



# Co-operative Financial Services

## Capital Markets Presentation

28 April 2006

# Agenda

**David Anderson**

**Chief Executive**

- CFS Structure, Purpose & Vision
- Opportunities & Progress to date

**John Reizenstein**

**Chief Financial Officer**

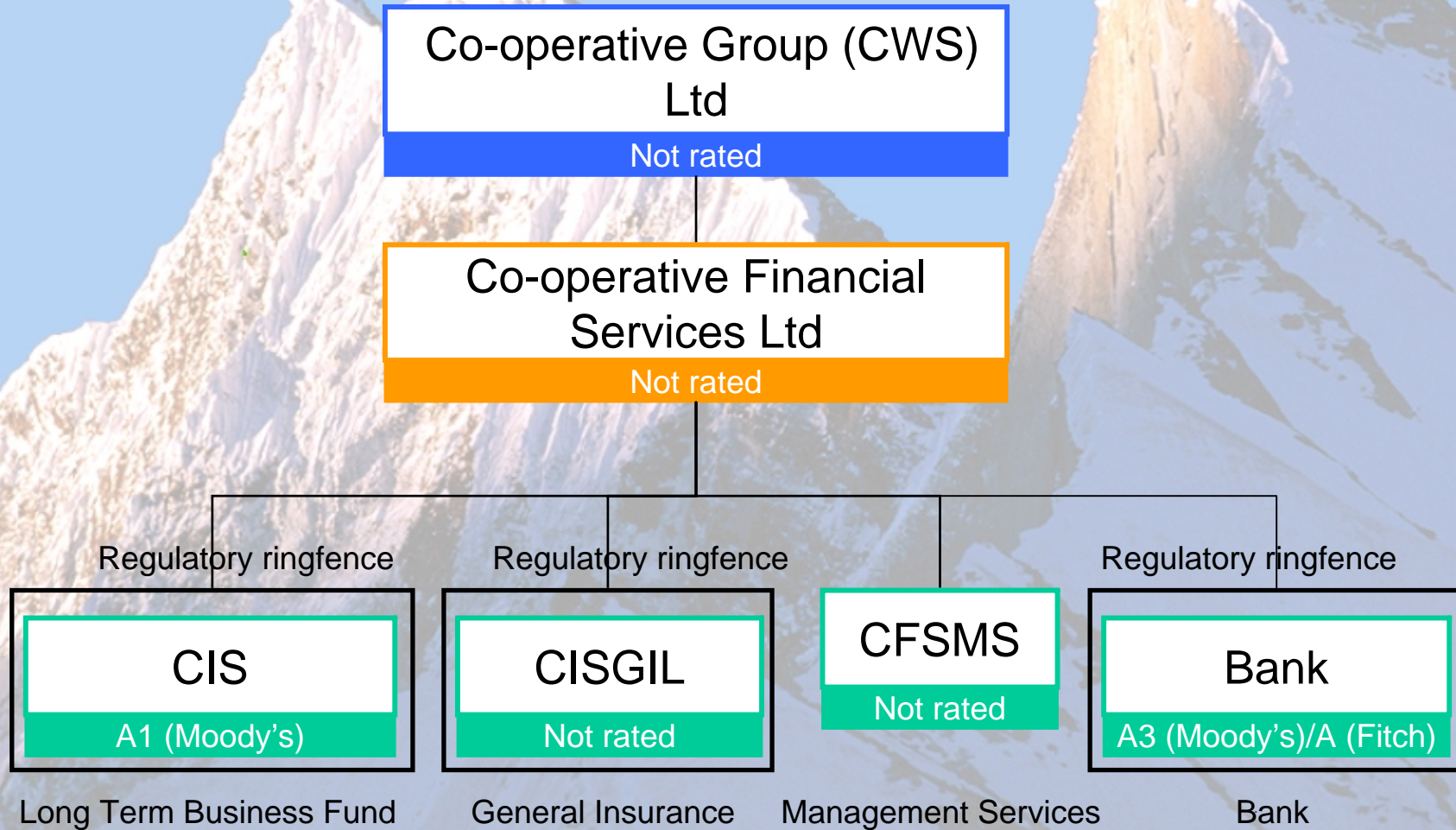
- Bank Performance
- General Insurance Performance
- Long Term Business Fund
- Pensions
- Challenges / Opportunities

Anderson

# David Anderson

## Chief Executive

# Structure





# Our Purpose

**To be a growing, pioneering financial services business delivering benefits to customers, members and communities through commitment to value, fairness and social responsibility.**

# Long Term Vision

## **Vision**

To be the UK's most admired financial services business

## **Underpinned by five key measures**

- Profit generation to create a sustainable model
- Market leading staff satisfaction
- Market leading customer satisfaction
- Market leading social responsibility approach
- Membership growth

# The Opportunities

- **Brand**
- **Existing customers**
- **Co-operative Group customers**

# Progress in last year

- **Restructured sales force**
- **Contact Centres**
- **Single organisational structure**
- **Staff Terms and conditions harmonised**
- **Pensions tackled**



# 2005 Highlights

- CFS operating profit before significant items was up 7% to £166.4m (2004:£155.8m)
- This includes £66.5m from General Insurance (2004:£42.5m) and £97.8m from Banking activities (2004:£114.3m)
- Pre-tax profit was up 3.8% at £135.7m (2004:£130.7m) including £96.5m (2004:£114.3m) from Banking and £37.1m (2004:£17.4m) from General Insurance
- General Insurance claims ratio reduced to 76% (2004:86%)
- Net revenue from Banking activities increased by £21.7m (4%) but bad debt increased to £99.8m (2004:£70.7m)
- Total assets grew to £38.6bn (2004:£36.8bn)

# What next

- **New branch trials**
- **Further infrastructure investment**
- **Focus on productivity**
- **Change plan development**

vision

# John Reizenstein

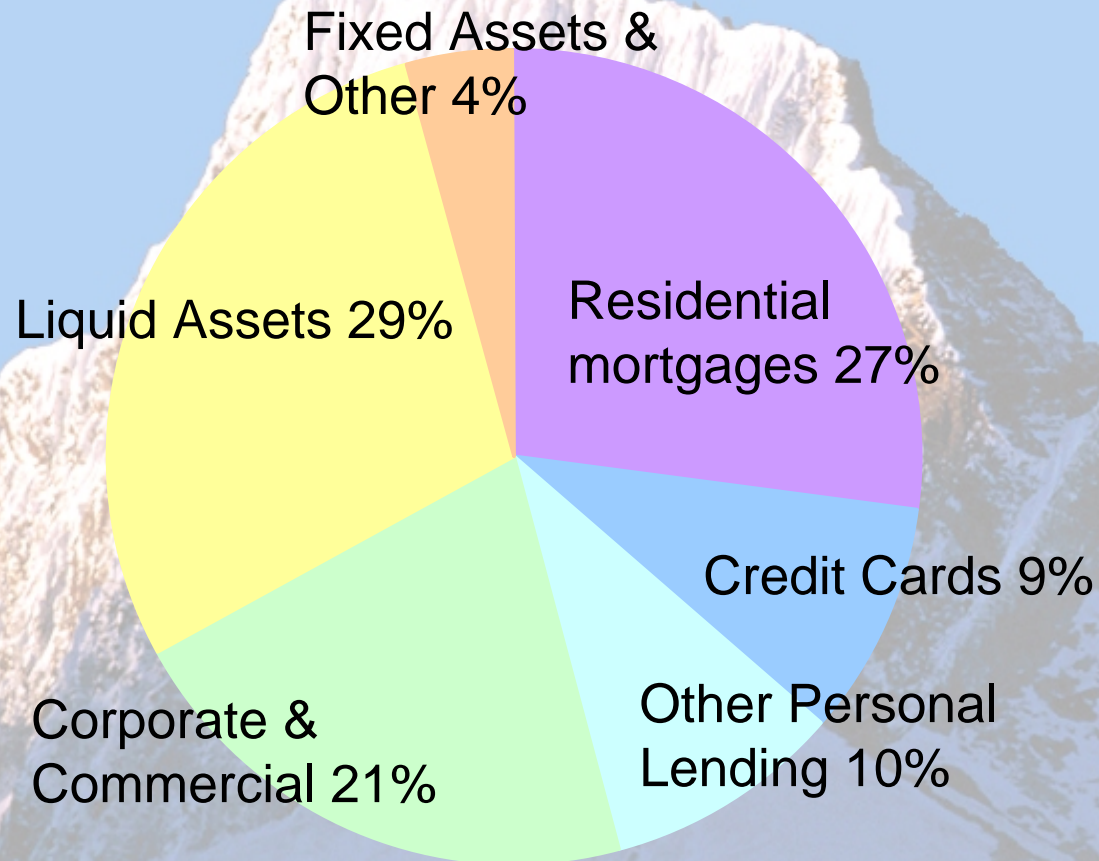
Chief Financial Officer

# Bank - Background

## **Profitable Clearing Bank**

- Underpinned by £11.9bn assets and 2 million customers
- Well balanced personal and business banking franchises
- Broad product range
- Unique brand
  - Ethical & partnership approach
  - Superior customer service
- Extensive distribution channels
- Strong capital & liquidity

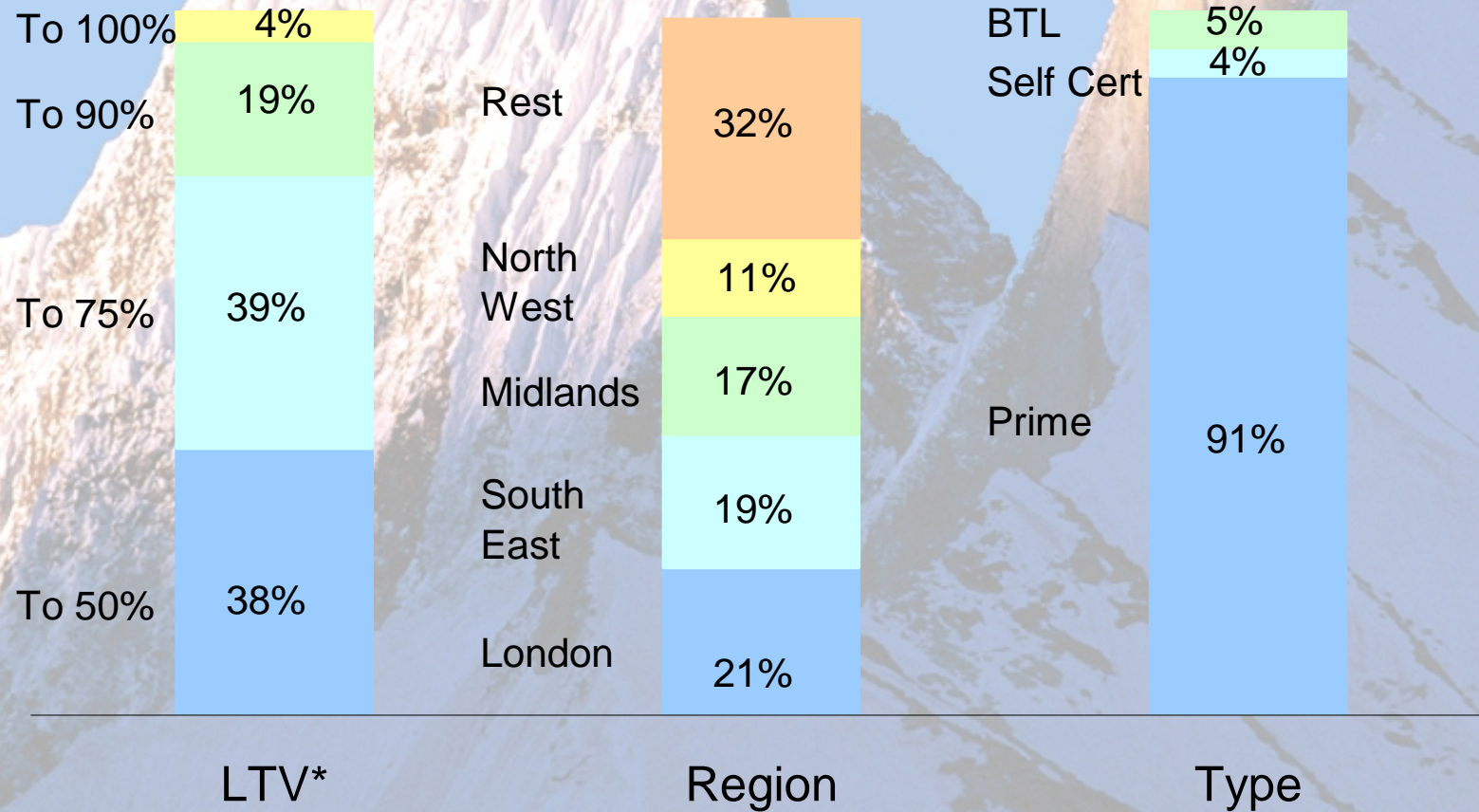
# Bank – Asset breakdown



- £11.9bn assets, 9% growth
- Highly liquid balance sheet
- Diverse asset & customer type

# Stable mortgage portfolio

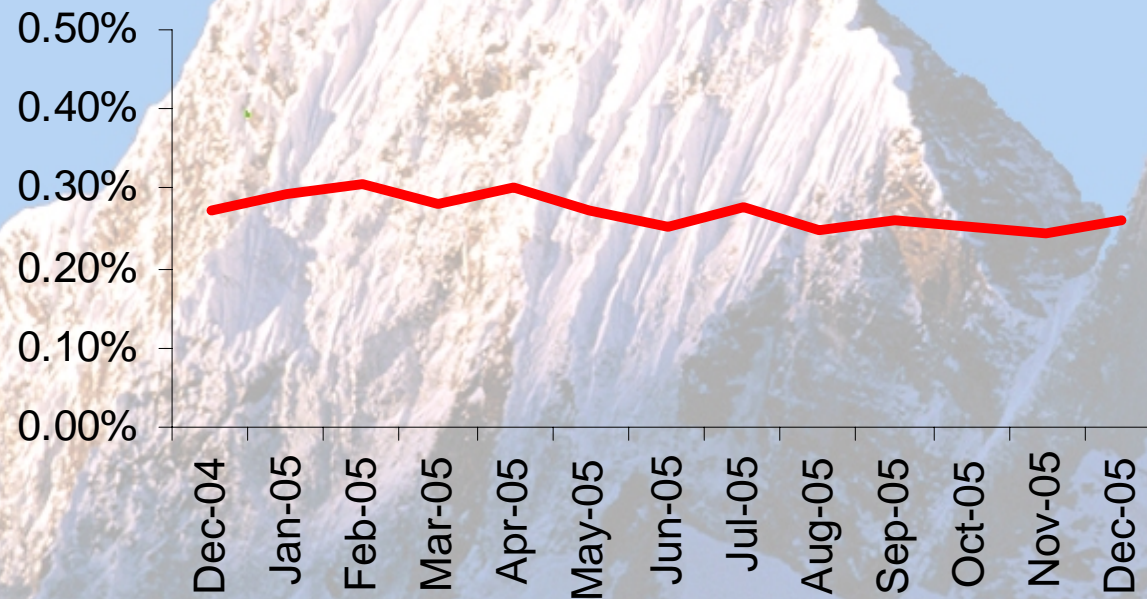
£3.2bn mortgage book



<sup>14</sup>\* LTV at inception, not indexed

# Strong credit characteristics

Mortgages >3m Arrears (% of balance)



## Statistics

68% new to Bank

Avg loan £65k

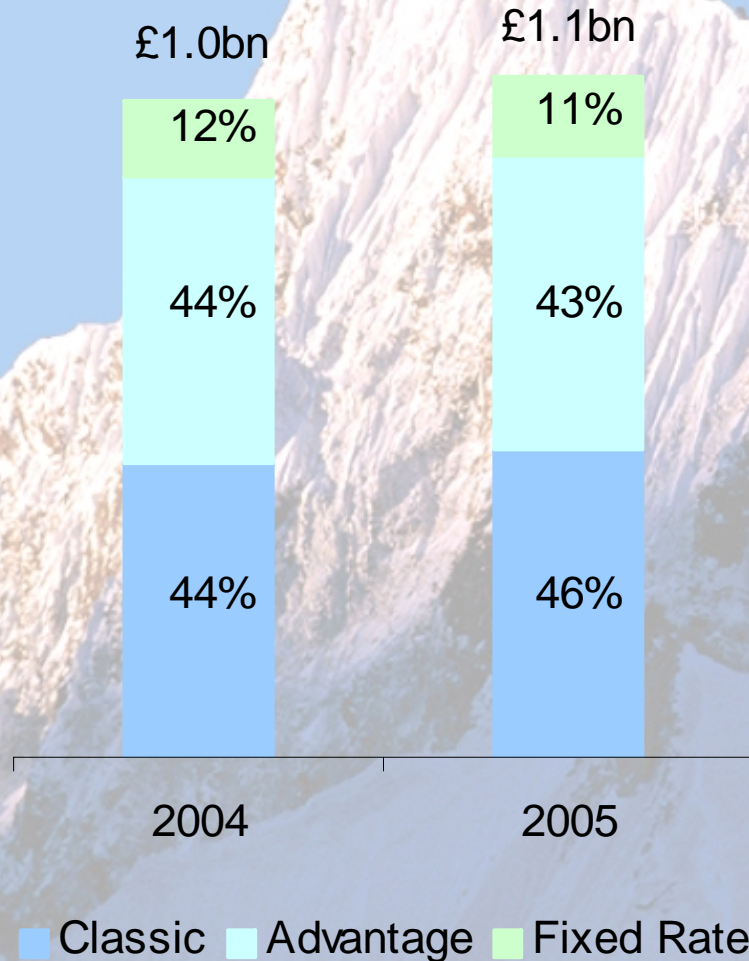
Book LTV\* 49%

New business  
LTV 50%

- Very low arrears levels
- Book now seasoned, started in 2000

15\* LTV at inception, not indexed

# Credit Cards

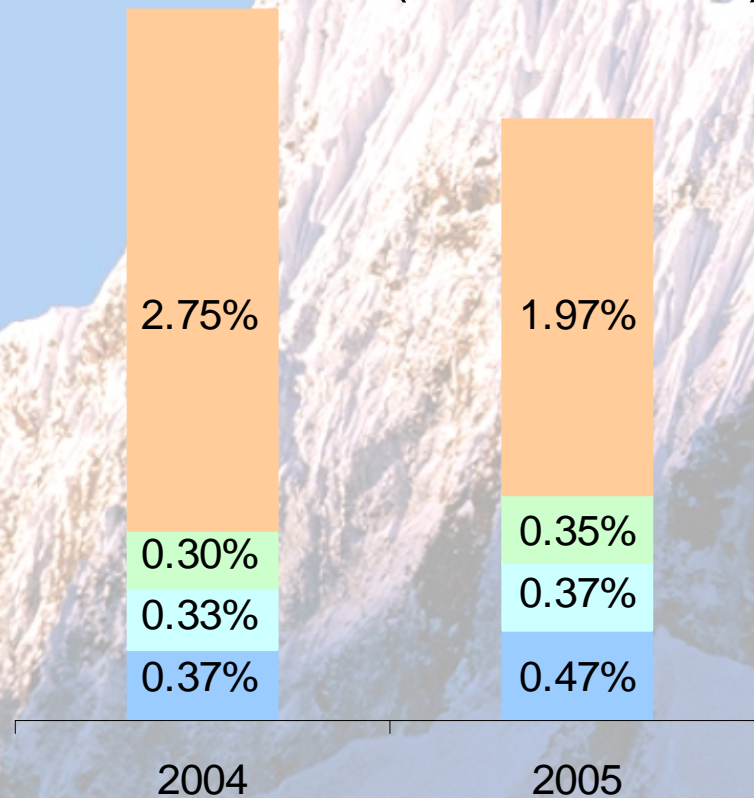


- £1.1bn credit card book
- Book stable
  - £35m growth
  - Static margin
- Continued innovation
  - New Clear card
  - Fixed rate cards



# Credit cards arrears

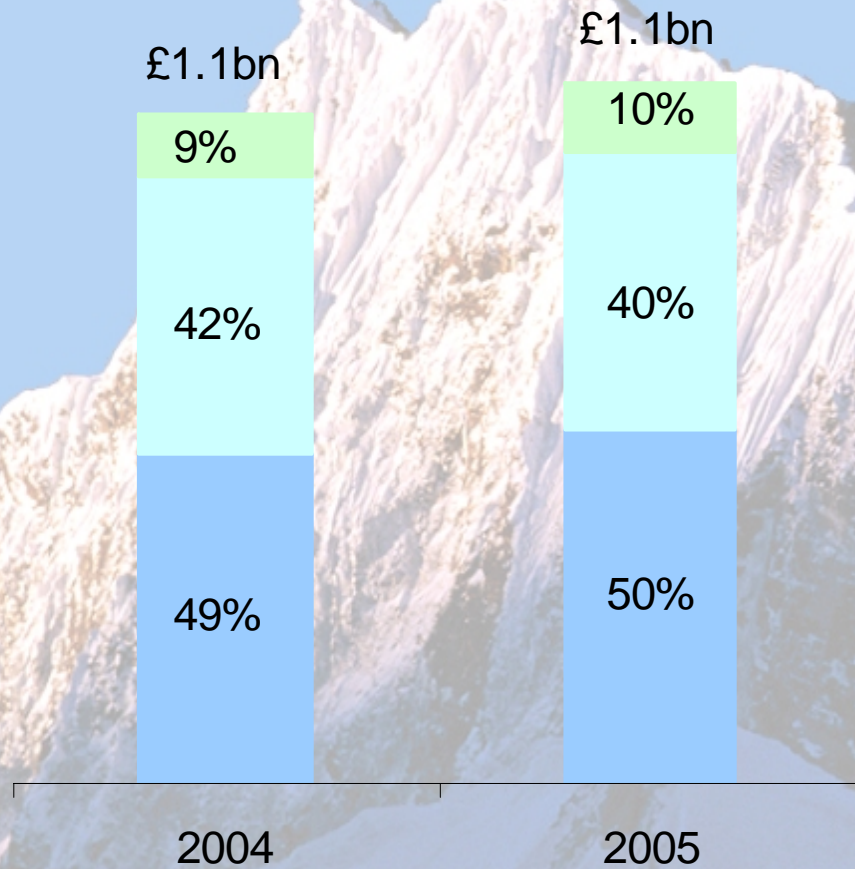
>4m Arrears (% of balance)



120-149 days    150-179 days  
180-209 days    Over 210 days

- Bad debt charge increased from 3.1% of book balance to 4.8%
- Provision rate increased from 3.8% to 5.2%
- >210days reduced due to debt sales
- 30-119 days fairly constant in recent years at under 5%

# Other unsecured personal balances

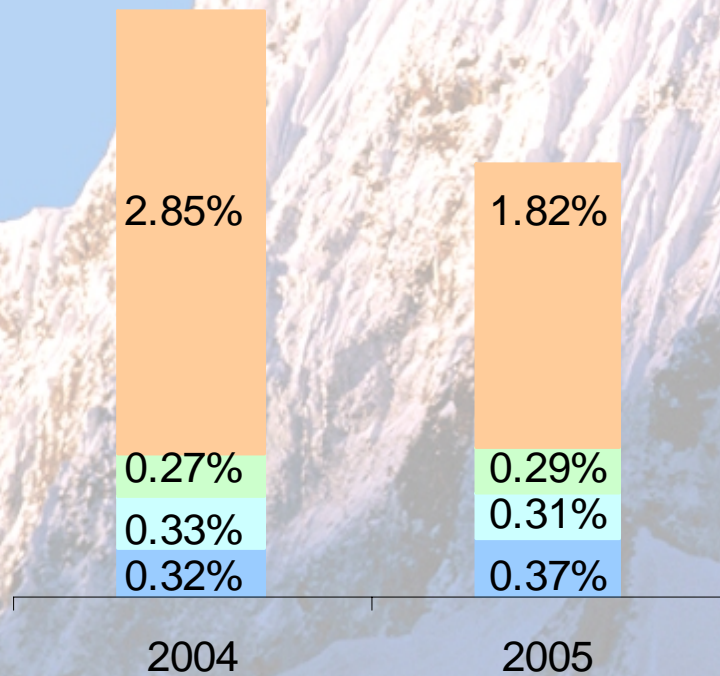


- **Static book**
  - Growth in personal loans
  - Direct loans static
  - £690m new business written in 2005

■ Personal Loans ■ Direct Loans  
■ Variable lending

# Other unsecured personal credit analysis

>4m Arrears (% of balance)

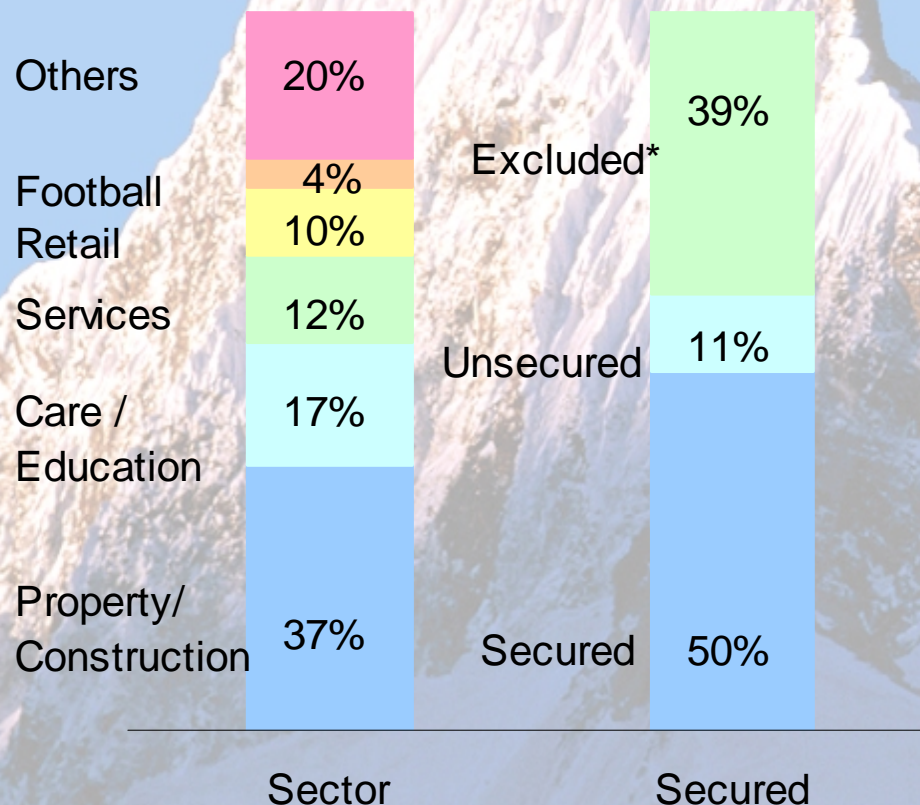


- Bad debt charge increased from 2.0% of book balance to 2.9%
- Provision rate static at 3.7%
- >210days reduced due to debt sales

■ 120-149 days    ■ 150-179 days  
■ 180-209 days    ■ Over 210 days

# Corporate Lending

£2.3bn corporate lending

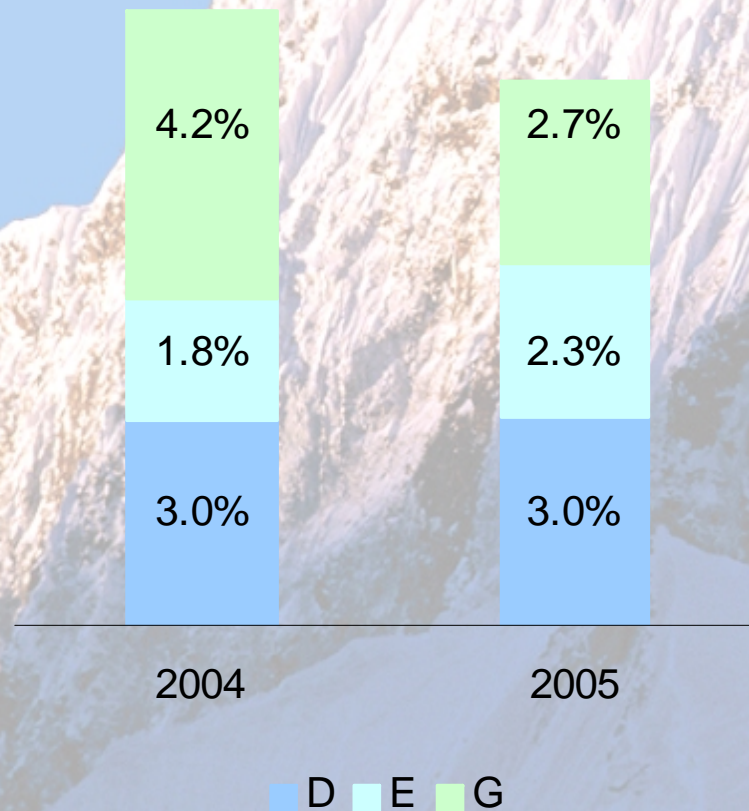


- Book grown by £0.3bn
  - 13% growth
  - exceeded £2bn size
  - diversified sectors from SME to PFI
- Relationships
  - ‘Business Lender of the Year’ by Credit Today
  - Federation of Small Businesses

\*Excluded is 75% Structured & Asset Finance

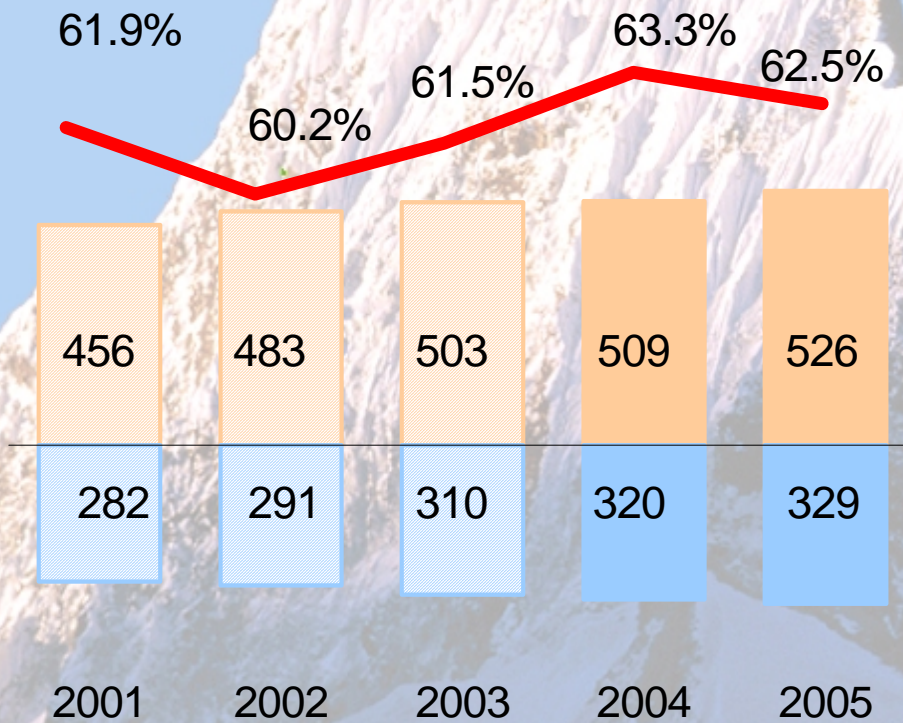
# Strong credit quality for corporate

Arrears % of book



- Impairment charge down by £2.6m to £11.5m
  - Provision rate reduced to 2.1% from 2.2%
- Grading system
  - D :performing, close control
  - E :performing, provisioned
  - G :recovery action
- Property & Construction
  - 77% investment property
  - Maximum LTV 70%

# Income & Cost Trends



- Income growth 4.3%
- Cost growth 2.8%

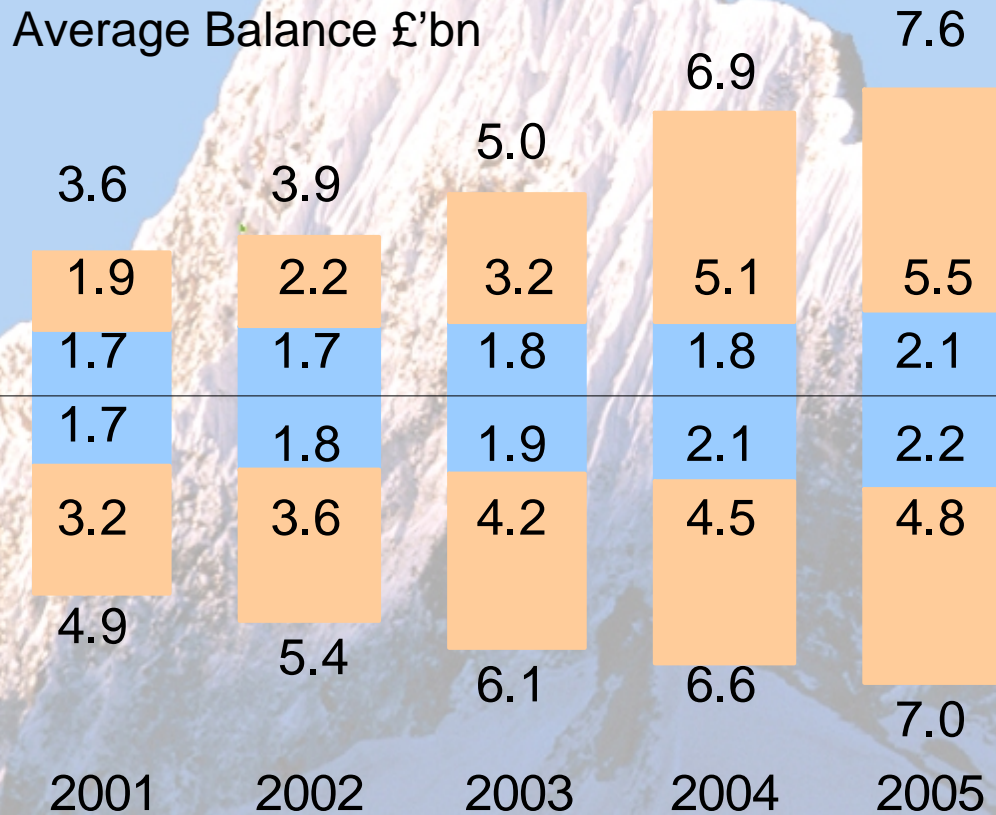
■ Operating income ■ Operating costs  
— Cost Income Ratio

2004 Income:  
£509m per Stats  
Full IFRS £505m

2001- 2003 UK GAAP. 2004 -2005 IFRS

# Asset and liability balance sheet growth

Average Balance £'bn



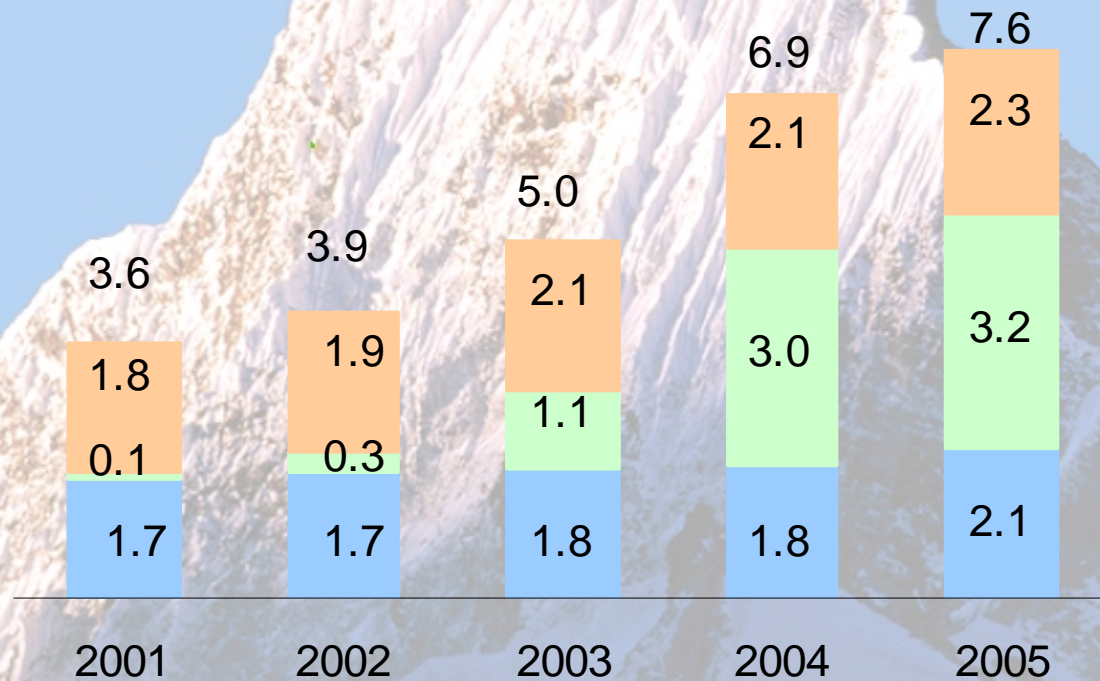
2001-2005 CAGR  
 Total lending 20.9%  
 Personal 30.5%  
 Corporate 6.0%

2001-2005 CAGR  
 Total deposits 9.5%  
 Personal 10.9%  
 Corporate 6.9%

Personal Corporate

# Increasingly secured balance sheet

Average balance £'bn

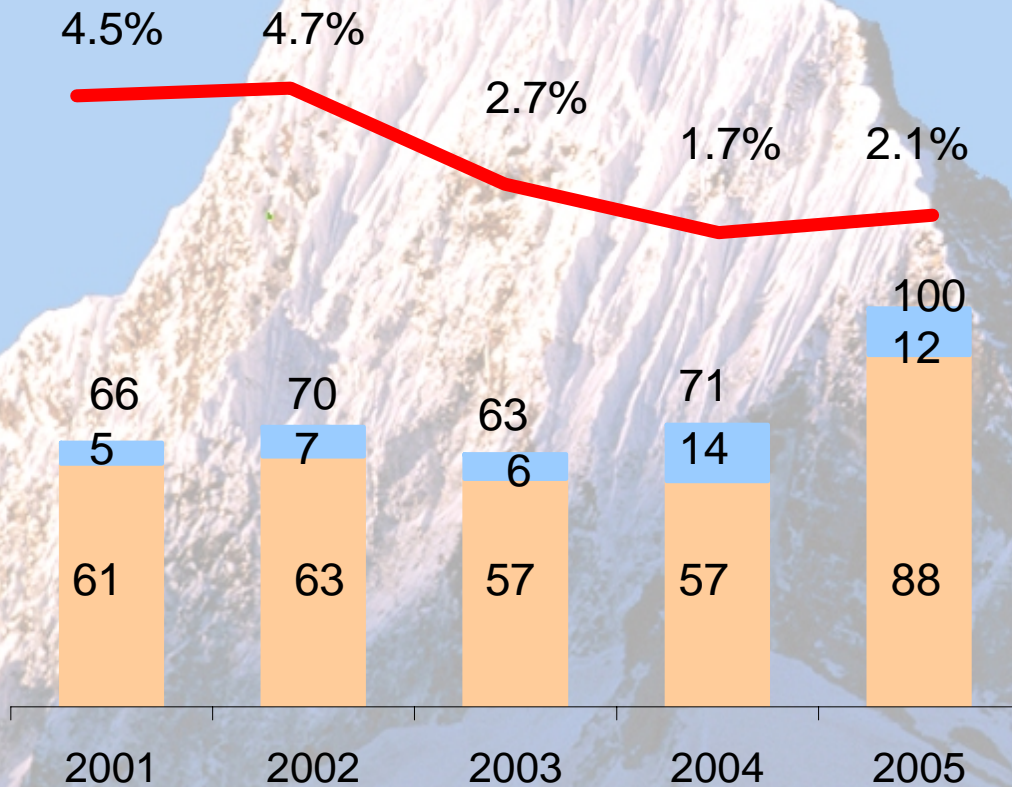


- 42% of customer loans are retail mortgages

■ Corporate ■ Personal Secured ■ Personal Unsecured



# Bad debts

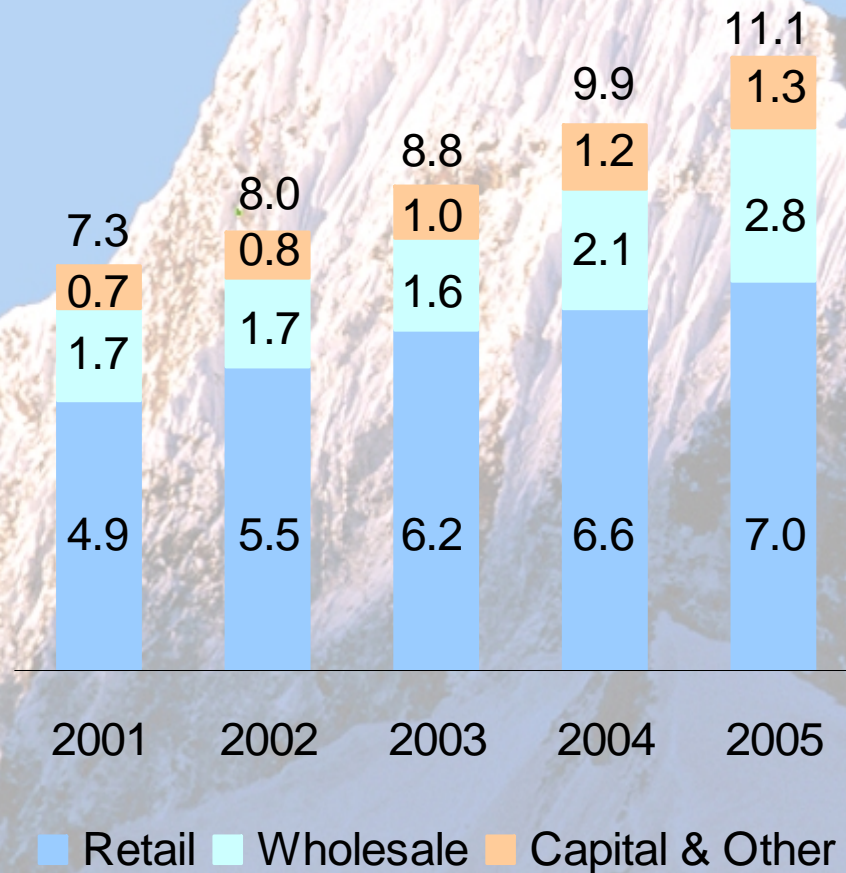


- In 2005 adverse personal unsecured bad debt partially off set by
  - Benign corporate environment
  - High quality personal secured portfolio

Personal Corporate  
% Provision/Assets

# Funding - overall

Total Liabilities & Capital (£bn)

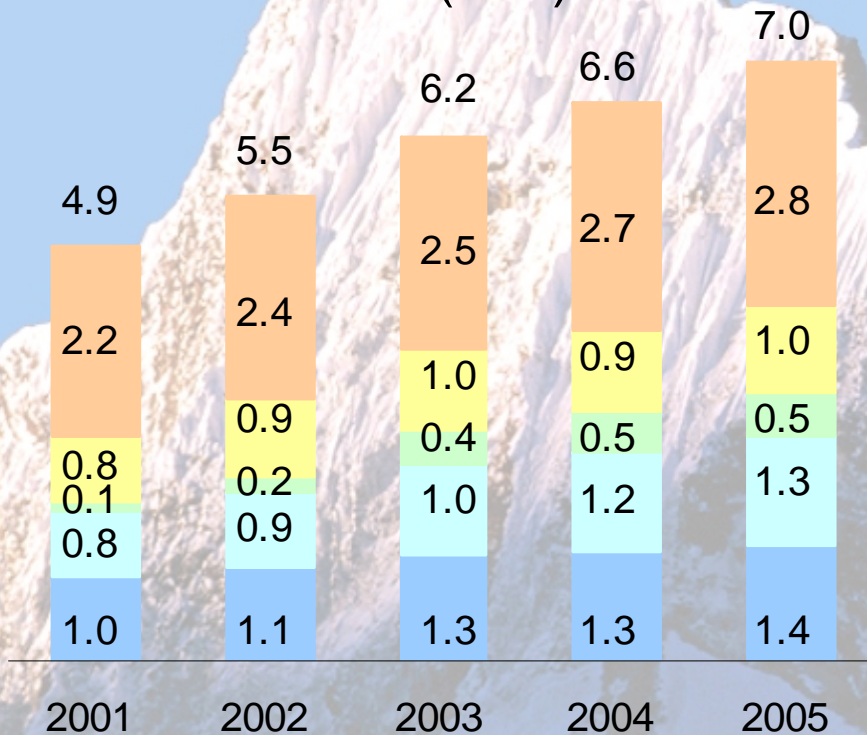


- Diversified and stable funding base
  - Strong and growing retail deposit base
  - Increased wholesale funding via CP and MTN

Note based on average balances

# Funding - retail

## Retail Balances (£bn)



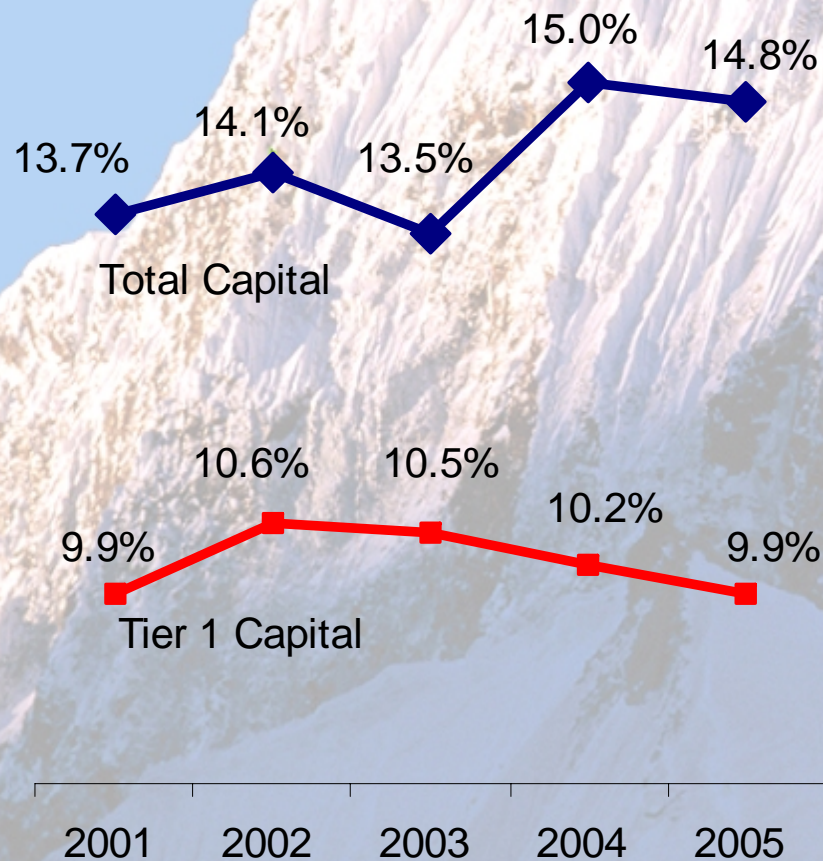
- Compound growth of 9.5% for the last 5 years

- Even growth across products
- Increased term deposits
- Balance sheet strengthened by high quality retail funding

■ Non-interest bearing C/A   ■ Current account  
■ Term deposits   ■ ISA's  
■ Savings

# Strong capital base

## Capital Ratios (%)

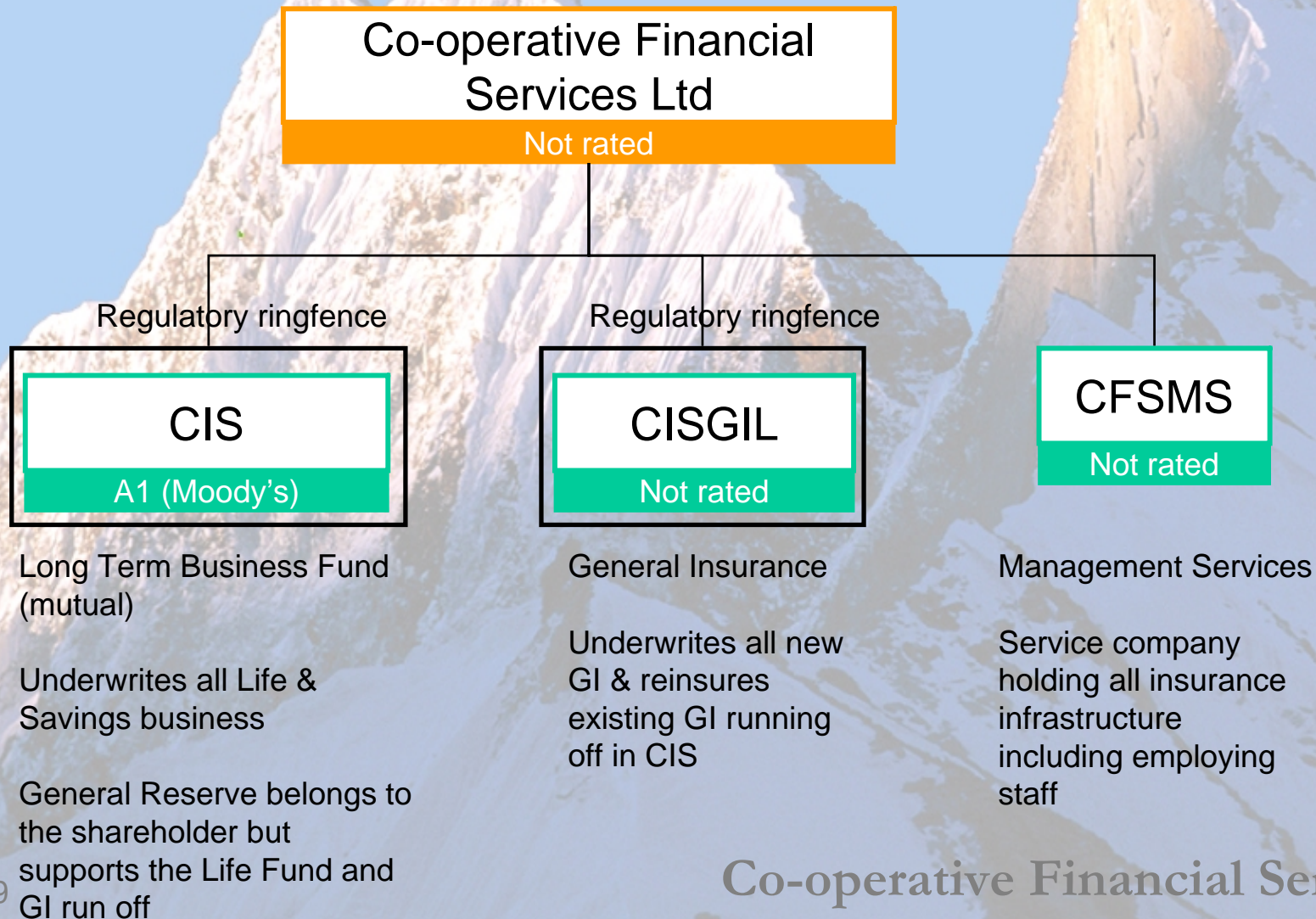


- Strong capital ratios

- More secured asset base
- Pensions addressed
- Low risk treasury operation

- Relatively low gearing of capital base

# Co-operative Insurance Society (CIS)



# CIS - change programme

- CISGIL established
- Closure of District Offices
- Streamlined premium collection
- Financial Advisers – new model
- Creation of Customer Contact Centres
- Claims transformation project
- General insurance pricing development
- 18 months through the 3 year restructuring programme.  
FTE's reduced by 2,894 net.
  - 3,764 reduction, 870 new jobs
- Net benefits run rate £102m

# General Insurance

<u>£m</u>	<u>2004</u>	<u>2005</u>
Gross written premiums	663.2	583.9
Earned premiums	648.9	592.1
Claims ratio	85.8%	76.2%
Expense ratio	28.5%	28.5%
Combined ratio	114.3%	104.7%

- Earned premiums lower due to selective repricing of unprofitable business. New pricing & distribution strategy, including new motor panels
- Combined ratio improved by 9.6% to 104.7%.

# General Insurance

£m

	<u>2004</u>	<u>2005</u>
Technical Result	(19.9)	40.6
Restructuring costs	(25.1)	(25.6)
Premium discount provision runoff	19.1	0.3
Rebates to Co-operative members	(3.0)	(4.9)
Operating profit before tax	(28.9)	10.4

- £360m capital allocated to CISGIL, following ICAS/ICG



# LTBF developments

- Broader product range by developing products with third parties eg unit-linked investment bond
- In house unit linked personal pension developed with a broad range of fund management options
- New business annual premium equivalent (APE) down 27% to £111.6m due to expected impact of financial adviser change programme.
- Range of de-risking actions undertaken

# CIS LTBF– strong capital management

Mutual, all profits retained for the benefit of policyholders

<u>Long Term Business Fund (£bn)</u>	<u>2004</u>	<u>2005</u>
Available assets (excluding gilt repos)	16.3	17.9
Realistic value of liabilities (excluding gilt repos)	15.6	17.1
Net surplus	0.7	0.8
Working capital ratio	4.50%	4.50%
Risk capital margin (RCM) cover	3.1	10.6
RCM cover, incl. £200m General Reserve	3.9	13.2

# Pensions

<u>Pensions 2005 (£m)</u>	<u>Bank</u>	<u>CIS</u>	<u>tCG</u>
IAS 19 pension surplus / (deficit)	(92.1)	81.0	230.7
Deferred tax	27.6	(17.8)	(69.2)
IAS 19 pension surplus, net of tax	(64.5)	63.2	161.5

- Existing schemes transferred on 6 April 2006 to PACE
  - the Co-operative Group Pension Average Career Earnings Scheme
  - PACE surplus at end of 2005 is £160.2m net of tax
- Competitive pension provision whilst controlling future costs and risks of occupational pension provision

# Challenges / Opportunities

	Bank	CISGIL	LTBF
Challenges	<ul style="list-style-type: none"> <li>Pressure on fees and RPI</li> <li>Consumer indebtedness</li> </ul>	<ul style="list-style-type: none"> <li>Unplanned attrition</li> <li>Continue to reduce Claims ratio</li> </ul>	<ul style="list-style-type: none"> <li>Industry perception and sales momentum following restructuring</li> </ul>
Developments	<ul style="list-style-type: none"> <li>New branches and corporate centres</li> <li>Alliances with third parties</li> </ul>	<ul style="list-style-type: none"> <li>New claims processes</li> <li>New sales channels &amp; products</li> </ul>	<ul style="list-style-type: none"> <li>New products</li> <li>Wider range of investment choices</li> </ul>
Opportunities	<ul style="list-style-type: none"> <li>Customer base</li> <li>Trading group</li> <li>Strong balance sheets</li> </ul>		



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