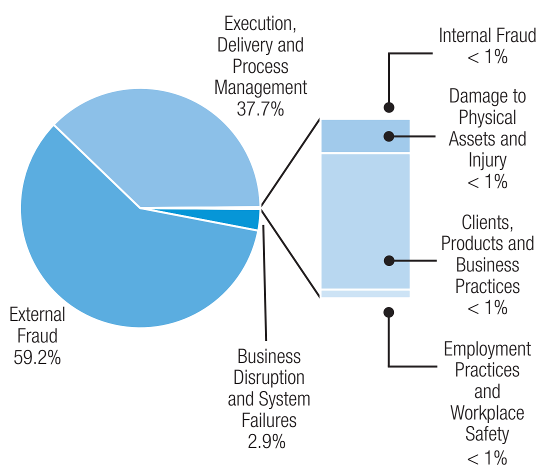
Operational Net Losses



Number of Risk Events 2015 (as a % of total)



Number of Risk Events 2014 (as a % of total)



The above analysis presents the Bank's operational risk events by Basel Level 1 risk event category as this aligns with industry best practice.

In 2015, Execution, Delivery and Process Management, the largest loss category, accounts for 46.7% of total net losses and 33.9% of the number of individual events. Events within this category include Redress Payments of £1.7m, incorrectly processed payments and Payment Service Regulations (PSR) and Regulatory breaches.

External Fraud accounts for 39.7% of the total net losses and 63.9% of the number of individual events. These events are driven by financial crime and include credit and debit card fraud, malware attacks, phishing, cheque frauds and mortgage frauds.

5.8 Operational risk continued

The increase in percentage over 2014 for the two items above do not indicate an increase in actual loss amounts which are lower than previous years but are a result of a significant decrease in the percentage for Clients, Products and Business Practices.

In 2015, Clients, Products and Business Practices accounts for 13.5% of the total net losses but less than 1% of the number of individual events. The loss category includes the Plevin PPI Provision (£1.3m).

In 2014, Clients, Products and Business Practices was the largest loss category accounting for 64.3% of the net losses, as a result of a number of material provisions including Packaged Accounts Current Accounts Provision (£24.2m) and breaches of PSR (£1.5m).

During 2015 net adjustments have been made to the previous provisions totalling in excess of £18.3m, and the 2014 Operational Loss data has been restated to reflect these changes.

As part of the process a review and analysis of risk events is performed to ensure that any required improvements to processes and/or controls and any learnings are implemented in order to help prevent reoccurrence. Other activities driven by risk events and losses include a strengthening of the 1st line process to carry out root cause analysis and continuous improvement to the control environment through management of the Risk Control Self Assessments and strengthening of the three lines of defence.

5.9 Pension risk

Pension risk occurs in defined benefit schemes when the market value of the scheme's assets is considered to be insufficient to meet its liabilities, resulting in a deficit. The scheme's liabilities are calculated using a discount rate referenced to bond yields and are an estimate of its long term obligations. Uncertainty in the estimated size of the liabilities and volatility in future investment returns from the assets may cause volatility in the pension fund deficit. The key risk factors that can have a positive or negative impact on the deficit are:

- Long term interest rates – A decrease in long term interest rates will cause the value of the scheme's liabilities to increase.
- Inflation – Where a scheme's benefits have an inflation link, an increase in inflation will cause the scheme's liabilities to increase. This may be offset where the scheme's assets are also linked to inflation (e.g. index-linked gilts and inflation swaps).
- Longevity risk (life expectancy) – The valuation of pension scheme liabilities is reliant on scheme member longevity and liabilities may substantially increase should longevity increase more than expected.
- Asset volatility – Changes in the value of the scheme's assets compared with that of its liabilities can create significant volatility in the estimated deficit. This is particularly prevalent in schemes with significant equity holdings where equity returns underperform the bond yields used to discount scheme liabilities.

In 2015, the Bank closed its defined benefit scheme and removed the link to final pensionable salary for both Pace and Britannia Pension Scheme members. Colleagues have been provided with defined contribution pension options for all future service. This action will assist in containing the Bank's exposure to pension risk going forward. During 2016, consideration will be given to strategies for separation of the Bank's element of the Pace scheme from that of The Co-operative Group.

Controls are applied to mitigate these risks and a monthly pension risk report is made to Bank's ALCO and EROC to monitor pension risk and decide if further action is necessary. These reports take account of the risk reporting delivered to pension scheme Trustees. The Bank is able to engage directly with the Trustees of the Britannia Pension Scheme and can influence the Trustees of Pace through its relationship with the sponsor, The Co-operative Group.

The HR Director chairs a pension steering group and pension risk is discussed at a number of Executive and Board Committees on a regular basis.

For further information see Note 34 of the accounts.

5.10 Regulatory risk

5.10.1 Regulatory environment

The Bank's operations, including its subsidiaries and associates, are subject to a significant body of rules and regulations that are a condition for authorisation to conduct banking and financial services business. These apply to business operations and affect financial returns and include reserve and reporting requirements and prudential and conduct of business regulations. The requirements often reflect global standards developed by, among others, the Basel Committee on Banking Supervision and the International Organisation of Securities Commissions. Requirements are increasingly derived from, or applied directly by, EU legislation in addition to the requirements mandated by the principle regulatory authorities that supervise the Bank in the jurisdictions in which it operates.

Changes to regulations

As the Bank must comply with wide-ranging legal and regulatory (including liquidity and capital) requirements and supervision, changes to the legal and regulatory environment may result in additional compliance costs (including the raising of further capital and/or liquidity) and diversion of management time and resources. These changes may negatively affect the Bank's business. In addition, failure to comply with these requirements may result in investigations, disciplinary action, fines, reputational damage and the revocation of the Bank's licences, permissions or authorisations, which could have a material negative effect on the Bank's business. The regulatory risk team is responsible for identifying and communicating changes to regulation. Adoption of these changes is owned and managed by the first line.

5.10 Regulatory risk continued

5.10.2 Regulatory risk management

The regulatory risk function is responsible for monitoring and reporting on regulatory risk across the Bank and facilitates production of regulatory, conduct, anti-money laundering and financial crime risk reporting to CRROC, EROC and RC.

5.11 Conduct risk

The Bank manages conduct risk in a way that is consistent with its overall risk appetite and aligns with its strategy. Conduct risk encompasses the principle of treating customers fairly and putting customers at the centre of what we do, it is outcome driven. Conduct risk may arise from any aspect of the way the Bank's business is conducted, a key criteria for the Bank being whether the outcome is fair for its customers for example, products and services not meeting the needs of its customers, sales processes resulting in poor advice or incorrect information, or failing to deal with a complaint appropriately. When assessing conduct risk there will often be a closely linked regulatory requirement arising from the FCA rules and guidance that are concerned with the conduct of business regulation.

At the end of 2015, the Bank has conduct risk provisions of £355.7m, to cover the costs relating to PPI mis-selling, breaches of the technical requirements of the Consumer Credit Act, interest rate swap mis-selling, packaged accounts and other provisions, further detail of which is provided in Note 32 to the accounts.

5.12 People risk

People risk is overseen by the HR Director, with responsibility held by the Executive teams and wider business. Key people policies and interventions are governed by the Executive People Committee.

A number of key initiatives have been undertaken in 2015 to tackle People risk issues. The Culture Programme seeks to improve colleague engagement, reinforcing the Co-operative Bank Values and Culture, and embedding these into people policies and processes. The current phase focuses on specific, executive sponsored work streams including customer, leadership and risk management. Employee engagement levels have improved significantly throughout 2015.

Employee turnover levels remain elevated, reflecting the buoyancy of the external market. The Employee Value Proposition is under ongoing development, and 2015 saw the launch of the new employer brand and employee recognition programme.

Building capability remains critical, with good progress made in strengthening the Bank's talent profile and succession planning.

5.13 Strategic and business risk

A failure to successfully implement or a delay in implementing the Bank's turnaround strategy may adversely impact the Bank's business, operating results, financial condition and prospects, its regulatory capital position and its ability to comply with its regulatory capital requirements.

There is a risk that this strategy may be unachievable due to the level of complex and overlapping changes required on multiple axes whilst seeking to strengthen the Bank's brand, reputation and customer satisfaction and its relationship with its employees. Recent action has been taken to restructure the project portfolio to focus on those projects most critical to the success of the Bank's strategy.

Strategic and business risk is managed through EROC, ExCo and the Board via consideration of risks to the strategy caused by changes in the external environment and assessment of forecast plan progress on a continual basis. Any required actions to address strategic risk are agreed on a regular basis and monitored through EROC.

5.14 Reputational risk

Reputational risk can arise as a result of any other principal risk crystallising; therefore, the significant initiatives covered in all other sections are relevant to managing reputational risk. In addition, responsibility for overseeing reputational risk has transferred to the Bank's second line risk team and work is ongoing to define an appropriate policy and key risk indicators. The Bank launched a revised Ethical Policy based on responses provided in the customer poll conducted in 2014, and used the principles to guide the development of a new overdraft proposition launched during the year.

Glossary

Item	Description
Advanced Internal Ratings Based (IRB) Approach	Advanced Internal Ratings Based approach stipulated within CRR allows a more sophisticated and risk sensitive approach to calculate credit risk. More advanced than Foundation IRB approach as PD, LGD and EAD parameters are derived by the Bank.
Application score	The credit score calculated on the application data alone. Typically, data provided on an application form and/or credit reference data.
Asset Backed Securities (ABS)	Securities that represent an interest in an underlying pool of referenced assets. The referenced pool can comprise any assets which attract a set of associated cash flows but are commonly pools of residential or commercial mortgages but could also include leases, credit card receivables, motor vehicles, student loans.
Basel II	A statement of best practice issued by the Basel Committee on Banking Supervision, that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the FSA Handbook. Basel 2.5 was an interim strengthening of requirements laid out in Basel II, with changes focussing on trading book and securitisations. Basel 2.5 was implemented within the UK in 2011 via the FSA's policy statement PS11/12. References to Basel II within these disclosures in accordance with Basel 2.5.
Basel III	A strengthening of the requirements laid out in Basel II, to be phased into the Bank from 2014 ahead of full implementation by 2022. Basel III is implemented within the UK through CRD IV.
Basis Points (bps)	One hundredth of a per cent (0.01%), so 100 basis points is 1%. Used in quoting movements in interest rates or yields on securities.
Behaviour score (behavioural scorecard)	A credit risk scoring system for retail customers assessing the performance of an existing customer's account. Typically using data from previous performance of a customer's account and/or credit reference data.
Business and Commercial Banking (BaCB)	The Non-core segment of the Bank which specialises in lending to businesses.
Calico	Calico Finance Number One Limited
Capital Requirements	Capital required under Pillar 1. Capital requirements are 8% of Risk Weighted Assets.
Capital Requirements Directive (CRD)	Capital Requirements Directive is a European regulation that applies directly to UK financial institutions, is part of the CRD IV package. Broadly, it contains a supervisory framework to ensure firms are able to meet their liabilities as they fall due, implementing the Basel III set of reform measure.
Capital Requirements Directive IV (CRD IV)	This encompasses both the Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) as well as the PRA's Policy Statement PS7/13: Strengthening capital standards. CRD IV implements Basel III within the European Union (including the UK) and is a strengthening of the requirements laid out in Basel II, with phased implementation from 2014, ahead of full implementation by 2022.
Capital Requirements Regulation (CRR)	CRR is a European regulation that applies directly to UK financial institutions. Broadly, it implements the Pillar 3 aspects of Basel III in relation to capital adequacy and new liquidity requirements. CRR is part of CRD IV.
Capital Resources	Regulatory capital held that is eligible to meet capital requirements.
Chief Executive Officer (CEO)	Chief Executive Officer
Chief Risk Officer (CRO)	Chief Risk Officer
Common Equity Tier 1 Capital (CET1)	A CRD IV regulatory measure of financial (capital) strength. Common Equity Tier 1 Capital is the highest quality of capital and comprises share capital and associated share premium, and general reserves from retained profits. The book values of goodwill and intangible assets as well as other regulatory adjustments, including the full amount of expected loss over provisions, are deducted from Common Equity Tier 1 Capital for the purposes of capital adequacy.
Common Equity Tier 1 (CET1) ratio	Common Equity Tier 1 Capital divided by Risk Weighted Assets.
Co-operative Asset Management (CoAM)	The segment that comprises Non-core assets managed for run down or exit.
Counterparty Credit Risk	The risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.
Credit Conversion Factor (CCF)	The CCF is an estimate of the proportion of undrawn commitments expected to have been drawn down at the point of default, and is used within the calculation of EAD.
Credit quality assessment scale	Published by the FSA in accordance with the Capital Requirements Regulations 2006 which maps the external credit rating provided by eligible ECAIs to credit quality steps.

Credit Quality Steps (CQS)	A credit quality step is a credit quality assessment scale as set out in the CRR.
Credit Risk	The current or prospective risk to earnings and capital arising from a borrower's failure to meet the terms of any contract with the Bank or their failure to perform as agreed.
Credit Risk Mitigation (CRM)	Reduction of credit risk by application of credit risk mitigants. The Bank utilises collateral and guarantees as credit risk mitigation.
Default	Circumstances in which Probability of Default is taken as 100% for the purposes of the calculation of regulatory capital and compliance with Basel II. This is defined as where the customer reaches a predefined arrears status or where the Bank may consider the borrower is unlikely to repay its credit obligation in full without recourse by the Bank to actions such as realising security.
Encumbrance	Encumbrance is an impediment to use of assets, for example a claim against a property by another party. Encumbrance usually impacts the transferability of the asset and can restrict its free use until the encumbrance is removed.
Enhanced Disclosure Task Force (EDTF)	The Enhanced Disclosure Task Force (EDTF) is a private sector group established by the Financial Stability Board (FSB) and composed of members representing both the users and preparers of financial reports. It released a report in October 2012 that included thirty-two recommendations for improving bank risk disclosures in the areas of usability, risk governance and risk management, capital adequacy, liquidity and funding, market risk, credit risk and other risks.
European Banking Authority (EBA)	European Banking Authority is a European organisation whose main task is to contribute, through the adoption of binding Technical Standards (BTS) and Guidelines, to the creation of the European Single Rulebook in banking. The Single Rulebook aims at providing a single set of harmonised prudential rules for financial institutions throughout the EU, helping create a level playing field and providing high protection to depositors, investors and consumers.
Expected Loss (EL)	Expected Loss is the amount estimated under the IRB approach to be lost on current exposures due to potential defaults on existing and committed lending over a one year time horizon. Expected loss equals Exposure At Default multiplied by Probability of Default (PD) and Loss Given Default (LGD). Expected Loss (EL) percentage equals expected loss divided by Exposure At Default.
Exposure	The maximum loss the Bank might suffer if a customer (or counterparty) or a group of connected clients default.
Exposure at Default (EAD)	Exposure at Default represents the amount estimated to be outstanding at the time of default. EAD calculated under the standardised approach is always reported post credit conversion factors and provisions. Under the IRB approach the EAD includes undrawn commitments after credit conversion factors.
External Credit Assessment Institution (ECAI)	An External Credit Assessment Institution is a credit rating agency e.g. Moody's, Standard and Poor's, and Fitch. A credit rating agency (CRA) is a company that assigns credit ratings for issuers of certain types of debt obligations as well as the debt instruments themselves.
FD	Finance Director
Financial Services Authority (FSA)	An independent body that regulates the financial services industry in the UK. The FSA was replaced as the UK's financial regulator on 1 April 2013 by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).
Forbearance	The Bank, for reasons relating to the actual or apparent financial stress of a borrower, grants a concession whether temporarily or permanently to that borrower. A concession may involve restructuring the contractual terms of a debt (such as an extension of the maturity date or any weakening of the security structure or adjustment/non enforcement of covenants) or payment in some form other than cash, such as an equity interest in the borrower.
Foreign exchange (FX)	Foreign exchange is the exchange of one currency for another, or the conversion of one currency into another currency.
Foundation Internal Ratings Based (IRB)	Foundation Internal Ratings Based approach uses standard LGD and EAD parameters but PD is estimated by the Bank.
General credit risk adjustment	According to EBA Credit Risk Adjustments Regulatory Technical Standard (RTS), a general credit risk adjustment represents provisions that need to cover 'credit risk losses that have not yet materialised' and for which there is 'currently no evidence that a loss event has occurred'. The Bank does not have any general credit risk adjustments; all of the Bank's provisions are classified as specific credit risk adjustments.
Impaired Loans	Loans where the Bank does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.
Impairment Allowance	A loss allowance held on the balance sheet as a result of the raising of a charge against profit from the incurred loss inherent in the lending book. An impairment loss allowance may be either individual or collective.

Term	Definition
Individual Capital Guidance (ICG)	The PRA's statement as to the regulatory capital it expects the Bank to hold. ICG is Pillar 1 plus Pillar 2a.
Individually Impaired	Impairment is measured individually for assets that are individually significant with risk.
Interest Rate Risk (IRR)	The variability in value borne by an interest bearing asset, such as a loan or a bond, due to variability of interest rates. In general, as rates rise, the price of a fixed rate bond will fall, and vice versa.
Internal Capital Adequacy Assessment Process (ICAAP)	The Bank's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events.
Internal Rating Grade (IRG)	For Corporate exposures the Bank has adopted an Internal Rating Based approach in accordance with Basel II guidelines. Exposures are sanctioned based on an assessment of the risks and are allocated a Risk Grade or Rating extracted from a suite of Basel compliant models. These models have been implemented with outputs calibrated to reflect the Corporate portfolio or PRA slotting standards as appropriate. For Treasury exposures individual counterparties may be allocated credit ratings obtained from External Credit Assessment Institutions. These ratings combined with expert judgment drive the formulation of internal rating grades ranging from 0 to 10 and associated Probability of Default. These internal rating grades form the basis of the Treasury Counterparty Limit Matrix.
Internal Ratings Based (IRB)	Internal Ratings Based is the approach used for measuring exposure to credit risks. IRB approaches are more sophisticated and risk sensitive than the Standardised Approach and may be Foundation or Advanced. IRB approaches may only be used with PRA permission.
Leverage Ratio	A CRD IV measure, calculated as the ratio of Tier 1 Capital to total exposures. Total exposures include on balance sheet items, off-balance sheet items and derivatives. The leverage ratio is a supplementary measure to the risk-based capital requirements and is intended to constrain the build-up of excess leverage in the banking sector.
Liability Management Exercise (LME)	Core part of the Bank's recapitalisation plan in June 2013. The LME involved existing debt and preference shareholders exchanging their holding for a combination of equity shares and new lower Tier 2 debt instruments as well as issuing new shares for cash.
Liquidity Coverage Ratio (LCR)	Liquidity Coverage Ratio introduced under CRD IV, is measuring highly liquid assets against stressed net cash outflows over a 30 day period.
Loan To Value (LTV)	A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Bank calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI)).
London Interbank Offered Rate (LIBOR)	The interest rate participating banks offer to other banks for loans on the London market.
Long Run Average Probability of Default (LRA PD)	A LRA PD is reflective of the long run average default rates expected over a full economic cycle. Also referred to as long run PD.
Loss Given Default (LGD)	Loss Given Default is a Pillar 1 parameter and represents an estimate of the actual loss that would occur in the event of default expressed as a percentage of the EAD.
Master Grading Scale	Brings together the respective Expected Default Frequency (EDF) from Moody's KMV RiskCalc and Moody's KMV CreditEdge models to ensure compliance with Corporate Banking PD.
Minimum Capital Requirement	The minimum amount of regulatory capital that the Bank must hold to meet the Pillar 1 capital requirements for credit, market and operational risk.
Mortgage Backed Securities (MBS)	Securities that represent interests in a group of mortgages. Investors in these securities have the right to cash received from future interest and/or principal mortgage payments.
Multilateral Development Banks	Supranational institutions which provide financial support and professional advice for economic and social development activities in developing countries. The term MDBs typically refers to the World Bank Group and Regional Development Banks.
Net Present Value (NPV)	Net Present Value represents the present value of the expected future cash in and out flows on an asset or liability.
Net Stable Funding Ratio (NSFR)	Net Stable Funding Ratio is a liquidity ratio introduced under CRD IV, measuring the proportion of long term assets which are funded by long term or stable funding.
Over-the-Counter (OTC) Derivatives	Derivatives contracts that are traded (and privately negotiated) directly between two parties, without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange traded products, they can be tailored to fit specific needs.
Past Due Items	When a counterparty has failed to make a payment when contractually due.

Probability of Default (PD)	Probability of Default, a Pillar 1 parameter under IRB approach, estimates the probability that a borrower will default in next 12 months.
Pillar 1	Pillar 1 capital is a prescribed measure of capital required by a bank representing the minimum capital requirements. The Pillar 1 capital ratio is calculated using regulatory capital and RWA. The total capital ratio must be no lower than 8%.
Pillar 2a	Pillar 2a is additional capital that the Bank is required to hold above Pillar 1, for risks not captured within Pillar 1. The Bank's internal capital adequacy assessment process is an input into this process, but the Bank's Pillar 2a requirement is ultimately set by the PRA.
Pillar 2b	Pillar 2b is the capital that must be held by the Bank in a severe but plausible stress in order to ensure that it can continue to meet its Pillar 1 plus Pillar 2a requirements. It is known as the Capital Planning Buffer (CPB) until 31 December 2015, and became the PRA buffer from 1 January 2016.
Pillar 2	Pillar 2 is Pillar 2a plus Pillar 2b.
Pillar 3	Pillar 3 covers market discipline. Market discipline takes the form of standard disclosure requirements that are intended to provide information about a bank's exposure to risks and risk assessment processes. The aim is to provide a means of disclosure comparable between banks.
Point in time (PiT)	Point in time refers to modelling approach which assesses the risk of an account at a single point in time.
Potential Future Exposure (PFE)	An add-on to derivative exposure for potential future exposure.
Private Finance Initiatives (PFI's)	Private Finance Initiatives.
Provisions	The level of provision that has been raised against its exposures to provide for unrecoverable losses from discrete categories or individual customers.
Probability of Possession Given Default (PPD)	Probability of Possession Given Default is the probability that a proportion of mortgages (secured accounts) will go to repossession.
Prudential Regulation Authority (PRA)	The FSA was replaced as the UK's financial regulator on 1 April 2013 by two new regulatory bodies: the PRA and the FCA. The PRA, a subsidiary of the Bank of England, is responsible for promoting the stable and prudent operation of the financial system through regulation of deposit-taking institutions.
Prudent Valuation	A deduction under CRD IV from Common Equity Tier 1 capital where the prudent value financial assets measured at fair value is materially lower than the fair value recognised in the Annual Report.
PV01	Daily calculation of the effect on the Net Present Value (NPV) of Treasury portfolios to both parallel and specific point of yield curve stress testing (i.e. non-linear yield curve shifts). Analysis includes daily parallel shifts in yield curve rates of +/ – 100 bps with the resultant change in NPVs representing the potential change in portfolio values.
Qualifying Revolving Retail Exposures (QRRE)	Qualifying Revolving Retail Exposures represents exposures with fluctuating debit or credit balances (i.e. overdrafts or credit cards).
Ratings Based Method	The calculation method used by the Bank for exposures to securitisations as defined under the IRB approach. The approach uses risk weightings based on ECAI ratings, the granularity of the underlying pool and the seniority of the position.
Rating systems	System for implementing scorecards and ranking customers/accounts by risk. May also include decision systems which use the ratings as a key input.
Regulatory Capital	The capital that the Bank holds in accordance with the PRA handbook.
Repurchase Agreement (Repo)/Reverse Repurchase Agreement (Reverse Repo)	A repurchase agreement that allows a borrower to use a financial security as collateral for a cash loan at a fixed rate of interest. In a repo, the borrower agrees to sell a security to the lender subject to a commitment to repurchase the asset at a specified price on a given date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo.
Residential Mortgage Backed Securities (RMBS)	Securities that represent an interest in an underlying pool of residential mortgages.
Residual Maturity	The remaining period for an exposure from the reporting date to its maturity.
Retail	The segment that comprises customer focused products and services for individuals, sole traders and small partnerships. This includes mortgages, credit cards, consumer loans, current accounts and savings products.
Risk grade	Credit risk score or output from a rating system or model.

Term	Definition
Risk Weighted Asset (RWA)	Risk Weighted Asset or Risk Weighted Assets, amount of exposure deemed 'at risk' according to PRA prescribed calculation for Pillar 1 capital requirement.
Securities Financing Transaction (SFT)	Loaning of a stock, derivative, or other security to a third party (i.e. repurchase agreements).
Securitisation	A process by which a portfolio of retail mortgages is used to back the issuance of new securities by an SPE. The Bank has established securitisation structures as part of its funding and capital management activities (see 'Special Purpose Entities (SPEs)').
Securitisation Position	An exposure to a securitisation.
Scorecard	A set of questions (called characteristics) that provide the most predictive information on future account performance. The account receives points (or weighting) for each question depending on the answer. These points are then added together to create a score.
Slotting approach	An approach applied to specialised lending exposures to calculate Pillar 1 capital requirement and EL. For each of five risk categories that may be assigned to a specialised lending customer, a set percentage based on the slotting category is applied to the account exposure value to derive capital requirement and expected loss.
Special Purpose Entities (SPE)	Entities that are created to accomplish a narrow and well defined objective. For the Bank this includes: 1. Various securitisation transactions in which mortgages were sold to SPEs. The equity of these SPEs is not owned by the Bank; and 2. Covered Bond Limited Liability Partnerships created in order to act as guarantors for issues of covered bonds.
Specialised lending	A specific Basel portfolio type which are Corporate exposures which possess the following characteristics: 1. The exposure is to an entity which was created specifically to finance and/or operate physical assets; 2. The contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate; and 3. The primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.
Specific credit risk adjustment	According to EBA Credit Risk Adjustments Regulatory Technical Standard (RTS), a general credit risk adjustment represents provisions that need to cover 'credit risk losses that have not yet materialised' and for which there is 'currently no evidence that a loss event has occurred', and that 'all other amounts shall be specific credit risk adjustments'. However, under IAS 39 banks are not permitted to book (individually assessed or collective) loss provisions unless there is 'objective evidence that a loss even has occurred'. Therefore, all of the Bank's provisions are classified as specific.
Standardised approach	Standardised approach is the basic method of calculating Pillar 1 capital requirements based on supervisory defined factors which are applied to exposure values based on external credit ratings of the customer.
Stress testing	Assessing the risk of a portfolio using a "what if" approach to represent various economic changes, for example, a rise in unemployment.
The Bank	The Co-operative Bank plc and its subsidiaries.
The Board	The Board of Directors. The Board's role is to provide entrepreneurial leadership of the Bank within a framework of prudent and effective controls which enables risk and customer outcomes to be assessed and managed.
Tier 1 capital	A regulatory measure of financial (capital) strength. Tier 1 is divided into Common Equity Tier 1 and Additional Tier 1 (AT1) capital. Common Equity Tier 1 capital comprises share capital and associated share premium, and general reserves from retained profits. The book values of goodwill and intangible assets are deducted from Common Equity Tier 1 capital and other regulatory adjustments may be made for the purposes of capital adequacy. The Bank does not currently have any AT1 capital.
Tier 1 capital Ratio	Tier 1 capital divided by Risk Weighted Assets.
Tier 2 capital	Tier 2 capital comprises the Bank's qualifying subordinated notes. Certain regulatory deductions may be made for the purposes of assessing capital adequacy.
Write off	When all economical avenues to recover an unsecured debt have been exhausted, the Bank permanently closes the loan account, i.e. it is written off. This final step sits at the end of a time frame within which the Bank attempts to manage the debt's recovery.

Appendix 1 – Capital Resources

The following table sets out full details of the Banks Capital resources, regulatory adjustments, Capital Ratios and buffers:

	2015		2014	
	Transitional £m	**Fully Loaded £m**	Transitional £m	Fully Loaded £m
Common Equity Tier 1 (CET1) Capital: instruments and reserves				
Capital instruments and the related share premium accounts	**1,759.5**	**1,759.5**	1,759.5	1,759.5
of which: Instrument type 1	**–**	**–**	–	–
of which: Instrument type 2	**–**	**–**	–	–
of which: Instrument type 3	**–**	**–**	–	–
Retained earnings	**(273.1)**	**(273.1)**	(36.7)	(36.7)
Accumulated other comprehensive income (and other reserves)	**500.2**	**500.2**	493.6	493.6
Amount of qualifying items referred to in Article 484 (3) and the related share premium accounts subject to phase out from CET1	**–**	**–**	–	–
Minority interests (amount allowed in consolidated CET1)	**–**	**–**	6.1	10.6
Independently reviewed interim profits net of any foreseeable charge or dividend	**–**	**–**	–	–
Common Equity Tier 1 (CET1) capital before regulatory adjustments	**1,986.6**	**1,986.6**	2,222.5	2,227.0
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
Additional value adjustments (negative amount)	**(0.8)**	**(0.8)**	(0.4)	(0.4)
Intangible assets (net of related tax liability) (negative amount)	**(142.8)**	**(142.8)**	(103.7)	(103.7)
Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)	**(4.0)**	**(4.0)**	–	–
Fair value reserves related to gains or losses on cash flow hedges	**(34.6)**	**(34.6)**	(59.0)	(59.0)
Negative amounts resulting from the calculation of expected loss amounts	**(30.0)**	**(30.0)**	(191.5)	(191.5)
Any increase in equity that results from securitised assets (negative amount)	**–**	**–**	–	–
Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	**–**	**–**	–	–
Defined-benefit pension fund assets (negative amount)	**–**	**–**	–	–
Direct and indirect holdings by an institution of own CET1 instruments (negative amount)	**–**	**–**	–	–
Direct, indirect and synthetic holdings of the CET 1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	**–**	**–**	–	–
Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	**–**	**–**	–	–
Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	**–**	**–**	–	–
Exposure amount of the following items which qualify for a RW of 1250%, where the institution opts for the deduction alternative	**–**	**–**	–	–
of which: qualifying holdings outside the financial sector (negative amount)	**–**	**–**	–	–
of which: securitisation positions (negative amount)	**–**	**–**	–	–
of which: free deliveries (negative amount)	**–**	**–**	–	–
Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)	**–**	**–**	–	–
Amount exceeding the 15% threshold (negative amount)	**–**	**–**	–	–
of which: direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities	**–**	**–**	–	–
of which: deferred tax assets arising from temporary differences	**–**	**–**	–	–
Losses for the current financial year (negative amount)	**(623.3)**	**(623.3)**	(236.4)	(236.4)

	2015		2014	
	Transitional £m	**Fully Loaded £m**	Transitional £m	Fully Loaded £m
Foreseeable tax charges relating to CET1 items (negative amount)	**–**	**–**	–	–
Regulatory adjustments applied to CET1 in respect of amounts subject to pre-CRR treatment	**–**	**–**	–	–
Regulatory adjustments relating to unrealised gains and losses pursuant to Articles 467 and 468	**–**	**–**	(24.6)	–
of which: filter for unrealised loss 1	**–**	**–**	–	–
of which: filter for unrealised loss 2	**–**	**–**	–	–
of which: filter for unrealised gain 1	**–**	**–**	–	–
of which: filter for unrealised gain 2	**–**	**–**	–	–
Amount to be deducted from or added to Common Equity Tier 1 capital with regard to additional filters and deductions required pre CRR	**–**	**–**	–	–
Qualifying AT1 deductions that exceed the AT1 capital of the institution (negative amount)	**–**	**–**	–	–
Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(835.5)**	**(835.5)**	(615.6)	(591.0)
Common Equity Tier 1 (CET1) capital	**1,151.1**	**1,151.1**	1,606.9	1,636.0
Additional Tier 1 (AT1) capital: instruments				
Capital instruments and the related share premium accounts	**–**	**–**	–	–
of which: classified as equity under applicable accounting standards	**–**	**–**	–	–
of which: classified as liabilities under applicable accounting standards	**–**	**–**	–	–
Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	**–**	**–**	–	–
Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in row 5) issued by subsidiaries and held by third parties	**–**	**–**	22.9	2.3
of which: instruments issued by subsidiaries subject to phase out	**–**	**–**	–	–
Additional Tier 1 (AT1) capital before regulatory adjustments	**–**	**–**	22.9	2.3
Additional Tier 1 (AT1) capital: regulatory adjustments				
Direct and indirect holdings by an institution of own AT1 instruments (negative amount)	**–**	**–**	–	–
Direct, indirect and synthetic holdings of the AT1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	**–**	**–**	–	–
Direct, indirect and synthetic holdings of the AT1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	**–**	**–**	–	–
Direct, indirect and synthetic holdings by the institution of the AT1 instruments of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)	**–**	**–**	–	–
Regulatory adjustments applied to additional tier 1 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts)	**–**	**–**	–	–
Residual amounts deducted from AT1 with regard to deduction from CET1 capital during the transitional period pursuant to article 472 of Regulation (EU) No 575/2013	**–**	**–**	–	–
of which: items to be detailed line by line e.g. material net interim losses, intangible, shortfall of provisions to expected losses etc	**–**	**–**	–	–
Residual amounts deducted from AT1 with regard to deduction from T2 capital during the transitional period pursuant to article 472 of Regulation (EU) No 575/2013	**–**	**–**	–	–
of which: items to be detailed line by line e.g. reciprocal cross holdings in Tier 2 instruments, direct holdings of non-significant investments in the capital of other financial sector entities etc	**–**	**–**	–	–

	2015		2014	
	Transitional £m	**Fully Loaded £m**	Transitional £m	Fully Loaded £m
Amount to be deducted from or added to AT1 capital with regard to additional filters and deductions required pre-CRR	**–**	**–**	–	–
of which: possible filter for unrealised losses	**–**	**–**	–	–
of which: possible filter for unrealised gains	**–**	**–**	–	–
Qualifying T2 deductions that exceed the T2 capital of the institution (negative amount)	**–**	**–**	–	–
Total regulatory adjustments to Additional Tier 1 (AT1) capital	**–**	**–**	–	–
Additional Tier 1 (AT1) capital	**–**	**–**	22.9	2.3
Tier 1 capital (T1 = CET1 + AT1)	**1,151.1**	**1,151.1**	1,629.8	1,638.3
Tier 2 (T2) capital: instruments and provisions				
Capital instruments and the related share premium accounts	**448.4**	**448.4**	196.4	196.4
Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	**–**	**–**	–	–
Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties	**–**	**–**	0.8	3.0
of which: instruments issued by subsidiaries subject to phase out	**–**	**–**	–	–
Credit risk adjustments	**–**	**–**	52.2	52.2
Tier 2 (T2) capital before regulatory adjustments	**448.4**	**448.4**	249.4	251.6
Tier 2 (T2) capital: regulatory adjustments				
Direct and indirect holdings by an institution of own T2 instruments and subordinated loans (negative amount)	**–**	**–**	–	–
Holdings of the T2 instruments and subordinated loans of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	**–**	**–**	–	–
Direct and indirect holdings of the T2 instruments and subordinated loans of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	**–**	**–**	–	–
Direct and indirect holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)	**–**	**–**	–	–
Total regulatory adjustments to Tier 2 (T2) capital	**–**	**–**	–	–
Tier 2 (T2) capital	**448.4**	**448.4**	249.4	251.6
Total capital (TC = T1 + T2)	**1,599.5**	**1,599.5**	1,879.2	1,889.9
Risk weighted assets in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts)	**71.0**	**71.0**	34.3	34.3
of which: items not deducted from CET1 (Regulation (EU) No 575/2013 residual amounts) (items to be detailed line by line = e.g. Deferred tax assets that rely on future profitability net of related tax liability, indirect holdings of own CET1, etc)	**5.7**	**5.7**	21.0	21.0
of which: items not deducted from AT1 (Regulation (EU) No 575/2013 residual amounts) (items to be detailed line by line = e.g. Reciprocal cross holdings in T2 instruments, direct holdings of non-significant investments in the capital of other financial sector entities etc)	**12.2**	**12.2**	13.3	13.3
Items not deducted from T2 items (Regulation (EU) No 575/2013 residual amounts) (items to be detailed line by line e.g. Indirect holdings of own T2 instruments, indirect holdings of non-significant investments in the capital of other financial sector entities, indirect holdings of significant investments in the capital of other financial sector entities etc)	**–**	**–**	–	–

	2015		2014	
	Transitional £m	**Fully Loaded £m**	Transitional £m	Fully Loaded £m
Total risk weighted assets	**7,422.9**	**7,422.9**	12,632.2	12,632.2
Capital ratios and buffers				
Common Equity Tier 1 (as a percentage of total risk exposure amount)	**15.5%**	**15.5%**	12.7%	13.0%
Tier 1 (as a percentage of total risk exposure amount)	**15.5%**	**15.5%**	12.9%	13.0%
Total capital (as a percentage of total risk exposure amount)	**21.6%**	**21.6%**	14.9%	15.0%
Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	**4.5%**	**7.0%**	4.0%	7.0%
of which: capital conservation buffer requirement	**–**	**2.5%**	–	2.5%
of which: countercyclical buffer requirement	**–**	**–**	–	–
of which: systemic risk buffer requirement	**–**	**–**	–	–
of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer	**–**	**–**	–	–
Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	**9.2%**	**9.2%**	7.0%	7.0%
Amounts below the thresholds for deduction (before risk weighting)				
Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	**53.0**	**53.0**	–	–
Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	**4.9**	**4.9**	5.3	5.3
Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)	**–**	**–**	21.0	21.0
Applicable caps on the inclusion of provisions in Tier 2				
Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap)	**–**	**–**	–	–
Cap on inclusion of credit risk adjustments in T2 under standardised approach	**11.5**	**11.5**	21.6	21.6
Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)	**–**	**–**	123.0	123.0
Cap for inclusion of credit risk adjustments in T2 under internal ratings-based approach	**29.1**	**29.1**	52.2	52.2
	–	**–**	–	–
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2014 and 1 Jan 2022)				
Current cap on CET1 instruments subject to phase out arrangements	**–**	**–**	–	–
Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)	**–**	**–**	–	–
Current cap on AT1 instruments subject to phase out arrangements	**–**	**–**	–	–
Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	**–**	**–**	–	–
Current cap on T2 instruments subject to phase out arrangements	**–**	**–**	–	–
Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)				

Appendix 2 – Capital Instruments

The following table sets out full details of the Banks qualifying Capital instruments in issue.

		Tier 1	Tier 2	
			11% Subordinated Notes	8.5% Subordinated Notes
1	Issuer	The Co-operative Bank plc	The Co-operative Bank plc	The Co-operative Bank plc
2	Unique identifier	N/A	GB00BFXW0853	XS1249403541
3	Governing laws of the instrument	English	English	English
	Regulatory treatment			
4	Transitional CRR rules	Common Equity Tier 1	Tier 2	Tier 2
5	Post-transitional CRR rules	Common Equity Tier 1	Tier 2	Tier 2
6	Eligible at solo/(sub-) consolidated/ solo & (sub-) consolidated	Solo and Consolidated	Solo and Consolidated	Solo and Consolidated
7	Instrument type (types to be specified by each jurisdiction)	Ordinary Shares	Subordinated Debt	Subordinated Debt
8	Amount recognised in regulatory capital (£m)	1,759.5	197.2	251.2
9	Nominal amount of instrument (£m)	22.6	206.0	250.0
9a	Issue price	5p nominal value	100	100
9b	Redemption price	N/A	100	100
10	Accounting classification	Shareholder's equity	Liability – amortised cost	Liability – amortised cost
11	Original date of issue	20/12/2013	20/12/2013	01/07/2015
12	Subsequent issue date	09/05/2014	N/A	N/A
13	Perpetual or dated	perpetual	dated	dated
14	Original maturity date	N/A	20/12/2023	01/07/2025
15	Issuer call	N/A	No	Yes
16	Optional call date, contingent call dates and redemption amount	N/A	101 tax call, 101 regulatory call	01/07/2020, 101 tax call, 101 regulatory call
17	Subsequent call dates, if applicable	N/A	N/A	N/A
	Coupons/dividends			
18	Fixed or floating dividend/coupon	Floating Dividend	Fixed	Fixed
19	Coupon rate and any related index	N/A	0.11	0.085
20	Existence of a dividend stopper	N/A	No	No
21	Fully discretionary, partially or mandatory (in terms of timing)	Fully Discretionary	Mandatory	Mandatory
22	Fully discretionary, partially or mandatory (in terms of amount)	Fully Discretionary	Mandatory	Mandatory
23	Existence of step up or other incentive to redeem	N/A	No	No
24	Noncumulative or cumulative	N/A	N/A	N/A
25	Convertible or non-convertible	N/A	Non-convertible	Non-convertible
26	If convertible, conversion trigger(s)	N/A	N/A	N/A
27	If convertible, fully or partially	N/A	N/A	N/A
28	If convertible, conversion rate	N/A	N/A	N/A
29	If convertible, mandatory or optional conversion	N/A	N/A	N/A
30	If convertible, specify instrument type convertible into	N/A	N/A	N/A
31	If convertible, specify issuer of instrument it converts into	N/A	N/A	N/A
32	Write-down features	N/A	None contractual Statutory bail-in	None contractual Statutory bail-in
33	If write-down, write-down trigger(s)	N/A	N/A	N/A
34	If write-down, full or partial	N/A	N/A	N/A
35	If write-down, permanent or temporary	N/A	N/A	N/A
36	If write-down, description of write-up mechanism	N/A	N/A	N/A
37	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	Subordinate to Tier 2	Senior Unsecured	Senior Unsecured
38	Non-compliant transitioned features	No	No	No
39	If yes, specify non-compliant features	No	N/A	N/A
40	Voting Rights	Yes	N/A	N/A

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