

This Interim Financial Report 2017, glossary of terms, Risk Factors reference document and an investor presentation are available within the Investor Relations section of our website [www.co-operativebank.co.uk/investorrelations](http://www.co-operativebank.co.uk/investorrelations).

## FORWARD LOOKING STATEMENTS

### Certain terms

The term 'the Bank' means The Co-operative Bank plc together with its consolidated subsidiaries. The term 'Company', refers to The Co-operative Bank plc. In this report the abbreviations '£m' represent millions of pounds sterling, and '£bn' represents billions of pounds sterling.

Unless otherwise stated, the income statement analyses and compares the 6 months to 30 June 2017 to the corresponding 6 months of 2016. The balance sheet comparisons relate to the corresponding position as at 31 December 2016. Unless otherwise stated, all disclosed figures relate to continuing operations. Relevant terms that are used in this document but are not defined under applicable regulatory guidance or International Financial Reporting Standards (IFRS) are explained in non-IFRS measures below.

### Non-IFRS measures

Certain non-IFRS measures are provided within this report. These can be found mainly (but not exclusively) in the Detailed Financial Review and the Key Highlights pages.

### Forward-looking statements

This document contains certain forward-looking statements with respect to certain of the Bank's strategy, plans and its current goals and expectations relating to its future financial condition and operating performance. The Bank cautions readers that no forward-looking statement is a guarantee of future performance and that actual results could differ materially from those contained in the forward-looking statements. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. Forward-looking statements sometimes use words such as 'may', 'will', 'seek', 'continue', 'aim', 'anticipate', 'target', 'projected', 'expect', 'estimate', 'intend', 'plan', 'goal', 'believe', 'achieve', 'predict', 'should' or in each case, their negative or other variations or comparable terminology, or by discussion of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. Examples of forward-looking statements include, among others, statements regarding the Bank's future financial position, income growth, assets, impairment charges, business strategy, capital ratios, leverage, payment of dividends, the industry in which the Bank operates, projected costs, commitments in connection with the 2017-2021 Strategic Plan (the Plan), estimates of capital expenditures and plans and objectives for future operations and other statements that are not historical fact.

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

Readers are advised to read, in particular, the Principal Risks and Uncertainties section for a summary of factors that could affect the Bank's future performance. In light of these risks, uncertainties and assumptions, the events and targets described in the forward-looking statements in this document may not occur.

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

## KEY HIGHLIGHTS

### 2017 Interim Results for the six months ended 30 June 2017

- Overall Bank losses before tax narrowed to £135.2m in H1 2017 (H1 2016: £177.0m). Lower operating income and increased exceptional items incurred during the first six months of 2017 were more than offset by reduced operating costs and project spend, conduct charges and fair value unwind related to the merger with the Britannia Building Society.
- Net interest margin decreased to 1.32% (H1 2016: 1.42%) reflecting the impact of the base rate cut, coupled with changes to the Bank's funding mix, including as a reaction to deposit outflows experienced in H1 2017.
- Total operating expenditure reduced by 9.9% to £200.8m in H1 2017 (H1 2016: £222.8m), reflecting the progress made in the cost reduction programme. The Bank completed 10 additional branch closures previously announced in March, and our network now comprises 95 branches.

- Operational, remediation and strategic project expenditure was lower in H1 2017 at £53.8m (H1 2016: £125.7m) reflecting progress made in 2016 and reprioritisation of the project portfolio to cease certain projects with the main focus being on essential regulatory projects.
- Fair value amortisation associated with the merger with the Britannia Building Society decreased to £58.3m (H1 2016: £97.2m), and has now substantially completed.
- Conduct charges were £4.7m (H1 2016: £21.1m) relating primarily to PPI (£9.2m), partially offset by releases from other conduct provisions.
- Customer service excellence was maintained, with the Bank's current account Net Promoter Score (NPS) up to 24 at the end of June 2017, compared to 17 at the end of 2016. Accordingly, the Bank now ranks #3 among its peers compared to #4 at the end of December 2016.
- Current account numbers reduced by less than 2% (c.25,000) since 31 December 2016 to 1.4m accounts. Prime current account numbers increased slightly compared with H1 2016. A new packaged current account, 'Everyday Extra', was launched in April 2017.
- The Bank's total Retail and BaCB customer loans decreased marginally to £15.0bn as at 30 June 2017 (31 December 2016: £15.3bn) with small reductions seen across all key product lines. Retail mortgage completions for the six months to 30 June 2017 totalled £1.4bn (H1 2016: £1.5bn) and redemptions (excluding contractual repayments) for the six months to 30 June 2017 increased to £1.3bn (H1 2016: £0.7bn) reflecting the relative maturity profile of the existing book. In April 2017, the Bank announced the implementation of enhancements to Platform to improve the retention of existing mortgage customers. Mortgage origination and pipeline remain on track to achieve full year targets.
- Retail and BaCB customer assets performed well with impairment losses of £0.5m in H1 2017 (H1 2016: gain of £2.7m). Overall, an impairment gain of £1.4m was recorded in H1 2017 as impairment charges were offset by a provision release of £2.6m in the Legacy portfolio.
- Retail and BaCB customer liabilities were £20.8bn as at 30 June 2017 compared to £22.1bn as at 31 December 2016. Movements in customer liabilities were affected by targeted BaCB deposit reductions as well as Retail customer reaction to uncertainty around the Restructuring and Recapitalisation processes and subsequent liabilities repricing activity. The Bank's Liquidity Coverage Ratio (LCR) was 175.5% as at 30 June 2017 (31 December 2016: 213.5%), representing a comfortable surplus to minimum regulatory requirements.
- The Bank successfully completed the migration of the majority of its mainframe based core banking systems to IBM during February 2017, resulting in the remediation of non-compliance with an FCA threshold condition in relation to the recoverability of the Bank's IT systems.
- Common Equity Tier 1 (CET1) ratio was 9.8% as at 30 June 2017 (31 December 2016: 11.0%) mainly reflecting the statutory loss after tax of £139.7m, partially offset by a £0.3bn reduction in Risk Weighted Assets (RWAs) to £6.3bn.
- The Bank's total capital ratio stood at 16.8% as at 30 June 2017 compared to 17.7% at the end of 2016.

### **The Restructuring and Recapitalisation**

- On 28 June 2017 the Board announced its support for a proposal to raise approximately £700m of additional CET1 capital, before transaction costs, positioning the Bank to meet its regulatory capital requirements and loss absorbing capacity in full in the medium to long term. This is expected to generate at least £443m of CET1 capital from the conversion of Tier 2 Notes, subject to regulatory approval, alongside an additional equity raise of £250m.
- The Bank and Co-operative Group have agreed principles with Pace Trustees Limited to sectionalise the Co-operative Pension Scheme (Pace) into two legally separate sections, with c.21% of assets and liabilities allocated to the Bank. In addition, it was agreed to remove the Bank's obligation to support the pension liabilities of Co-operative Group's section and an agreement has been reached as to the recovery plan for the Bank section and the related deficit recovery contributions. This separation is expected to complete in 2018.
- The Restructuring and Recapitalisation is at an advanced stage but implementation remains subject to conditions including the approval of the requisite majorities of Tier 2 Noteholders and shareholders, the sanction of the Creditors' Scheme and the Members' Scheme by the Court and obtaining regulatory approvals.

Liam Coleman, Chief Executive Officer, said:

"The capital raising proposal we announced in June is progressing to plan and is currently on track to conclude by September. This will secure the future of The Co-operative Bank as a viable stand-alone entity with greater capital strength enabling a new phase in its turnaround.

"Against this backdrop, business performance in the first half of 2017 has been resilient. Customer satisfaction for the service we provide has increased and we have continued to reduce our cost base. Customer relationships are hugely important to us and the vast majority of customers have remained very loyal as we have progressed the sale and capital raise process and I am extremely grateful for their ongoing support.

"Of course there is more hard work ahead, and like other banks, we recognise there are risks to the UK economy, but this is a great bank and we are positive about the future. We have a competitive product set; strong customer service and a distinct ethical position and brand and although it is early days we look ahead with a robust mortgage pipeline and a renewed current account offer. As we celebrate 25 years of our customer-led ethical policy, we believe we have an important role to play in creating a more competitive banking market."

## RESTRUCTURING AND RECAPITALISATION

On 26 January 2017, the Bank announced that it expected its CET1 ratio (in the absence of any management actions) to fall and remain below 10% over the medium term and that it was unlikely to meet its Individual Capital Guidance (ICG) over the planning period to 2020. In addition, the Bank reported that it continued to expect to meet its Pillar 1 capital requirements and to maintain sufficient liquidity to meet its obligations.

The Bank's announcement on 13 February 2017 noted that:

- the Bank had always been clear that, although it met Pillar 1 regulatory capital requirements and expected to continue to do so, it needed to build its capital and meet longer term UK bank regulatory capital requirements;
- its capacity to do so organically had been constrained by (i) the impact of interest rates that are lower than previously forecast, reducing the Bank's ability to generate income, and (ii) higher than anticipated transformation and conduct remediation costs; and
- the Bank needed to consider enhanced regulatory capital and MREL requirements expected of all UK banks.

As a result, and having concluded its annual planning review, the Bank announced the commencement of a sale process, inviting offers for all of its issued ordinary share capital, and indicating that it was considering ways of raising equity capital from existing and new capital providers and a potential liability management exercise of its outstanding public debt.

The Bank has made a number of announcements regarding the Restructuring and Recapitalisation. These are summarised below; full information is available on the Bank's website (<http://www.cooperativebank.co.uk/investorrelations>).

On 9 March 2017, alongside publication of the 2016 Annual Report and Accounts, the Bank disclosed further details of an alternative strategy to raise an additional £700m to £750m of CET1 resources before transaction costs, and that this may be achieved via a liability management exercise involving the potential exchange of the Bank's debt securities for equity (taking into account the Bank's creditor hierarchy) alongside an additional primary equity capital raise to enable the Bank to achieve Tier 1 ICG compliance from 2017 onwards. Furthermore, the Bank indicated that it was anticipating c.£250m Tier 2 issuance during 2018, with the objective of achieving full ICG compliance from 2018 and meeting all capital and interim MREL requirements from 1 January 2020, with further MREL qualifying debt issuances in 2020 and 2021.

On 28 June 2017, the Bank announced that the Board had decided to support an equity capital raise and recapitalisation proposal (Restructuring and Recapitalisation) from the Bank's current investors (the Principal Investors) and had entered into a Lock-up Agreement whereby the Principal Investors and the Bank have committed to take certain steps to implement the Restructuring and Recapitalisation to generate approximately £700m of additional CET1 capital before transaction costs. It also announced that the Bank and Co-operative Group had agreed principles with Pace Trustees Limited to separate their respective sections of The Co-operative Pension Scheme (Pace).

The Restructuring and Recapitalisation involves, amongst other elements: (i) an equity raise of £250m; (ii) the cancellation of an assumed £30m of 11.0% Fixed Rate Notes due December 2023 (the 2023 Notes) of Retail Noteholders in consideration of the payment of a cash amount of no more than £13.5m, subject to regulatory approval; and (iii) the cancellation of the remaining aggregate principal amount of the 2023 Notes of non-retail holders and all of the £250m 8.5% Fixed Rate Notes due July 2025, subject to regulatory approval, in consideration of the issue of Ordinary Shares (the A Shares) in a new holding company of the Bank to such holders, which, taken together, are expected to create approximately £700m of incremental CET1 capital for the Bank, before transaction costs of approximately £63m. The term Retail Noteholder is explained in paragraph 2 of the Practice Statement Letter (on the Bank's website: <http://www.cooperativebank.co.uk/investorrelations>). Noteholders, including Retail Noteholders, should seek their own financial advice, where appropriate.

The agreements reached with the Principal Investors, Co-operative Group and Pace Trustees Limited were considered to secure the long-term future of the Bank and position it to meet its regulatory capital requirements and loss absorbing capacity in full in the medium to long term.

On 14 July 2017, the Bank announced the launch of the creditors' scheme of arrangement and the members' scheme of arrangement through the publication of the Practice Statement Letter. The Bank confirmed on 28 July 2017 that the High Court of Justice had granted the Bank permission to convene meetings of the Bank's Tier 2 Noteholders and shareholders, in order to allow them to consider the creditors' and members' schemes of arrangement relating to implementing the Restructuring and Recapitalisation, and that the Bank had published the formal documents convening these meetings and explaining the detail of the Restructuring and Recapitalisation.

On 28 July 2017, the Bank announced that investors which hold 91% of the Notes (80% of the 2023 Notes and 99% of the 2025 Notes) had entered into an agreement to commit, subject to certain conditions, to take steps to implement the Restructuring and Recapitalisation. It also announced that investors which hold 80% of the Bank's ordinary shares had also agreed to support the Restructuring and Recapitalisation, including c.20% indirectly held by Co-operative Group Limited, subject to certain conditions.

The Bank anticipates completion of the Restructuring and Recapitalisation in early September 2017.

### Corporate Governance

It is envisaged that, on successful completion of the Restructuring and Recapitalisation (the Settlement Date), the Bank will become a wholly owned subsidiary of a newly incorporated holding company (Holdco). Holdco was incorporated and registered in England and Wales as a private limited company under the name of Balloon Street Holdings Limited on 13 July 2017, with company number 10865342. It is intended that, with effect from the Settlement Date, and subject to obtaining appropriate approvals, Holdco will change its name to The Co-operative Bank Holdings Limited.

Holders of Holdco A Shares who hold 10% or more of the fully diluted A Shares at completion (and fulfil other criteria) will be entitled to subscribe at par for B Shares on the basis of one B Share for every 1% of A Shares held by them. A Shares will bear the primary economic interest in Holdco but B Shares will, subject to limited exceptions, carry all of the voting rights at a general meeting. Additionally, B Shareholders (which are expected to include Anchorage Capital, Invesco, Cyrus Capital, Golden Tree and Silver Point Capital) will have the right to nominate up to two directors to the Holdco Board and, via Holdco's ownership of the Bank, to the Bank's Board (the B Shareholder Nominee Directors) and have the benefit of certain shareholder approval and notifications and other rights.

As at the Settlement Date, the Holdco Board will comprise up to ten members including up to two B Shareholder Nominee Directors, six independent Non-Executive Directors, the Chief Executive Officer and the Chief Financial Officer.

Holdco has incorporated the principles of values and ethics into its incorporation articles as they relate to oversight of the Bank and the Holdco Articles of Association to be adopted as of the Settlement Date continue to include core provisions relating to values and ethics.

The Holdco Board will approve plans presented by management for the achievement of the Holdco Group strategic objectives. The Holdco Board will have full power and responsibility to conduct the business and affairs of Holdco and oversight of the Holdco Group. It is expected that, as of the Settlement Date, and going forward, the membership of the Bank's Board will be the same as that of the Holdco Board.

Tom Wood joined the Bank as the Chief Restructuring Officer (CRO) Designate, subject to regulatory approval, in July 2017, and will report to the Chief Executive Officer. He was appointed to the Holdco Board on 13 July 2017.

## **CHAIRMAN'S INTERIM STATEMENT**

On 28 June 2017, the Board was pleased to announce its support for the Restructuring and Recapitalisation proposal. This marked the achievement of an important milestone within a process which we began in February, with the objective of building capital and enabling the Bank to meet the longer term capital requirements applicable to all UK banks.

The expected conclusion of the Restructuring and Recapitalisation will help secure the continuation of the Bank as a stand-alone entity. Our investors, many of whom have been with us since 2013, share our belief that the value of the Bank is embedded in the strong relationship our customers have with us, which is centred on our distinctive values and ethics, and the Restructuring and Recapitalisation will enable the Bank to enter a new phase in its turnaround focused on sustainable profitability.

Since 2013, the Bank has faced considerable challenges, the majority the result of legacy issues. The 2013 recapitalisation of the Bank helped rebuild the Bank's capital resources, and ensure that it complied with the new Basel III Pillar 1 Capital requirements, the minimum capital requirement for all banks, when they were introduced in January 2014. The Bank has continued to meet its Pillar 1 requirement at all times since then, but our progress in rebuilding robust capital in order to meet our Individual Capital Guidance and additional buffer requirements has been constrained by the impact of interest rates that are lower than previously forecast, reducing the Bank's ability to generate income, and by higher than anticipated transformation and conduct redress and remediation costs.

Over the last three years we have significantly de-risked the balance sheet and more than half of the original Non-core portfolio has been sold. We have built more resilient risk processes and IT infrastructure, migrating our key systems to IBM, which marked a major milestone in the separation of core IT systems from Co-operative Group. Many of the transformation and remediation projects are now largely complete, including remediating legacy conduct risk issues, and we have substantially reduced the operating cost base by over 25% since 2014. During the first half of 2017 the accounting fair value unwinds relating to the merger of the Bank and Britannia Building Society in 2009, which have adversely impacted the Bank's financial performance since 2013, have substantially concluded. Finally, the recent agreement on separation from Co-operative Group on the Pace pension scheme has enabled the Bank to move forward with its Restructuring and Recapitalisation plans.

During the last three years, while these major changes were delivered, we have focused relentlessly on reshaping our business around how customers want to bank today, with significant improvements in our digital proposition and investment in our product range and ethical brand, and we are pleased with the progress we have made so far. Our customer service has remained strong and we are in the top three banks for current account customer service in the UK. We intend to build on these strengths as we look to the future.

Our investors have supported the turnaround of the Bank since 2013 and together we believe that the proposed Restructuring and Recapitalisation currently underway will provide the Bank with the capital needed to return to full regulatory capital requirements and loss absorbing capacity in the medium to long term and realise its potential as the UK's leading ethical bank. We are pleased to have their continued support and look forward to continuing to develop our ethical banking proposition for our Retail and SME customers from a position of greater capital strength and sustainability.

On behalf of the Board, I want to thank our customers for their loyalty during this period of uncertainty, the Executive and wider team members for their commitment to finding this solution, and all colleagues at the Bank for continuing to deliver for our customers during the first six months of 2017. We now have renewed foundations in place on which to build our valued customer franchise.

**Dennis Holt**  
Chairman

## **CHIEF EXECUTIVE'S INTERIM STATEMENT**

## **Building a sustainable future with values and ethics at the heart of our business**

In February 2017, we announced that we were commencing a sale process alongside considering other options to build capital to meet the longer term capital requirements applicable to all banks, and to secure the future of our distinctive ethical franchise.

We received a number of proposals from different parties and following consideration of these, on 28 June 2017, the Board gave its approval to support a Restructuring and Recapitalisation proposal from an ad hoc committee representing certain existing Tier 2 Noteholders. While, of course, the Restructuring and Recapitalisation remains subject to some conditions including obtaining shareholder, bondholder and regulatory approvals, this is progressing in accordance with our plans and we expect to conclude the process in early September 2017. Following the completion of the transaction and on raising approximately £700m of additional CET1 capital before transaction costs, we believe that the Restructuring and Recapitalisation will position the Bank to meet regulatory capital requirements and loss absorbing capacity in full in the medium to long term. It will mean that The Co-operative Bank can continue as a stand-alone entity, with values and ethics at its heart.

In this context, during the first half of 2017, our business performance has been resilient as we have continued to focus on delivering our strategy. We have made good progress against our key priority areas of delivering good outcomes for our customers and delivering on the commitments made in our Ethical Policy, controlling our costs and embedding our Risk Management Framework. Our overall performance is in line with expectations.

### **Financial performance**

Overall losses before tax reduced by 23.6% to £135.2m in H1 2017, which compares to a loss of £177.0m in H1 2016. A number of one-off items have contributed to this but the underlying trends remain encouraging. More information on the Bank's financial performance is included in the Detailed Financial Review, but the largest drivers of the loss reflect lower operating income due mainly to the low interest rate environment and strong price competition in the UK mortgage market, together with continued investment and the costs associated with the Restructuring and Recapitalisation. As expected, our CET1 ratio at the end of June 2017 was 9.8% and we believe that the Restructuring and Recapitalisation will fundamentally improve our capital position in the future.

We have continued our investment activities with a total project spend of £53.8m, compared to £125.7m in the first half of 2016, to progress IT resilience, remediation of systems and processes and to simplify products. This reduction in project spend reflects the progress made in 2016 and the completion of a number of significant projects, as well as our decision to refocus our transformation work which meant the cessation of some projects.

We also improved our customer experience through a range of digital improvements including a new Mortgage in Principle (MiP) tool launched in February 2017, making it easier for customers to join the Bank. Further improvements have been made based on customer feedback.

Our branch network remains an important part of our multi-channel service, reflecting customer demand. Our branch network comprises 95 branches, following the closure of 10 branches announced earlier this year. At the same time we have also invested in core branches, evidenced by our recent move to new premises in Manchester, Liverpool and Sheffield.

### **Resilient business performance**

In the first half of 2017, we have maintained customer service excellence. Our current account NPS score has risen to 24, from 17 at the end of 2016. Along with further improvements in customer satisfaction scores, we rank number three for current account customer service compared with other UK banks. We were also delighted to be recognised in the moneysavingexpert.com bi-annual banking poll, where we were rated third best UK bank for customer service. While we have seen overall current account numbers reduce slightly versus the same period in 2016 (from 1.42m to 1.41m), prime current account customer numbers have seen a modest increase compared with the same period in 2016 (from 645,896 to 647,669), though this is a slight decrease compared with the second half of 2016.

We have continued to focus on mortgage new business origination in particular through our Platform brand, which was commended in the Business Moneyfacts awards in the Best Buy-to-Let Mortgage Provider category in March of this year. In addition, we successfully completed activity to enhance our mortgage retention capability for Platform customers. Completions for the first six months totalled £1.4bn compared to £1.5bn for the same period of 2016 whilst redemptions increased to £1.3bn from £0.7bn, reflecting the relative maturity profile of the existing book.

In savings, we actively sought to reduce deposit balances in the first quarter in line with our plan to simplify our approach to business banking. While we have seen outflows from Retail instant access savings of £0.4bn during the 6 month period against the backdrop of a sale and Restructuring and Recapitalisation process, our competitively priced fixed term savings and ISA products have continued to attract strong customer demand, with around 70 per cent of existing customers choosing to continue their fixed term savings products with us, on maturity, demonstrating further how the strength of our values and ethics franchise encourages loyalty from our customer base.

Our total Retail and Business and Commercial Banking (BaCB) customer loans decreased slightly by c.£0.3bn in the first half of 2017. We are proud to provide banking for over 93,000 small business customers and to provide banking services to the members of 279 credit unions, almost 60% of the UK credit union sector. This is another example of how we continue to deliver on our commitment to values and ethics, and we were delighted that the team were awarded Best Charity Banking Provider and Best Service from a Business Bank by Moneyfacts.

In April 2017, we launched a new packaged current account, 'Everyday Extra', as we seek to develop our range of current accounts. The product features several benefits which reflect our ethical brand, with the unique benefit of no excess charges on insurance claims. Crucially, this further demonstrates how we are continuing to deliver the commitments in our Ethical Policy by offering products that our customers want

based on their needs.

Our values and ethics continue to set us apart from our competitors and we are delighted to be celebrating the 25th anniversary of our customer led Ethical Policy in the second half of 2017 and we will be investing in our differentiated brand. We are the only UK high street bank with a customer-led Ethical Policy and in July 2017 we launched our third annual Values and Ethics Report which brings together stories and case studies to illustrate how we make the difference. In the first half of this year, customer donations to our charity partners, including donations from our Everyday Rewards current account, reached £379,197.

In 2017, we have launched a charity partnership with youth homelessness charity Centrepoin, including a mortgage product where the Bank will donate £25 to the charity for every new mortgage customer on completion of their application. We're continuing to support our partnership with Centrepoin through our current switching offer which provides a £25 donation to Centrepoin for each customer who switches their account to us and meets the relevant criteria, and the customer will receive £125. This partnership also provides volunteering and fundraising opportunities for colleagues.

### **Risk management and improved resilience**

A major milestone in building greater resilience for the Bank was the migration of our mainframe-based core banking systems to IBM in February 2017, resulting in stronger end-to-end disaster recovery capability and ensuring that we met key regulatory requirements for the remediation of the IT estate, which has reduced the Bank's overall risk profile.

### **People and culture**

We continue to foster a culture centred around customers, informed by a keen awareness of risk, and we have made significant progress in embedding our Risk Management Framework. The commitment from colleagues during a period of uncertainty for the Bank has been remarkable.

Our focus on cost effectiveness across all areas of the Bank includes continuing to improve the working environment for colleagues and we are on track to move into our newly refurbished head office, in Balloon Street, in the heart of Manchester city centre by the end of this year.

Since being appointed to the position of CEO in January this year, I have received excellent support from the Executive team. I am delighted that Tom Wood has joined the Bank as Chief Restructuring Officer Designate (subject to regulatory approval), and I look forward to working with him and the rest of the team as we take the Bank forward.

### **Summary**

Following a period of uncertainty around the future of the Bank, I'd like to express my thanks to our customers for their loyalty and our colleagues, regulators and wider stakeholders for the support they have shown. As we move forward on our journey and finalise the remaining elements of the Restructuring and Recapitalisation in early September, I am confident that we can continue to build on this momentum and deliver on our commitment to provide an ethical banking proposition for our customers. I look forward to building a successful Co-operative Bank.

### **Liam Coleman**

Chief Executive Officer

## **DETAILED FINANCIAL REVIEW**

### **Basis of preparation**

The results presented in the following section are on a management accounting basis and are representative of how the Bank was managed in H1 2017.

The basis of preparation of the Bank's management and Board reporting has changed in 2017. Central to the changes is that the Bank is no longer separated into a Core and Non-core Bank, with a simplified reporting structure more suited to this stage of the Bank's turnaround plan. The Bank's operating segments are unchanged, comprising Retail, Business and Commercial Banking (BaCB), Treasury, Legacy Portfolio, Optimum and Other.

Historically, including in 2016, the Bank has presented its cost base through two sub categories: direct costs and indirect costs. Direct costs were reported within the contribution of each operating segment and included those that related to the staff and operations of the specific business unit. Indirect costs covered those functions that support Bank wide operations, including HR, Finance, IT and Risk. The Bank structures and manages its costs on a functional basis, rather than aligned to its operating segments, and accordingly, the contribution for each operating segment is no longer reported.

As a result of the above, the Detailed Financial Review now reports segmental income net of impairments, and operating costs are now reported as staff and non-staff costs for the total Bank only.

Segmental net interest income is presented post the application of funds transfer pricing (FTP). Transfer pricing is managed through the Bank's Treasury segment. Treasury charges assets within each segment an Interest Rate Transfer Pricing (ITP) charge and a Liquidity Transfer Pricing (LTP) charge for using the Bank's funding, and correspondingly credits segment liabilities with ITP and LTP for providing the funds. The FTP mechanism nets out to zero across the Bank, but the amount paid and received across the segments changes year on year as the respective balance sheet and LTP rates may be updated. The same LTP rates have been applied in H1 2016 and H1 2017.

## Re-presentation of comparative financial information

	Re-presentation			Current basis £m
	Prior basis £m	Legacy Portfolio impairment release £m	Treasury gain on sale £m	
<b>Period to 30 June 2016 re-presentation</b>				
Net interest income	201.5	-	-	201.5
Losses on asset sales	(11.6)	0.9	(0.5)	(11.2)
Non-interest income	38.3	8.6	0.5	47.4
<b>Operating income</b>	<b>228.2</b>	<b>9.5</b>	<b>-</b>	<b>237.7</b>
Operating expenditure	(222.8)	-	-	(222.8)
Operating project expenditure	(19.7)	-	-	(19.7)
Impairment gains/(losses) on loans and advances	11.6	(9.5)	-	2.1
<b>Operating result</b>	<b>(2.7)</b>	<b>-</b>	<b>-</b>	<b>(2.7)</b>

During H1 2016, the Bank undertook a restructuring transaction in connection with a Legacy Portfolio loan. In H2 2016, the restructured loan was subsequently sold. In order to simplify the presentation of the impact of the entire transaction, the related elements have been re-presented as losses on asset sales.

In addition, a £0.5m gain on sale of residential mortgage backed securities (RMBS) assets in H1 2016 has been reclassified from losses on asset sales to non-interest income. Losses on asset sales reflect net losses incurred on disposal of customer assets.

The Bank has re-presented the comparative balance sheet as at 31 December 2016 following progress made in the Bank's transformation of finance processes (see note 3 for full segmental balance sheet). This is driven by a reallocation of £0.1bn of previously unallocated assets and £0.5bn of previously unallocated liabilities into the Other business unit. In addition, £0.2bn of Optimum assets have been reallocated to the Other business unit. These reallocations reflect the way the business was managed during H1 2017.

## Summary Bank performance

	Period to 30 June 2017 £m	Re-presented <sup>1</sup> Period to 30 June 2016 £m	Change £m
Net interest income	172.0	201.5	(29.5)
Losses on asset sales	(1.1)	(11.2)	10.1
Non-interest income	38.0	47.4	(9.4)
<b>Operating income</b>	<b>208.9</b>	<b>237.7</b>	<b>(28.8)</b>
Impairment gains on loans and advances	1.4	2.1	(0.7)
<b>Income net of impairment</b>	<b>210.3</b>	<b>239.8</b>	<b>(29.5)</b>
Operating expenditure – staff	(82.0)	(97.5)	15.5
Operating expenditure – non-staff	(118.8)	(125.3)	6.5
Operational project expenditure	(8.3)	(19.7)	11.4
<b>Operating result</b>	<b>1.2</b>	<b>(2.7)</b>	<b>3.9</b>
Conduct risk	(4.7)	(21.1)	16.4
Remediation project expenditure	(34.8)	(71.3)	36.5
Strategic project expenditure	(10.7)	(34.7)	24.0
Severance	(2.5)	(8.5)	6.0
Other exceptional items	(25.5)	58.1	(83.6)
Share of post-tax profits from joint ventures	0.1	0.4	(0.3)
Fair value amortisation	(58.3)	(97.2)	38.9
<b>Loss before taxation</b>	<b>(135.2)</b>	<b>(177.0)</b>	<b>41.8</b>
<b>Net interest margin<sup>2</sup></b>	<b>1.32%</b>	<b>1.42%</b>	<b>(0.10)%</b>
<b>Cost:income ratio<sup>3</sup></b>	<b>99.6%</b>	<b>97.4%</b>	<b>2.2%</b>

	30 June 2017 £bn	31 December 2016 £bn	Change £bn
<b>Total assets</b>	<b>25.0</b>	<b>27.6</b>	<b>(2.6)</b>
<b>Total liabilities</b>	<b>24.2</b>	<b>26.6</b>	<b>(2.4)</b>

<sup>1</sup> The 2016 information has been re-presented to show 'income net of impairment' and the other re-presentations as described in the basis of preparation.

<sup>2</sup> Net interest margin is calculated as net interest income divided by the average of the opening and closing asset balances for the period.

<sup>3</sup> Operating expenditure and operating projects (including associated depreciation and amortisation) divided by operating income excluding losses on asset sales.

The Bank's statutory loss before taxation for H1 2017 is £135.2m (H1 2016: £177.0m).

Net interest income has fallen by £29.5m as a result of a number of factors, including narrowing asset margins reflecting changes in customer asset mix out of higher margin assets including Retail unsecured, BaCB and Optimum, and into Platform mortgages, together with an overall reduction in the size of the Bank's balance sheet. Mortgage margins remain under pressure due to strong market competition driving low introductory rates on new business originations and switches. The Bank of England base rate (the base rate) reduction in August 2016 and lower yield curves have further reduced wholesale returns and hedging of non-interest bearing balances, whilst margin compression has occurred on variable deposits where customer rate reductions were less than the 25bps base rate reduction.

The Bank's net interest margin (NIM) has reduced from 1.42% to 1.32%. Pricing actions on customer liabilities have driven margin compression and wholesale returns have reduced, as discussed above, driving the reduction in Bank NIM. In addition, H1 2017 included reduced charges relating to the Bank's mortgage portfolio effective interest rate asset compared to H1 2016. These charges have arisen where the Bank's projected base rate expectations change relative to planning assumptions, and were partially offset by other accounting adjustments.

Non-interest income has reduced relative to the prior period, including the non-reoccurrence of £7.3m one-off recoveries against PPI redress and remediation in respect of portfolios previously acquired by the Bank, together with an increase in expenses related to the Everyday Rewards proposition and reduced gains on treasury asset sales relative to H1 2016, partially offset by hedge accounting volatility which increased versus the prior period, primarily reflecting the reduction in basis exposure in the Bank's cash flow hedges.

Losses on customer asset sales have reduced to £1.1m (H1 2016: £11.2m), following a planned period on period reduction in the level of Legacy Portfolio deleverage.

The Bank has continued to deliver a significant reduction in operating expenditure, down £22.0m period on period, continuing to reflect the progress of cost reduction initiatives. The main reductions in costs are as a result of the continued focus on improving efficiency and simplification of Bank processes, as well as reviewing expenditure relating to third party suppliers. This is primarily attributable to the reduction in operating staff costs of £15.5m and the ongoing benefit from initiatives in previous years such as the branch network rationalisation.

The Bank has continued its investment activities in H1 2017 with total project expenditure, comprising operational, remediation and strategic project expenditure, recognised in the income statement of £53.8m (H1 2016: £125.7m) to progress IT resilience, remediation of systems and processes and to simplify products. Overall project expenditure has reduced relative to H1 2016, reflecting the progress made in 2016 and the cessation and completion of a number of the Bank's significant projects.

Conduct risk charges totalled £4.7m in the period (H1 2016: £21.1m), a decrease of £16.4m on H1 2016, as the Bank continues to progress through the redress and remediation programme.

In H1 2017, other exceptional items included the costs incurred in respect of the Restructuring and Recapitalisation of £48.3m. This is partially offset by a gain on the sale of VocaLink shares (£22.8m). In H1 2016, other exceptional items comprised the gain recognised on sale of the Bank's share in Visa Europe (£58.1m). As at 30 June 2017, the Restructuring and Recapitalisation was in progress. Accordingly all expenses accrued to date are recorded in the H1 2017 income statement. On successful completion an element may be reclassified directly to equity, to the extent that they are clearly external, direct and incremental to the equity raised as part of the Restructuring and Recapitalisation. The CET1 impact of any reclassification of costs on successful completion of the transaction is nil.

Though legacy issues continue to impact the Bank's financial performance in H1 2017, the impact of these issues has reduced. Fair value unwinds related to the merger with Britannia Building Society amounted to £58.3m (H1 2016: £97.2m), primarily reflecting unwinds relating to the final Leek Finance Number 19 plc (Leek 19) securitisation (a Special Purpose Vehicle in place at the time of the Britannia merger), which was called in June 2017.

The Bank's cost:income ratio has increased period on period to 99.6% (H1 2016: 97.4%). Operating costs and operational projects have reduced by £33.4m to £209.1m (H1 2016: £242.5m), continuing to reflect the progress of cost reduction initiatives and reduced levels of operating project expenditure, as described above. However, Bank operating income (excluding gains/losses on asset sales) has reduced by £38.9m, to £210.0m (H1 2016: £248.9m). Net interest income has reduced by £29.5m with a reduction in the size of the Bank's balance sheet together with pressure on both asset and liability margins following, in particular, the base rate reduction in August 2016. Non-interest income has reduced by £9.4m, in particular due to non-recurrence of £7.3m one-off recoveries against PPI redress and remediation in respect of portfolios previously acquired by the Bank.

Despite the good progress made in reducing the Bank's operating costs and operational project expenditure, the relative impacts of reductions in both operating income and expenses, as described above, is such that the cost:income ratio has increased with reference to the comparative period.

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

## Capital position

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

£m unless stated

As at

As at

Change

	30 June 2017	31 December 2016	
CET1	620.3	736.9	(116.6)
Tier 1 Capital	620.3	736.9	(116.6)
Tier 2 Capital	446.7	447.0	(0.3)
Total Capital	1,067.0	1,183.9	(116.9)
Total Credit RWAs	5,703.7	5,944.0	(240.3)
Operational RWAs	636.0	732.1	(96.1)
Total RWAs	6,339.7	6,676.1	(336.4)
CET1 ratio (%)	9.8%	11.0%	(1.2)%
Total capital (%)	16.8%	17.7%	(0.9)%
Leverage Ratio (%)	2.4%	2.6%	(0.2)%

### Capital Ratios

The Bank's consolidated Common Equity Tier 1 (CET1) post regulatory deductions has decreased by £116.6m in the period to £620.3m, primarily as a result of the £139.7m statutory loss after tax for the period to 30 June 2017, partially offset by movements in other reserves and regulatory deductions.

Total RWAs have fallen by £336.4m. Credit RWAs have reduced by £240.3m, primarily as a result of a reduction in Optimum RWAs following the removal of the remaining temporary model adjustment for Optimum mortgages not included within the Calico synthetic securitisation. Operational Risk RWAs have decreased by £96.1m following the annual recalculation of the Pillar 1 Operational Risk requirement subsequent to the 2016 year end results.

The movements outlined above are the primary factors resulting in:

- the CET1 ratio decreasing by 1.2% from 11.0% to 9.8%;
- the total capital ratio reducing from 17.7% to 16.8%; and
- the leverage ratio decreasing from 2.6% to 2.4%.

### Individual Capital Guidance

In November 2016, the Bank received an updated Individual Capital Guidance (ICG), being the PRA's statement as to the regulatory capital (Pillar 1 and Pillar 2a) it expects the Bank to hold.

As at 30 June 2017, the Bank had Pillar 1 requirements equivalent to 8.0% of total RWAs and a Pillar 2a requirement equivalent to 15.0% of total RWAs. Of the total ICG requirement of 23.0% of total RWAs, the Bank must currently meet a minimum of 17.3% with CET1 Capital.

The Bank had insufficient capital resources as at 30 June 2017 to meet its total ICG requirement of £1,457.2m.

### Combined Buffer Compliance

The Bank does not currently meet its ICG and Combined Buffer. Under the Capital Requirements Regulation, failure to meet the Combined Buffer prevents the Bank from making distributions, which includes the payment of dividends and creating an obligation to pay variable remuneration during the period of non-compliance.

### Liquidity

#### Overview

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

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

- manage Retail and corporate deposits to match balance sheet assets and reduce the cost of the liability base;
- ensure the Liquid Asset Buffer predominantly comprises highly liquid securities, allowing for limited reliance on short date secured funding sources;
- maintain the availability of mortgage and other collateral to support the secondary liquidity position; and
- use secured wholesale funding to manage the balance sheet and the Bank's liquidity position.

#### Credit rating

On 15 February 2017, Moody's announced that it had downgraded the Bank's long term senior unsecured rating to Ca from Caa2 with a developing outlook. On 21 February 2017 Fitch downgraded the Bank's long term Issuer Default Rating (IDR) to B- from B with an evolving outlook. Following the announcement of the Restructuring and Recapitalisation on 28 June 2017, Moody's has placed the Bank on review for an upgrade and revised its rating outlook from developing to under review. Fitch has maintained the Bank's rating but downgraded the Viability Rating (VR) from cc to c reflecting its methodology which classifies proposed conversion of subordinated debt as Distressed Debt Exchange.

The current ratings are:

	Long term	Short term
Moody's	Ca	NP
Fitch	B-	B

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

- sub-investment grade ratings on the Bank's senior unsecured debt, leading to a significant reduction in the demand for these types of instrument;
- a negative impact on the Bank's ability to access short term unsecured wholesale funding; and
- heightened collateral requirements within some clearing systems.

### Liquidity portfolio

The Bank's liquidity resources, as at 30 June 2017, were £9.6bn compared to £8.2bn as at 31 December 2016. As at 30 June 2017 the liquid asset ratio was 12.3% (31 December 2016: 13.8%). The Bank continues to hold liquidity in excess of minimum regulatory requirements which is in line with the rest of the industry.

Primary liquidity has decreased over the first half of 2017 by £0.7bn and secondary liquidity has increased by £2.1bn. Primary liquidity consists of liquid assets that are eligible under European Banking Authority (EBA) regulations (high quality liquid assets). The reduction in primary liquidity reflects a combination of Retail and corporate deposit flows and wholesale funding activities. Secondary liquidity comprises liquid unencumbered investment securities not included as part of primary liquidity, as well as other forms of contingent liquidity securities and eligible mortgage collateral. Secondary liquidity is defined as assets (excluding primary liquid assets) that are eligible for central bank facilities or have been specifically created to provide a source of secondary liquidity. The increase in secondary liquidity in 2017 includes the eligibility of Platform originated mortgage portfolio and the creation of the Silk Road Finance Number Four plc (Silk Road 4) securitisation, as well as reflecting a combination of amortisation of assets, sale and management of secured funding collateral requirements and retention of Class A Notes to support the Bank's funding profile.

	As at 30 June 2017 £m	As at 31 December 2016 £m	Change £m
Operational balances with central banks	1,580.2	2,571.4	(991.2)
Gilts	1,095.6	676.2	419.4
Central government and multilateral development bank bonds	408.6	568.5	(159.9)
<b>Total primary liquidity</b>	<b>3,084.4</b>	<b>3,816.1</b>	<b>(731.7)</b>
<b>Total secondary liquidity</b>	<b>6,476.7</b>	<b>4,424.2</b>	<b>2,052.5</b>
<b>Total liquidity</b>	<b>9,561.1</b>	<b>8,240.3</b>	<b>1,320.8</b>

### Retail and corporate funding

The majority of the Bank's funding comes from Retail and corporate accounts. As at 30 June 2017, total customer deposits were £20.9bn compared to £22.4bn as at 31 December 2016.

Customer deposits reduced over the period by £1.5bn, reflecting both targeted deposit reductions and customer withdrawals as a result of the sale and Restructuring and Recapitalisation process. The Bank's strategy is to manage its Retail and corporate deposits to broadly match balance sheet assets and to reduce the cost of liabilities. The reduction in corporate deposits was achieved through the planned withdrawal of fixed rate deposit products and some reductions in credit interest rates. The reduction in Retail deposits in 2017 also reflects lower deposit levels and customer reaction to the Bank's announcements of its sale and capital raise processes and subsequent pricing activity to deliver more positive deposit performance.

	As at 30 June 2017 £m	As at 31 December 2016 £m	Change £m
<b>Current accounts</b>			
Retail	4,099.7	4,229.2	(129.5)
Corporate	1,812.2	2,105.1	(292.9)
<b>Total current accounts</b>	<b>5,911.9</b>	<b>6,334.3</b>	<b>(422.4)</b>
<b>Instant access savings accounts</b>			
Retail	6,030.8	6,384.0	(353.2)
Corporate	335.2	482.4	(147.2)
<b>Total instant access saving accounts</b>	<b>6,366.0</b>	<b>6,866.4</b>	<b>(500.4)</b>
<b>Term deposits and bonds</b>			
Retail	3,739.3	3,947.7	(208.4)
Corporate	79.6	249.2	(169.6)
<b>Total term deposits and bonds</b>	<b>3,818.9</b>	<b>4,196.9</b>	<b>(378.0)</b>
<b>Individual savings accounts (ISA)</b>			
Retail – ISA Fixed	2,430.5	2,491.7	(61.2)
Retail – ISA Demand	2,231.6	2,351.5	(119.9)
<b>Total ISA accounts</b>	<b>4,662.1</b>	<b>4,843.2</b>	<b>(181.1)</b>
Other deposits	143.4	196.1	(52.7)
<b>Total customer deposits</b>	<b>20,902.3</b>	<b>22,436.9</b>	<b>(1,534.6)</b>

### Wholesale funding

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

The decrease in secured funding reflects the Leek 19 securitisation which was called in June 2017. The reduction in Repos largely reflects a normal movement in Gilt Repo volume at June month end.

	As at 30 June 2017 £m	As at 31 December 2016 £m	Change £m
Subordinated debt <sup>1</sup>	478.9	472.6	6.3
Secured funding	732.7	1,197.6	(464.9)
Repos	489.1	990.6	(501.5)
Market borrowing	4.1	4.1	-
MTNs	405.6	405.4	0.2
<b>Total wholesale funding</b>	<b>2,110.4</b>	<b>3,070.3</b>	<b>(959.9)</b>

1. Re-presented to include accrued interest and fair value

Figures are based on nominal values and accrued interest as at 30 June 2017 and 31 December 2016.

### Detailed Bank financial performance

#### Business segment income net of impairment

	Period to 30 June 2017 £m	Re-presented period to 30 June 2016 £m	Change £m
Retail	177.6	188.5	(10.9)
BaCB	27.8	32.5	(4.7)
Treasury	13.5	19.8	(6.3)
Legacy Portfolio	0.4	(1.1)	1.5
Optimum	(7.8)	(14.1)	6.3
Other	(1.2)	14.2	(15.4)
<b>Total income net of impairment</b>	<b>210.3</b>	<b>239.8</b>	<b>(29.5)</b>

Total income net of impairment was £210.3m for the period (H1 2016: £239.8m), a reduction of £29.5m. The key drivers of the segmental changes period-on-period are described below.

The £15.4m reduction in Other income net of impairment includes the non-reoccurrence of one-off net interest income gains relating to prior year subsidiary accounting adjustments of £7.6m in H1 2016 and £7.3m of one-off recoveries against PPI redress and remediation in respect of portfolios previously acquired by the Bank, recognised in non-interest income.

### Retail income net of impairment

	Period to 30 June 2017	Re-presented period to 30 June 2016	Change
	£m	£m	£m
Net interest income	165.9	171.1	(5.2)
Non-interest income	12.2	14.1	(1.9)
<b>Operating income</b>	<b>178.1</b>	<b>185.2</b>	<b>(7.1)</b>
Impairment (losses)/gains on loans and advances	(0.5)	3.3	(3.8)
<b>Income net of impairment</b>	<b>177.6</b>	<b>188.5</b>	<b>(10.9)</b>

	As at 30 June 2017	As at 31 December 2016	Change
	£m	£m	£m
<b>Segment assets</b>	<b>14,683.9</b>	<b>14,844.6</b>	<b>(160.7)</b>
<b>Segment liabilities</b>	<b>18,599.1</b>	<b>19,405.1</b>	<b>(806.0)</b>

Retail income net of impairment has reduced by £10.9m to £177.6m (H1 2016: £188.5m).

The Retail business continued to focus on mortgage new business origination activities in the period, in particular through the Bank's Platform intermediary channel. Mortgage completions have reduced slightly to £1.4bn in the first six months of 2017 compared to £1.5bn in the same period of 2016, with lower originations seen in buy-to-let and direct mortgages. Total mortgage redemptions increased to £1.3bn (H1 2016: £0.7bn). The Bank successfully completed activity to enhance its intermediary mortgage retention capability during the period. The mortgage portfolio, including contractual repayments, had a net decrease of £0.2bn from 31 December 2016.

Retail customer liability balances have reduced by £0.8bn to £18.6bn (31 December 2016: £19.4bn). The Bank's current account volumes have reduced over the period by approximately 25,000, whilst balances have fallen by £0.1bn. The Bank has continued a managed reduction in its fixed term savings products and has also seen some outflows of instant access savings as customers reacted to the Bank's announcement of the potential sale and the Restructuring and Recapitalisation.

Net interest income has seen a £5.2m reduction in H1 2017. This is reflective of a reduction in mortgage margins as a result of strong market competition driving low introductory rates on new business originations and switches. In addition, the base rate reduction in August 2016 has given rise to reduced returns on hedging of non-interest bearing current account balances (and associated transfer pricing credits from the Bank's Treasury business unit) and margin compression has occurred on variable deposits where customer rate reductions were less than the 25bps base rate reduction. H1 2016 included an £17.3m charge in respect of adjustments to the effective interest rate asset following a reduction in interest rate expectations, whilst in H1 2017 similar adjustments amounted to a £4.1m charge.

Retail non-interest income reduced marginally to £12.2m (H1 2016: £14.1m), primarily on current accounts, due to increased expense on the Bank's Everyday Reward account as the number of accounts has increased following the launch in January 2016.

Retail net impairment charge was £0.5m in the period, £3.8m adverse to the same period in 2016, following the non-reoccurrence of £3.3m of releases on the unsecured portfolio in 2016. This was due to reductions in customer loan balances as a result of redress payments made against the outstanding balances, as part of the Consumer Credit Act (CCA) remediation project.

### Business and Commercial Banking (BaCB) income net of impairment

	Period to 30 June 2017	Re-presented period to 30 June 2016	Change
	£m	£m	£m
Net interest income	19.3	26.4	(7.1)
Non-interest income	8.5	6.7	1.8
<b>Operating income</b>	<b>27.8</b>	<b>33.1</b>	<b>(5.3)</b>
Impairment losses on loans and advances	-	(0.6)	0.6
<b>Income net of impairment</b>	<b>27.8</b>	<b>32.5</b>	<b>(4.7)</b>

	As at 30 June 2017	As at 31 December 2016	Change
	£m	£m	£m
<b>Segment assets</b>	<b>354.8</b>	434.9	(80.1)
<b>Segment liabilities</b>	<b>2,155.7</b>	2,719.3	(563.6)

BaCB income net of impairment was £27.8m in H1 2017, a £4.7m reduction on H1 2016.

BaCB customer assets decreased from £434.9m to £354.8m, reflecting net attrition of balances following a planned reduction in new business volumes. As disclosed in the 2016 Annual Report and Accounts, £0.4bn of Private Finance Initiative (PFI) and Renewable Energy and Asset Finance (REAF) assets were transferred from Legacy Portfolio into BaCB in H1 2016.

In H2 2016, following further management review of the go forward SME banking strategy targeting delivery of simple solutions for small business customers focused around savings and current accounts, the PFI and REAF assets were transferred back to Legacy Portfolio. These assets contributed £2.1m of BaCB net interest income in H1 2016 which did not reoccur in BaCB in H1 2017.

Customer liabilities have reduced by £0.6bn from 31 December 2016 to £2.2bn through managed relationship balances as the Bank looks to simplify its product offering to focus on meeting the needs of smaller Business Banking customers, in line with the reviewed SME strategy.

The reduction in both asset and liability volumes, together with margin deterioration on BaCB liabilities following the base rate reduction in August 2016 that were not fully passed on to customers, has given rise to a £7.1m reduction in net interest income against the comparative period.

Non-interest income has increased by £1.8m; this is largely due to £3.0m of Foreign Services (FS) income which was historically included in Legacy Portfolio, as the product offering is largely driven by BaCB customers. Like-for-like income decreased by £1.1m due to a reduction in the balance sheet driving reduced fee income.

#### Treasury income net of impairment

	Period to 30 June 2017	Re-presented period to 30 June 2016	Change
	£m	£m	£m
Net interest (expense)/income	(4.7)	5.5	(10.2)
Non-interest income	18.2	14.3	3.9
<b>Operating income</b>	<b>13.5</b>	19.8	(6.3)
Impairment gains/(losses) on loans and advances	-	-	-
<b>Income net of impairment</b>	<b>13.5</b>	19.8	(6.3)

	As at 30 June 2017	As at 31 December 2016	Change
	£m	£m	£m
<b>Segment assets</b>	<b>5,741.9</b>	7,794.1	(2,052.2)
<b>Segment liabilities</b>	<b>2,940.4</b>	3,741.1	(800.7)

Treasury income net of impairment was £13.5m for H1 2017 compared to £19.8m for the same period in 2016.

Net interest expense was £4.7m in H1 2017 compared to net interest income of £5.5m in H1 2016. The reduction in the base rate in August 2016 has resulted in reduced income from cash, gilts and other assets in the Bank's Liquid Asset Buffer and also income earned on hedging of the Bank's non-interest bearing balances. In addition, the sale of higher yielding assets such as gilts and residential mortgage backed securities (RMBS) has further contributed to reduced income. These factors were partially offset by a reduction in interest expense following the maturity of an RMBS issued by the Bank, together with a reduction in transfer pricing credits transferred to other business units as a result of the reduction in the Bank's balance sheet.

Non-interest income was £18.2m in H1 2017 (H1 2016: £14.3m). Hedge accounting volatility resulted in an increase of £10.1m on the comparative period, primarily reflecting the reduction in basis exposure in the Bank's cash flow hedges. This was however, partially offset by lower levels of recognised gains on disposal of available for sale assets, which reduced from £18.4m in H1 2016 to £11.9m in H1 2017.

#### Legacy Portfolio income net of impairment

	Period to 30 June 2017	Re-presented period to 30 June 2016	Change
	£m	£m	£m
Net interest (expense)/income	(1.8)	0.6	(2.4)
Losses on asset sales	(1.1)	(11.2)	10.1

Non-interest income	0.7	3.9	(3.2)
<b>Operating expense</b>	<b>(2.2)</b>	<b>(6.7)</b>	<b>4.5</b>
Impairment gains on loans and advances	2.6	5.6	(3.0)
<b>Income/(expense) net of impairment</b>	<b>0.4</b>	<b>(1.1)</b>	<b>1.5</b>

	As at 30 June 2017 £m	As at 31 December 2016 £m	Change £m
<b>Segment assets</b>	<b>1,355.7</b>	<b>1,471.4</b>	<b>(115.7)</b>
<b>Segment liabilities</b>	<b>124.0</b>	<b>61.3</b>	<b>62.7</b>

Legacy Portfolio income net of impairment increased from a net expense of £1.1m in H1 2016 to net income of £0.4m in H1 2017.

As disclosed in the 2016 Annual Report and Accounts, £0.4bn of Private Finance Initiative (PFI) and Renewable Energy and Asset Finance (REAF) assets were transferred from Legacy Portfolio into BaCB in H1 2016. In H2 2016, following further management review of the go forward SME Banking strategy targeting delivery of simple solutions for small business customers focused around savings and current accounts, the PFI and REAF assets were transferred back to Legacy Portfolio.

In H1 2017, the income attached to these portfolios is reported in Legacy Portfolio, albeit these assets yield a lower net interest income margin in the Legacy portfolio as a result of the higher average LTP charged on assets in this portfolio versus those in BaCB.

Net interest expense of £1.8m was incurred in H1 2017 (H1 2016: £0.6m net interest income). The net interest expense generated by Legacy assets (after the application of LTP) increased following the continued deleverage of the higher margin assets since H1 2016. The amount of net interest income generated from Legacy liabilities has also reduced following continued run down of the balances compared to H1 2016.

Losses on asset sales reduced by £10.1m to £1.1m (H1 2016: £11.2m) as the volume of Non-core asset deleverage seen in prior periods has decreased, reflecting the Bank's progress in this area.

Non-interest income reduced by £3.2m to £0.7m, reflecting the non-reoccurrence of foreign transaction fee income, which is attributed to BaCB from 1 January 2017.

The net impairment gain for H1 2017 was £2.6m (H1 2016: £5.6m) as the same level of specific and collective provision releases recognised in H1 2016 did not reoccur in the current period.

### Optimum expense net of impairment

	Period to 30 June 2017 £m	Re-presented period to 30 June 2016 £m	Change £m
Net interest expense	(6.5)	(9.6)	3.1
Non-interest expense	(0.6)	1.5	(2.1)
<b>Operating expense</b>	<b>(7.1)</b>	<b>(8.1)</b>	<b>1.0</b>
Impairment losses on loans and advances	(0.7)	(6.0)	5.3
<b>Expense net of impairment</b>	<b>(7.8)</b>	<b>(14.1)</b>	<b>6.3</b>

	As at 30 June 2017 £m	Re-presented as at 31 December 2016 £m	Change £m
<b>Segment assets</b>	<b>2,504.6</b>	<b>2,604.0</b>	<b>(99.4)</b>

Optimum expense net of impairment was £7.8m (H1 2016: £14.1m).

Net interest expense has reduced by £3.1m to £6.5m, which is largely attributable to a reduction in funding costs following redemption of Leek Finance Number Seventeen and Leek Finance Number Eighteen in June 2016 and December 2016 respectively.

The net impairment charge in Optimum has fallen by £5.3m to £0.7m. This improvement is driven by both an additional impairment charge for interest-only balances in H1 2016 that did not reoccur in H1 2017 together with marginal underlying improvements in the book profile and other accounting adjustments.

### Operating expenditure

	Period to 30 June 2017	Re-presented period to 30 June 2016	Change
	£m	£m	£m
Operating expenditure – staff	(82.0)	(97.5)	15.5
Operating expenditure – non-staff	(118.8)	(125.3)	6.5
<b>Total operating expenditure</b>	<b>(200.8)</b>	<b>(222.8)</b>	<b>22.0</b>

Total operating expenditure reduced by £22.0m, from £222.8m in H1 2016 to £200.8m, reflecting the progress against the Bank's cost reduction targets.

### Staff costs

Operating staff costs have reduced by £15.5m to £82.0m (H1 2016: £97.5m), with the Bank benefitting from the ongoing savings associated with branch rationalisation in line with the strategy of a shift to digital for new and existing customers, and other cost saving initiatives including targeted resource reductions during H2 2016. Permanent staff numbers (full time equivalents) have reduced by 897 to 3,313 (H1 2016: 4,210) with associated costs falling by £12.7m. The number of short to medium term specialist contractors, excluding temporary staff, has reduced by half when compared to H1 2016 (falling from 81 to 40 FTE). This reduction is due to increased management focus on reducing proportionally more expensive resource, resulting in lower specialist staff costs of £6.1m, which is a saving of £1.9m when compared to H1 2016. Temporary staff numbers increased from 93 in H1 2016 to 166 in H1 2017 as a method to efficiently meet short-term resourcing requirements. Note these numbers exclude any FTE and associated expenses relating to the Bank's project expenditure and the Redress and Remediation programme.

### Non-staff costs

H1 2017 has seen a net £6.5m reduction in non-staff costs, to £118.8m (H1 2016: £125.3m). The reduction includes £1.7m lower costs relating to the FSCS Levy (reflecting latest guidance from FSCS), the impact of initiatives such as Branch Transformation and other one-off benefits, including provision releases.

### Project expenditure

	Period to 30 June 2017	Period to 30 June 2016	Change
	£m	£m	£m
Operational projects expenditure	(0.9)	(12.2)	11.3
Operational projects depreciation	(7.4)	(7.5)	0.1
<b>Operational projects</b>	<b>(8.3)</b>	<b>(19.7)</b>	<b>11.4</b>
Remediation projects expenditure	(31.8)	(68.2)	36.4
Remediation projects depreciation	(3.0)	(3.1)	0.1
<b>Remediation projects</b>	<b>(34.8)</b>	<b>(71.3)</b>	<b>36.5</b>
Strategic projects expenditure	(5.0)	(33.0)	28.0
Strategic projects depreciation	(5.7)	(1.7)	(4.0)
<b>Strategic projects</b>	<b>(10.7)</b>	<b>(34.7)</b>	<b>24.0</b>
<b>Total Projects expenditure</b>	<b>(53.8)</b>	<b>(125.7)</b>	<b>71.9</b>
<b>Severance</b>	<b>(2.5)</b>	<b>(8.5)</b>	<b>6.0</b>

### Operational projects

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

The charge for the period to 30 June 2017 was £8.3m (H1 2016: £19.7m). This primarily comprises £7.4m of depreciation of previous investments (H1 2016: £7.5m).

### Remediation projects

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

H1 2017 expenditure of £34.8m (H1 2016: £71.3m) includes depreciation of £3.0m (H1 2016: £3.1m). Key projects in the period included: Enterprise Services outsourcing and separation from Co-operative Group expenditure net of provision utilisation for the period of £10.8m; Blue Data Centre Migration (further separating the Bank's IT infrastructure from Co-operative Group) expenditure net of provision utilisation of £7.7m; Core IT (£6.8m); and other smaller projects (£6.5m) for ongoing remediation activities.

The primary driver for the £36.5m reduction in H1 2017 remediation expenditure relative to H1 2016 is due to reduced spend on Enterprise Services of £28.1m net of provisions, lower Data and Reporting project expenditure (£10.9m) and other smaller projects (£5.2m). This has been partially offset by the commencement of Blue Data Centre Migration (£7.7m).

### Strategic projects

Strategic projects relate to those projects that are transformational in nature and deliver significant cost or income benefits to the business.

H1 2017 strategic project expenditure was £10.7m (H1 2016: £34.7m), primarily driven by depreciation of previous investments of £5.7m (H1 2016: £1.7m), together with smaller projects (£4.4m), including residual investment in the Bank's digital capability.

The £24.0m reduction in H1 2017 strategic expenditure compared to H1 2016 is driven by the delivery of Branch Transformation 2016 (£9.8m), End-to-end Loan Processing, which is no longer being progressed (£5.7m), reduced Digital activity (£5.5m) and cessation of spend on Mortgage outsourcing (£3.5m). A further reduction of £3.5m relates to smaller projects, offset by an increase of £4.0m of depreciation for previous investments.

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

### Conduct (charges)/releases

	Period to 30 June 2017 £m	Period to 30 June 2016 £m	Change £m
CCA	-	10.7	(10.7)
PPI Redress	(9.2)	(33.5)	24.3
Mortgages	3.4	0.9	2.5
Other	1.1	0.8	0.3
<b>Total</b>	<b>(4.7)</b>	<b>(21.1)</b>	<b>16.4</b>

The H1 2017 charges relating to conduct risk were £4.7m (H1 2016: £21.1m).

PPI complaint volumes in H1 2017 increased due to increased publicity and the publication of the FCA policy statement PS17/03 which introduced new requirements to contact customers whose PPI complaints had previously been rejected and that fall under the scope of the Plevin ruling. These factors have led to a charge of £9.2m for PPI (£3.9m redress; £5.3m delivery costs). Key uncertainties remain, including the impact of the FCA time bar and associated consumer communication campaign which commences on 29 August 2017, and the impact of the Judicial Review by claims management company 'We Fight Any Claim Ltd' on the implementation of the FCA's proposals in PS17/03.

Work completed in H1 2017 on conduct issues relating to mortgages has resulted in a net release of £3.4m as a result of more accurate data on the number of customers in scope and the redress due for each customer. The FCA has published its final guidance on auto capitalisation of arrears payments and work has commenced planning remediation in line with the guidance and FCA deadline that remediation should be completed by 30 June 2018.

The scope of work to design and implement changes to make Bank systems CCA compliant has increased and is now expected to be completed in H2 2017. However, the anticipated redress required to complete the programme has reduced compared to previous expectations, following earlier than planned implementation of some of the system fixes, lower than forecast volume of accounts requiring redress and lower average redress per customer. As a result there was no net charge or release for CCA in H1 2017.

### Outlook

This outlook should be read in conjunction with the Principal Risks and Uncertainties section, the Going Concern disclosures in note 1 of the financial statements and the Forward Looking Statements section on page 3.

As previously noted in this Detailed Financial Review, the Bank has made substantial progress towards completion of the Restructuring and Recapitalisation which is expected to generate approximately £700m of additional CET1 before transaction costs, and position the Bank to be able to meet regulatory capital requirements and loss absorbing capacity in full in the medium to long term.

As part of the Restructuring and Recapitalisation process the Bank has prepared a 2017 May Outlook. The key assumption changes from the Plan are as follows:

- the amount of the capital raise as part of the Restructuring and Recapitalisation and the costs incurred through the process;
- future interest rate expectations;
- updated phasing of project costs;
- balance sheet funding assumptions;
- RWAs of c.£5-£5.5bn in the final years of the Plan;
- potential for dividend in 2021 (subject to regulatory capital requirements, including CRR Maximum Distributable Amount restrictions on dividends and distributions, PRA approval and the availability of distributable reserves, which is expected to require shareholder and court approved reduction in share capital);
- a regulatory call of securities issued by Calico Finance Number One Designated Activity Company (Calico) and subsequent deleveraging of c.£2bn of Optimum assets; and
- revised future Pillar 2a and Pillar 2b capital requirements, including the impact of Pace sectionalisation.

As a result the Bank is now targeting:

2016 reported	2017 outlook	Assuming completion of capital raising <sup>1</sup>	Longer term targets <sup>2</sup>
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<b>Balance sheet</b>				
Retail and Business Banking customer assets	£15.3bn	Broadly flat		c.£1bn net growth p.a.
Other assets	£12.3bn	c.£10bn		Reduce with Legacy Portfolio run-off
<b>Income statement</b>				
NIM <sup>3</sup>	1.39%	1.35-1.40%		Increasing from 2018, with increasing base rates, up to 10bps p.a.
Non-interest income	£67m	c.£50m		c.£40m p.a.
Operating costs	(£445)m	c.(£410)m		c.(£350m) p.a. targeted from the end of 2018 onwards
Project costs	(£310)m	c.(£100)m		c.(£120m) in 2018, run rate of c.(£50m) over the medium term
FV unwind	(£181)m	c.(£50)m		-
Profitability (post-tax)	(£419)m	£(225)m to £(250)m <sup>4</sup>		Sustainable profitability in the medium term <sup>5</sup>
RoE <sup>6</sup>	n.m.	n.m.		Mid-single digit in 2021 <sup>7</sup> with material progress by 2019
<b>Capital</b>				
RWAs	£6.7bn	c.£5.5bn		c.£5-5.5bn in the final years of the Plan
CET1 ratio	11.0%	22-23%		c.25% which will comply with all regulatory requirements
Pillar 2a and ICG	14.5%	Tier 1 <sup>8</sup> ICG compliance	Full ICG <sup>9</sup> compliance with c.£250m Tier 2 issuance <sup>10</sup> in 2018. End state Pillar 2a of approximately 8.5%	
Excess capital	n.m.	n.m.		PRA Buffer <sup>9</sup> compliance in 2019, potential for 2021 dividend <sup>11</sup>
MREL	n.m.	n.m.		MREL <sup>12</sup> issuance <sup>10</sup> in 2020/21. Meet interim MREL from 1 January 2020.

<sup>1</sup>For significant execution risks and material uncertainties regarding successful completion of the capital raising, which may not be completed on acceptable terms, or at all, see the Risk Factors section included on the Bank's website (<http://www.co-operativebank.co.uk/investorrelations>).

<sup>2</sup>This replaces all previous guidance.

<sup>3</sup>Calculated based on average total assets.

<sup>4</sup>Adjusted loss forecast excludes the one-off income statement transactional impact.

<sup>5</sup>Assuming utilisation of a significant amount of deferred tax assets.

<sup>6</sup>Profit after tax over average total equity.

<sup>7</sup>Based on a capital stack that meets all capital requirements.

<sup>8</sup>Equivalent to 75% ICG (75% is equal to Tier 1 requirements, made up of not less than 56% CET1 capital and maximum 19% Additional Tier 1 (AT1) capital) to be met with CET1 capital as the Bank has no AT1 capital.

<sup>9</sup>Based on the Bank's internal assessment of future Pillar 2a and 2b requirements. Subject to future Supervisory Review and Evaluation Process (SREP).

<sup>10</sup>Tier 2 and MREL issuances assume successful capital raising, Bank credit rating improvement and conducive capital markets. Issuances may not be completed, when required, on acceptable terms, or at all.

<sup>11</sup>Subject to regulatory capital requirements, including CRR Maximum Distributable Amount restrictions on dividends and distributions, PRA approval and the availability of distributable reserves, which is expected to require shareholder and court approved reduction in share capital.

<sup>12</sup>Per statement of policy on the Bank of England's approach to setting MREL (November 2016).

(<http://www.bankofengland.co.uk/financialstability/Documents/resolution/mrelpolicy2016.pdf>).

The forward-looking targets set out in the table above are not statements of historical fact nor are they guarantees of future performance. Rather, they are based on current management views and assumptions that involve known and unknown risks, uncertainties and other factors that are subject to change and may cause the actual results, performance, achievements or developments of the Bank or the industry in which it operates to differ materially from any targeted or expected future results, performance, achievements or developments expressed or implied from the forward-looking statements.

For more information regarding these targets and the assumptions underlying them, please read Section 9 (The Bank's Outlook and Longer Term Targets and Expectations) of Part 7 (Operating and Financial Review) of the Shareholder and Members' Scheme Circular, including the Principal Assumptions and Risks relating to each target, published on the Bank's website at <http://www.co-operativebank.co.uk/investorrelations>.

For more information regarding the risks and uncertainties that may cause the actual results to differ materially from the targets, please read the Risk Factors at <http://www.co-operativebank.co.uk/investorrelations>.

## PRINCIPAL RISKS AND UNCERTAINTIES

This section summarises the principal risks and uncertainties facing the Bank. This summary should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties facing the Bank. The risk factors which are considered by the Bank to be material to it are discussed in more detail in the Risk Factors document included at <http://www.co-operativebank.co.uk/investorrelations> (the Risk Factors), published in connection with the proposed Restructuring and Recapitalisation of the Bank. This summary and the Risk Factors update and supersede the Principal Risks and Uncertainties set out on pages 35 to 48 of the Bank's 2016 Annual Report and Accounts dated 9 March 2017.

Since 13 February 2017, there have been significant developments as described in the Detailed Financial Review Outlook section of this document that have affected the Bank's outlook for its business and the prospects of, and principal risks and uncertainties relating to, achieving some of the key components of the Plan. The principal risks and uncertainties for the remaining months of the financial year include risks

relating to:

- the successful execution of the Restructuring and Recapitalisation;
- the failure to deliver the Plan and achieve the aims and targets contained in the Plan and the 2017 May Outlook;
- CRR, ICG, PRA buffer non-compliance and other regulatory risks;
- action the Authorities may take at any time, irrespective of whether the Restructuring and Recapitalisation is successful;
- the need to reduce the Bank's high cost:income ratio and implement the cost reduction initiatives;
- pensions and sectionalisation;
- separation from Co-operative Group;
- the Bank not achieving sustainable profitability in the medium term and shareholders not receiving dividends in the near term, or at all;
- the Bank's dependence on proper functioning of IT and communications systems, third party outsourcing contracts for critical infrastructure and cyber security risks;
- the Bank's Risk Management Framework, reliance on manual processes and intervention, data management and protection; and
- changes in interest rates, the supply and affordability of housing and other macroeconomic and market risks.

Further details of some of the above principal risks and uncertainties, including those relating to the successful execution of the Restructuring and Recapitalisation of the Bank, the objectives in the Plan and the 2017 May Outlook and Bank's Going Concern statement are included in Note 1 to the Bank's Interim Financial Statements in this document.

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

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.

The Bank's Risk Appetite is translated into specific risk measures which are tracked, monitored and reported to the appropriate risk committees of the Bank and the Board. The Bank's Risk Appetite framework has been designed to create clear links to the Bank's strategic planning process whereby appropriate metrics and limits for each risk category are clearly established, calibrated and reported.

The Bank has an established Risk Management Framework which is defined within the Risk Management Framework Policy which has established principles for managing risk throughout the organisation. It sets out the principles by which the Bank defines the risk taxonomy, and identifies processes, ownership, responsibilities and the risk oversight required to support effective implementation across the Bank.

There are four main constituent risk types that cover all the risks within the Bank's principal risks framework:

Principal Risk <sup>1</sup>	Definition	Risk Taxonomy		
<b>Capital</b>	The risk that the Bank's regulatory capital is inadequate to cover its capital requirements.	<ul style="list-style-type: none"> <li>• Credit</li> <li>• Model</li> </ul>	<ul style="list-style-type: none"> <li>• Market</li> <li>• Pension</li> </ul>	<ul style="list-style-type: none"> <li>• Strategic</li> <li>• Operational</li> </ul>
<b>Operational (Subset of Capital)</b>	The risk of loss resulting from inadequate or failed internal processes, people and systems or external events.	<ul style="list-style-type: none"> <li>• Regulatory</li> <li>• Conduct</li> <li>• Product</li> <li>• Fraud</li> <li>• AML</li> <li>• Financial Reporting</li> <li>• Information and Data</li> </ul>	<ul style="list-style-type: none"> <li>• Payments</li> <li>• Legal</li> <li>• Technology</li> <li>• Change</li> <li>• People</li> <li>• Third Party</li> <li>• Supplier</li> </ul>	<ul style="list-style-type: none"> <li>• Physical Assets (including Health and Safety)</li> <li>• Insurance</li> <li>• Business Continuity</li> </ul>
<b>Liquidity and funding</b>	The risk that the Bank is unable to meet its obligations as they fall due or can only do so at excessive cost.			
<b>Reputational</b>	The risk of damage to how the Bank's reputation, brand or image is perceived by its internal or external stakeholders as a result of its conduct, performance, or the impact of operational failures or other external issues.			

<sup>1</sup> Full details of the Risk Management Framework and Principal Risks are available in the 2016 Annual Report and Accounts.

## RESPONSIBILITY STATEMENT

We confirm that to the best of our knowledge:

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

changes in the related party transactions described in the last annual report that could do so.

By Order of the Board

**Liam Coleman**  
Chief Executive

**John Worth**  
Chief Financial Officer

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

<b>Dennis Holt</b>	Chairman
<b>Liam Coleman</b>	Chief Executive Officer
<b>John Worth</b>	Chief Financial Officer
<b>Aidan Birkett</b>	Senior Independent Director
<b>Alistair Asher</b>	Non-Executive Director
<b>Charles Braalver</b>	Non-Executive Director
<b>Laura Martine Carstensen</b>	Non-Executive Director
<b>Maureen Laurie</b>	Non-Executive Director
<b>Glyn Michael Smith</b>	Non-Executive Director
<b>William Gennydd Thomas</b>	Non-Executive Director
<b>Derek James Weir</b>	Non-Executive Director

## **RISK MANAGEMENT**

### **1. Risk management objectives and policies**

#### **1.1 Overview**

The Bank has a formal structure for identifying, reporting, monitoring and managing risks. This comprises, at its highest level, Risk Appetite statements which are set and approved by the Board and are supported by granular Risk Appetite measures across the Bank's principal risk categories. This is underpinned by a Risk Management Framework (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 first half of 2017 the Bank made significant progress with the formal RMF embedding programme which focused on aligning roles and responsibilities between the 1st and 2nd Lines of defence, updating the Bank's policy framework and the Bank's committee structure. The programme has transitioned to business as usual management and focus remains on maintaining risk management within the Bank, building on the progress already made and developing the RMF further through defined evolution plans.

Material risks and issues, whether realised or emerging, inclusive of those observed in relation to the RMF itself are detailed within the Principal Risks and Uncertainties.

#### **1.2 Approach to risk management**

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 model which is outlined below:

- 1st Line of defence - The Bank's business teams are the Risk Owner (RO) and sit within the 1st Line of defence with the exception of Model Risk where the ROs are the specific model owners which can reside in 2nd Line. ROs are responsible for owning and managing all risks within the business to defined appetites, ensuring supporting procedures are written, and are responsible for reporting the performance, losses, near misses and status of risks through governance. ROs are also responsible for the design, maintenance and testing of the control environment.
- 2nd Line of defence - The Bank's Compliance and Risk functions act as the 2nd Line of defence. The Risk Framework Owners (RFOs) generally sit within the 2nd Line of defence and, where there are exceptions for some specialist areas and the RFO sits within 1st Line of defence (specifically Legal, Financial Reporting and People Risk), the 2nd line Risk Function will provide oversight over the RFO activities. RFOs are accountable for ensuring there is an appropriate risk framework, oversight activity, challenging and monitoring the implementation of the risk framework and underlying Policies and Control Standards.
- 3rd Line of defence - The Bank's Internal Audit function assesses the adequacy and effectiveness of the Bank's control environment and independently challenges the overall management of the RMF.

#### **1.3 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 Risk Appetite which defines the type and amount of risk 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 the Board to understand the impact of potentially severe risks to ensure the Bank remains resilient to them.

The Bank's Risk Appetite is translated into specific risk measures which are tracked, monitored and reported to the appropriate risk committees of the Bank. The Bank's Risk Appetite framework has been designed to create clear links to the Bank's strategic planning process whereby appropriate metrics and limits for each risk category are clearly established, calibrated and reported.

## 2. Credit risk

### 2.1 Overview and credit exposure

Credit Risk is managed through a framework that sets out policies and procedures covering both its measurement and management and aligned to the Bank's RMF. There is a clear segregation of duties between transaction originators in the businesses and approvers in the Risk function. All credit exposure limits are approved within a defined credit approval authority framework. The Bank manages its credit exposures through diversification across products, geographies, client and customer segments.

The following analysis of credit exposure shows:

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

Cash and balances at central banks are credit exposures with the Bank of England and have been excluded from the analysis. Impaired and not impaired balances in the tables below are defined in the following sections on Retail credit risk, corporate credit risk and investment securities credit risk. All amounts are stated in £m unless otherwise indicated. All comparatives are 31 December 2016 unless otherwise stated.

	Loans and advances to banks	Loans and advances to customers	Investment securities	Derivative financial instruments	Total
<b>As at 30 June 2017</b>					
<b>Analysis of balance in notes</b>		8	9		
Gross balance	1,081.8	19,028.8	2,500.0	285.7	22,896.3
Less: allowance for losses	-	(95.1)	-	-	(95.1)
	1,081.8	18,933.7	2,500.0	285.7	22,801.2
<b>Analysis of credit risk exposure</b>					
Not impaired	1,081.8	18,413.1	2,500.0	285.7	22,280.6
Impaired	-	615.7	-	-	615.7
	1,081.8	19,028.8	2,500.0	285.7	22,896.3
Credit commitments (incl. derivative and financial guarantees)	-	2,443.5	-	-	2,443.5
<b>Gross credit risk exposure</b>	1,081.8	21,472.3	2,500.0	285.7	25,339.8
Less: Allowance for losses	-	(95.1)	-	-	(95.1)
<b>Net credit risk exposure</b>	1,081.8	21,377.2	2,500.0	285.7	25,244.7

	Loans and advances to banks	Loans and advances to customers	Investment securities	Derivative financial instruments	Total
<b>As at 31 December 2016 (Restated<sup>1</sup>)</b>					
<b>Analysis of balance in notes</b>		8	9		
Gross balance	836.9	19,575.0	3,551.9	425.5	24,389.3
Less: allowance for losses	-	(122.3)	-	-	(122.3)
	836.9	19,452.7	3,551.9	425.5	24,267.0
<b>Analysis of credit risk exposure</b>					
Not impaired <sup>1</sup>	836.9	18,871.5	3,551.9	425.5	23,685.8
Impaired <sup>1</sup>	-	703.5	-	-	703.5
	836.9	19,575.0	3,551.9	425.5	24,389.3
Credit commitments (incl. derivative and financial guarantees)	-	2,441.7	-	-	2,441.7
Gross credit risk exposure	836.9	22,016.7	3,551.9	425.5	26,831.0
Less: Allowance for losses	-	(122.3)	-	-	(122.3)
<b>Net credit risk exposure</b>	836.9	21,894.4	3,551.9	425.5	26,708.7

<sup>1</sup> Restated for change in Secured residential forbearance definition (see Forbearance section).

### 2.2 Credit risk management

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

- 2.2.1 Loans and advances to customers;
- 2.2.2 Investment securities;
- 2.2.3 Loans and advances to banks;
- 2.2.4 Derivative financial instruments; and
- 2.2.5 Wholesale credit risk.

#### 2.2.1 Loans and advances to customers

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

Secured residential credit risk, Retail Unsecured credit risk and Corporate credit risk are all based on the gross customer balances in the below tables (unless otherwise noted).

The Bank's exposures are predominantly within the UK and so any geographic analysis is only UK based. At 30 June 2017 the amount of overseas exposure was £71.5m (2016: £95.0m), split across corporate (£46.3m) and unsecured (£25.2m). This represents 0.3% (2016: 0.4%) of the total credit risk exposure.

Other accounting adjustments include accrued interest, interest fair value adjustments, effective interest rate adjustments and Britannia merger fair value Lifetime Expected Losses (LEL). The value of the LEL represents a difference in the externally reported level of impairment against the gross impairment calculated by Credit Risk. The LEL is an accounting adjustment and Credit Risk manages these assets on a gross customer balance basis. Only the Optimum LEL adjustment now remains and this continues to reduce in scale with the run off of the portfolio.

As at 30 June 2017	Secured residential		Unsecured	Corporate		Total
	Retail Secured	Optimum		BaCB	Legacy Portfolio	
<b>Analysis of balance in note 8</b>						
Gross loans and advances	14,095.8	2,498.7	631.9	389.4	1,413.0	19,028.8
Less: allowance for losses	(4.4)	(11.9)	(39.3)	(0.9)	(38.6)	(95.1)
	14,091.4	2,486.8	592.6	388.5	1,374.4	18,933.7
<b>Analysis of credit risk exposure</b>						
Not impaired	13,941.2	2,227.4	582.7	370.3	1,291.5	18,413.1
Impaired	154.6	271.3	49.2	19.1	121.5	615.7
	14,095.8	2,498.7	631.9	389.4	1,413.0	19,028.8
Credit commitments (incl. derivative and financial guarantees)	574.8	-	1,562.6	119.0	187.1	2,443.5
<b>Gross credit risk exposure</b>	<b>14,670.6</b>	<b>2,498.7</b>	<b>2,194.5</b>	<b>508.4</b>	<b>1,600.1</b>	<b>21,472.3</b>
Less: Allowance for losses	(4.4)	(11.9)	(39.3)	(0.9)	(38.6)	(95.1)
<b>Net credit risk exposure</b>	<b>14,666.2</b>	<b>2,486.8</b>	<b>2,155.2</b>	<b>507.5</b>	<b>1,561.5</b>	<b>21,377.2</b>
<b>Reconciliation of accounting to customer balances</b>						
Gross loans and advances	14,095.8	2,498.7	631.9	389.4	1,413.0	19,028.8
Accounting adjustments	(143.7)	16.1	(21.6)	(38.4)	(22.8)	(210.4)
<b>Gross customer balances</b>	<b>13,952.1</b>	<b>2,514.8</b>	<b>610.3</b>	<b>351.0</b>	<b>1,390.2</b>	<b>18,818.4</b>

As at 31 December 2016 (Restated <sup>1</sup> )	Secured residential		Unsecured	Corporate		Total
	Retail Secured	Optimum		BaCB	Legacy Portfolio	
<b>Analysis of balance in note 8</b>						
Gross loans and advances	14,215.1	2,618.3	710.0	499.0	1,532.6	19,575.0
Less: allowance for losses	(3.7)	(12.5)	(57.6)	(1.0)	(47.5)	(122.3)
	14,211.4	2,605.8	652.4	498.0	1,485.1	19,452.7
<b>Analysis of credit risk exposure</b>						
Not impaired <sup>1</sup>	14,045.1	2,321.8	638.6	469.6	1,396.4	18,871.5
Impaired <sup>1</sup>	170.0	296.5	71.4	29.4	136.2	703.5
	14,215.1	2,618.3	710.0	499.0	1,532.6	19,575.0
Credit commitments (incl. derivative and financial guarantees)	459.9	-	1,621.8	142.7	217.3	2,441.7
<b>Gross credit risk exposure</b>	<b>14,675.0</b>	<b>2,618.3</b>	<b>2,331.8</b>	<b>641.7</b>	<b>1,749.9</b>	<b>22,016.7</b>
Less: Allowance for losses	(3.7)	(12.5)	(57.6)	(1.0)	(47.5)	(122.3)
<b>Net credit risk exposure</b>	<b>14,671.3</b>	<b>2,605.8</b>	<b>2,274.2</b>	<b>640.7</b>	<b>1,702.4</b>	<b>21,894.4</b>
<b>Reconciliation of accounting to customer balances</b>						
Gross loans and advances	14,215.1	2,618.3	710.0	499.0	1,532.6	19,575.0
Accounting adjustments	(77.6)	17.1	(12.9)	(36.0)	(23.4)	(132.8)
<b>Gross customer balances</b>	<b>14,137.5</b>	<b>2,635.4</b>	<b>697.1</b>	<b>463.0</b>	<b>1,509.2</b>	<b>19,442.2</b>

<sup>1</sup>Restated for change in Secured residential forbearance definition (see Forbearance section).

### Secured residential mortgage credit risk

The secured residential mortgage book comprises two portfolios:

- Retail – these are prime mortgages originated direct (via telephone/internet/branch) under the Britannia and The Co-operative brands, and via intermediaries under the Platform brand. All new completions are in this portfolio.
- Optimum – a closed book of predominantly interest only intermediary and acquired residential mortgage books. These loans include a range of asset types, including prime residential (both income verified and self-certified), buy-to-let and non-conforming mortgages. The book was closed in 2009 and has been in run off since that point leaving a balance of £2.5bn as at 30 June 2017.

## Acquisition and account management

Mortgages are loans to customers secured by a first charge over a residential property. Mortgages are originated directly to customers via branches, telephone and the internet under the Britannia and The Co-operative Bank brands, and via intermediaries under the Platform brand. In the period to 30 June 2017, 6.5% (2016: 12.5%) of mortgages were originated directly and 93.5% (2016: 87.5%) through intermediaries.

The Britannia and The Co-operative Bank brands only originate prime residential mortgages, while Platform currently originates a combination of prime residential and buy-to-let loans. Historically, these loans have been advanced on a capital and interest payment basis, where the loan is repaid over the term of the loan, or interest only, where the capital element of the loan is repayable at the end of the term. All new advances are on a capital repayment basis, with the exception of buy-to-let lending and existing interest only loans for customers moving home.

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

The table below shows residential mortgage completions in the period (including cases where customers have ported their mortgage from one property to another), analysed by loan-to-value (LTV) and repayment method.

	Period to 30 June 2017			Year to 31 December 2016		
	Amount advanced	Average LTV %	Interest only %	Amount advanced	Average LTV %	Interest only %
Retail direct residential prime	93.5	56.0	2.1	396.9	60.2	0.7
Platform residential prime	1,268.8	69.0	-	2,347.2	69.1	-
Total prime	1,362.3	67.9	0.1	2,744.1	67.8	0.1
Buy-to-let	75.5	62.0	83.2	439.6	65.1	91.7
<b>Total completions (including ports)</b>	<b>1,437.8</b>	<b>67.4</b>	<b>4.5</b>	<b>3,183.7</b>	<b>67.4</b>	<b>12.7</b>

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

## Portfolio analysis

The following tables show the Retail and Optimum total customer balances by a number of key risk measurements. Overall, the Retail and Optimum books have benefited from the impact of positive HPI changes resulting in reduced LTVs. However, the Retail book has been impacted by the new completions through Platform which has offset the impact of improved HPI movements as the new origination LTVs are of a higher value. Overall, the book has shown a slight decrease in overall value of £0.3bn, partly due to the natural run off of the closed Optimum book and lower net lending in London and the South East.

The table below shows gross customer balances split by indexed LTV bandings; with interest only including mortgages on a part-repayment/part-interest basis:

LTV %	As at 30 June 2017				Total
	Retail secured		Optimum		
	Capital Repayment	Interest only	Capital Repayment	Interest only	
Less than 50%	4,583.6	1,509.1	178.8	407.0	6,678.5
50% to 60%	1,728.0	599.4	75.3	449.2	2,851.9
60% to 70%	1,983.1	569.3	57.3	456.8	3,066.5
70% to 80%	1,623.6	157.5	27.6	417.2	2,225.9
80% to 90%	1,035.8	46.5	5.9	293.2	1,381.4
90% to 100%	87.7	17.1	0.7	100.8	206.3
Greater than 100%	2.4	9.0	0.7	44.3	56.4
	<b>11,044.2</b>	<b>2,907.9</b>	<b>346.3</b>	<b>2,168.5</b>	<b>16,466.9</b>

LTV %	As at 31 December 2016				Total
	Retail secured		Optimum		
	Capital Repayment	Interest only	Capital Repayment	Interest only	
Less than 50%	4,773.2	1,641.1	177.0	389.6	6,980.9
50% to 60%	1,776.5	660.4	76.3	465.8	2,979.0
60% to 70%	1,923.0	599.9	70.8	475.0	3,068.7
70% to 80%	1,563.6	195.8	37.5	439.0	2,235.9
80% to 90%	829.5	58.0	8.5	312.8	1,208.8
90% to 100%	79.3	25.4	1.2	137.9	243.8
Greater than 100%	3.1	8.7	0.7	43.3	55.8
	<b>10,948.2</b>	<b>3,189.3</b>	<b>372.0</b>	<b>2,263.4</b>	<b>16,772.9</b>

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

	As at 30 June 2017					
	Retail secured			Optimum		
	Gross customer balance	Average LTV %	Interest only %	Gross customer balance	Average LTV %	Interest only %
Prime residential	12,717.2	51.6	14.3	161.5	65.3	85.1
Buy-to-let	1,160.2	57.0	89.7	867.6	61.2	95.0
Self-certified	49.4	38.6	89.4	724.8	61.6	87.4
Almost prime	24.2	40.2	34.0	402.4	72.3	78.6
Non-conforming	1.1	53.0	53.3	358.5	58.9	71.8
	<b>13,952.1</b>	<b>52.0</b>	<b>20.9</b>	<b>2,514.8</b>	<b>63.0</b>	<b>86.2</b>

  

	As at 31 December 2016					
	Retail secured			Optimum		
	Gross customer balance	Average LTV %	Interest only %	Gross customer balance	Average LTV %	Interest only %
Prime residential	12,802.8	50.5	15.7	172.1	66.2	84.6
Buy-to-let	1,254.3	57.2	89.8	903.7	62.0	94.8
Self-certified	52.7	38.3	88.2	759.7	62.2	87.2
Almost prime	26.5	40.9	32.7	422.6	73.2	78.2
Non-conforming	1.2	52.4	47.7	377.3	59.8	71.2
	<b>14,137.5</b>	<b>51.1</b>	<b>22.6</b>	<b>2,635.4</b>	<b>63.8</b>	<b>85.9</b>

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

	As at 30 June 2017		As at 31 December 2016	
	Retail secured	Optimum	Retail secured	Optimum
London and South East	6,090.3	1,122.9	6,173.4	1,182.8
Northern England	2,722.8	566.7	2,750.8	590.4
Midlands and East Anglia	2,808.9	405.8	2,866.3	423.8
Wales and South West	1,628.4	249.5	1,657.6	262.3
Other	701.7	169.9	689.4	176.1
<b>Total</b>	<b>13,952.1</b>	<b>2,514.8</b>	<b>14,137.5</b>	<b>2,635.4</b>

The London and South East is the main geographic value of the book. However, its LTV values are better than the rest of the book. London and the South East have:

- 94.5% of the Retail book with an LTV below 80% compared to 91.4% for the whole book; and
- 99.4% of the Optimum book with an LTV below 80% compared to 82.3% for the whole book.

The differential has remained broadly the same since the year end.

### Impairment

Where objective evidence of impairment has been observed as a result of one or more loss events, the impairment held at the balance sheet date is defined as identified impairment.

Loans under forbearance are subject to a specific identified impairment assessment. Loans where no objective evidence has been observed are collectively assessed for unidentified impairment (i.e. where a loss event has occurred, but objective evidence of impairment has not yet been identified).

The table shown below reports coverage ratios calculated using:

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

	As at 30 June 2017		As at 31 December 2016 (Restated)	
	Retail secured	Optimum	Retail secured	Optimum
<b>Gross loans and advances<sup>1</sup></b>	<b>14,095.8</b>	<b>2,498.7</b>	14,215.1	2,618.3
of which impaired <sup>2</sup>	154.6	271.3	170.0	296.5
Impaired as a % of gross loans and advances	1.1%	10.9%	1.2%	11.3%
Allowance for losses	4.4	11.9	3.7	12.5



Interest only switches	0.2	-	0.2	-	0.2	0.6	0.8	-
Capitalisations	-	-	-	-	-	0.2	0.2	-
Term expired	32.1	3.6	35.7	0.5	29.7	5.7	35.4	1.6
Payment holiday	2.1	0.3	2.4	-	2.4	0.4	2.8	-
Deceased grace period	1.3	1.1	2.4	-	1.8	0.1	1.9	-
	<b>54.6</b>	<b>85.8</b>	<b>140.4</b>	<b>4.8</b>	51.6	90.4	142.0	6.4

The categorisation of forbearance has been further amended during 2017 as a scheduled review progresses. A restatement of the position as at 31 December 2016 has been made to allow direct comparison. The main differences are i) removal of the majority of term extensions from forbearance as they were product switches and not concessions due to financial difficulty; and ii) a small change in allocation to remaining classifications for accounts no longer marked as term extension as their lead forbearance type. This has reduced the Retail Secured impaired balance from £184.7m to £170.0m and Optimum has reduced by £1.0m from £297.5m to £296.5m.

Retail forbearance balances have decreased by £9.9m (9.7%) since 31 December 2016 primarily due to a reduction in term expiry and payment holiday solutions.

Optimum forbearance balances have decreased by £1.6m (1.1%) since 31 December 2016 primarily due to a reduction in interest only switches and payment holiday arrangements, balanced by an increase in the bereavement grace period balances.

Overall, reductions in levels of arrangements and concessions across the Retail portfolio are in line with the reduction in balances for the portfolio as a whole.

### Exposure at Default and Risk Weighted Assets

The following tables provide an analysis of the Exposure at Default (EAD) and EAD pre Credit Conversion Factor (CCF), Risk Weighted Assets (RWAs) by risk grade including Probability of Default (PD) and Loss Given Default (LGD):

#### As at 30 June 2017

Internal grades	PD range	Exposure value pre-CCF	Exposure at default	Average PD	Average LGD	RW	RWA
	%	£m	£m	%	%	%	£m
<b>Retail secured by immovable property</b>							
1	0.00 to 0.04	2,216.6	2,272.1	0.04%	6.4%	0.7%	16.1
2	0.04 to 0.07	2,691.9	2,757.9	0.06%	8.7%	1.6%	44.1
3	0.07 to 0.31	2,671.7	2,730.5	0.16%	10.1%	3.6%	97.0
4	0.31 to 1.00	4,969.7	5,072.9	0.53%	11.7%	10.4%	525.8
5	1.00 to 3.00	2,031.9	2,076.0	1.54%	15.3%	28.1%	582.9
6	3.00 to 15.32	236.2	241.9	7.42%	15.5%	61.3%	148.3
7	15.32 to 99.99	662.8	613.5	37.26%	6.9%	20.1%	123.4
8	100.00	198.7	198.9	100.00%	16.9%	185.1%	368.1
<b>Total Retail secured by immovable property</b>		<b>15,679.5</b>	<b>15,963.7</b>	<b>3.20%</b>	<b>10.6%</b>	<b>11.9%</b>	<b>1,905.7</b>

#### As at 31 December 2016

Internal grades	PD range	Exposure value pre-CCF	Exposure at default	Average PD	Average LGD	RW	RWA
	%	£m	£m	%	%	%	£m
<b>Retail secured by immovable property</b>							
1	0.00 to 0.04	2,351.3	2,410.6	0.04%	6.4%	0.7%	17.4
2	0.04 to 0.07	3,005.2	3,079.1	0.06%	8.8%	1.7%	51.3
3	0.07 to 0.31	2,644.6	2,705.3	0.16%	10.2%	3.7%	100.5
4	0.31 to 1.00	4,685.9	4,786.4	0.53%	11.4%	10.4%	499.1
5	1.00 to 3.00	2,090.8	2,137.9	1.55%	14.5%	29.3%	627.4
6	3.00 to 15.32	260.4	266.7	7.23%	15.7%	76.0%	202.8
7	15.32 to 99.99	563.5	525.3	30.81%	7.4%	29.6%	155.3
8	100.00	213.0	213.1	100.00%	17.2%	250.1%	532.9
<b>Total Retail secured by immovable property</b>		<b>15,814.7</b>	<b>16,124.4</b>	<b>2.85%</b>	<b>10.4%</b>	<b>13.6%</b>	<b>2,186.7</b>

### Unsecured Retail credit risk

The unsecured book comprises balances for Personal Loans, Professional and Career Developments Loans, Credit Cards and Overdrafts.

### Impairment

An impairment provision is recognised for the following categories:

- identified impairment – at ‘one penny, one day past due’, forborne or in excess, based on the probability of default and the discounted cash flow of recoveries from default; and
- unidentified impairment – on the performing book, based on the probability of the emergence of delinquencies, the probability of default and the discounted cash flow of recoveries from default.

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

	As at 30 June 2017	As at 31 December 2016
Gross loans and advances <sup>1</sup>	631.9	710.0
of which impaired	49.2	71.4
Impaired as a % of gross loans and advances	7.8%	10.1%
Allowance for losses	39.3	57.6
<b>Coverage – impaired assets</b>	<b>79.9%</b>	<b>80.7%</b>
<b>Coverage – total book</b>	<b>6.22%</b>	<b>8.11%</b>

<sup>1</sup> All ratios are based on gross loans and advances, which include other accounting adjustments.

A reduction of £78.1m (11.0%) in gross loans and advances in the period to 30 June 2017 is driven by asset amortisation, low volumes of new business across all portfolios and unsecured debt sale, including £19.9m of impaired credit card and overdraft loans. The proportion of impaired loans has reduced from 10.1% to 7.8% driven largely by the unsecured debt sale. Coverage, reported as allowance for losses as a percentage of impaired balances, has remained broadly stable at 79.9%, however allowance for losses as a percentage of gross loans and advances has reduced from 8.1% to 6.2% following the sale of impaired loans.

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

	As at 30 June 2017	As at 31 December 2016
Balance at start of period	71.4	126.8
Classified as impaired during the period	11.5	20.8
Transferred to unimpaired during the period	(6.9)	(7.2)
Debt sale during the period	(19.9)	(45.1)
Non debt sale write off during the period	(2.8)	(7.0)
Other repayments during the period	(4.1)	(16.9)
Balance at end of the period	49.2	71.4

### Exposure at Default and Risk Weighted Assets

The following tables provide an analysis of the EAD and RWAs by risk grade including PD and LGD. The tables are split between qualifying revolving Retail exposures and Retail non-SMEs.

#### As at 30 June 2017

Internal grades	PD range	Exposure value pre-CCF	Exposure at default	Average PD	Average LGD	RW	RWA
	%	£m	£m	%	%	%	£m
<b>Qualifying revolving retail exposures</b>							
1	0.00 to 0.04	89.2	438.4	0.04%	74.4%	2.2%	9.6
2	0.04 to 0.07	-	-	-	-	-	-
3	0.07 to 0.12	575.1	470.1	0.09%	80.3%	4.5%	21.1
4	0.12 to 0.31	445.0	228.3	0.22%	79.8%	9.8%	22.3
5	0.31 to 0.50	363.0	250.7	0.42%	79.7%	16.4%	41.1
6	0.50 to 1.00	92.0	76.9	0.71%	80.7%	25.0%	19.2
7	1.00 to 5.00	304.5	303.0	1.94%	79.4%	51.8%	157.0
8	5.00 to 10.00	60.0	61.4	5.70%	82.0%	114.5%	70.3
9	10.00 to 20.00	6.9	5.5	13.90%	81.2%	190.9%	10.5
10	20.00 to 50.00	5.1	4.4	39.35%	80.9%	256.8%	11.3
11	50.00 to 99.99	1.1	1.1	61.42%	82.6%	227.3%	2.5
12	100.00	11.6	11.6	100.00%	90.4%	52.6%	6.1
<b>Total qualifying revolving retail exposures</b>		<b>1,953.5</b>	<b>1,851.4</b>	<b>1.45%</b>	<b>78.8%</b>	<b>20.0%</b>	<b>371.0</b>

#### As at 31 December 2016

Internal grades	PD range	Exposure value pre-CCF	Exposure at default	Average PD	Average LGD	RW	RWA
	%	£m	£m	%	%	%	£m
<b>Qualifying revolving retail exposures</b>							
1	0.00 to 0.04	88.9	428.2	0.04%	74.4%	2.2%	9.4
2	0.04 to 0.07	-	-	-	-	-	-

3	0.07 to 0.12	596.7	485.9	0.09%	80.4%	4.5%	21.8
4	0.12 to 0.31	459.8	234.1	0.22%	79.9%	9.8%	22.9
5	0.31 to 0.50	382.9	259.5	0.42%	79.8%	16.4%	42.6
6	0.50 to 1.00	98.6	94.0	0.72%	80.0%	24.9%	23.4
7	1.00 to 5.00	324.1	320.7	1.97%	79.4%	52.5%	168.4
8	5.00 to 10.00	66.3	69.6	5.76%	81.7%	114.8%	79.9
9	10.00 to 20.00	8.1	6.3	14.05%	81.4%	192.1%	12.1
10	20.00 to 50.00	7.7	6.5	39.75%	80.8%	260.0%	16.9
11	50.00 to 99.99	1.4	1.3	61.35%	82.4%	246.2%	3.2
12	100.00	29.8	29.8	100.00%	90.9%	51.0%	15.2
Total qualifying revolving retail exposures		2,064.3	1,935.9	2.45%	79.0%	21.5%	415.8

#### As at 30 June 2017

Internal grades	PD range	Exposure value pre-CCF	Exposure at default	Average PD	Average LGD	RW	RWA
	%	£m	£m	%	%	%	£m
<b>Retail other non-SME</b>							
1	0.00 to 0.04	-	-	-	-	-	-
2	0.04 to 0.07	-	-	-	-	-	-
3	0.07 to 0.12	-	-	-	-	-	-
4	0.12 to 0.31	0.1	0.1	0.27%	79.1%	-	-
5	0.31 to 0.50	60.6	60.6	0.41%	81.3%	55.1%	33.4
6	0.50 to 1.00	0.1	0.1	0.58%	74.4%	-	-
7	1.00 to 5.00	66.0	66.0	2.41%	80.5%	109.7%	72.4
8	5.00 to 10.00	5.8	5.8	9.12%	81.0%	139.7%	8.1
9	10.00 to 20.00	0.1	0.1	18.76%	79.1%	100.0%	0.1
10	20.00 to 50.00	5.6	5.6	35.24%	80.3%	219.6%	12.3
11	50.00 to 99.99	0.2	0.2	62.04%	74.4%	150.0%	0.3
12	100.00	19.5	19.5	100.00%	88.4%	83.6%	16.3
<b>Total Retail other non-SME</b>		<b>158.0</b>	<b>158.0</b>	<b>15.19%</b>	<b>81.8%</b>	<b>90.4%</b>	<b>142.9</b>

#### As at 31 December 2016

Internal grades	PD range	Exposure value pre-CCF	Exposure at default	Average PD	Average LGD	RW	RWA
	%	£m	£m	%	%	%	£m
<b>Retail other non-SME</b>							
1	0.00 to 0.04	-	-	-	-	-	-
2	0.04 to 0.07	-	-	-	-	-	-
3	0.07 to 0.12	-	-	-	-	-	-
4	0.12 to 0.31	0.1	0.1	0.27%	80.8%	-	-
5	0.31 to 0.50	67.2	67.2	0.41%	-	55.2%	37.1
6	0.50 to 1.00	0.1	0.1	0.58%	80.1%	-	-
7	1.00 to 5.00	81.2	81.2	2.43%	80.1%	109.4%	88.8
8	5.00 to 10.00	6.8	6.8	9.14%	80.4%	139.7%	9.5
9	10.00 to 20.00	0.2	0.2	18.76%	78.5%	150.0%	0.3
10	20.00 to 50.00	6.6	6.6	34.85%	80.2%	218.2%	14.4
11	50.00 to 99.99	0.2	0.2	62.03%	74.4%	250.0%	0.5
12	100.00	19.1	19.1	100.00%	88.4%	90.1%	17.2
<b>Total Retail other non-SME</b>		<b>181.5</b>	<b>181.5</b>	<b>13.50%</b>	<b>81.4%</b>	<b>92.5%</b>	<b>167.8</b>

#### Corporate credit risk

The corporate book is managed within two portfolios:

- Business and Commercial Banking – this represents the segment of the Bank which specialises in lending to small businesses, including charities.
- Legacy Portfolio – this is a closed portfolio of corporate assets which are inconsistent with the Bank's current business strategy and risk appetite. The portfolio has been actively deleveraged over a number of years which has significantly reduced the Bank's exposure, particularly in the higher risk Commercial Real Estate (CRE) sector. The main elements of the book are now in the lower risk sectors of Housing Associations and PFIs.

#### Acquisition and account management

The Bank operates lending criteria that require borrowers to meet parameters as laid down in individual sector strategy guidelines and strict policy with regards to single name and sector concentrations. Currently the Bank has a very limited appetite for new corporate lending.

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

	As at 30 June 2017			As at 31 December 2016		
	Exposure	Collateral <sup>1</sup>	Impairment provision	Exposure	Collateral <sup>1</sup>	Impairment provision
<b>BaCB</b>						
<b>Non-default loans with ≤1 year until refinancing and all defaulted exposures regardless of term</b>						
Less than 50%	34.8	34.8	-	28.9	28.9	-
50% to 80%	14.4	14.4	0.1	12.7	12.6	-
80% to 100%	0.8	0.8	-	5.3	5.2	0.1
Greater than 100%	0.1	-	-	-	-	-
Unsecured	4.5	-	0.5	39.5	-	0.5
	<b>54.6</b>	<b>50.0</b>	<b>0.6</b>	<b>86.4</b>	<b>46.7</b>	<b>0.6</b>
<b>Non-default loans with &gt;1 year until refinancing and all non-loan non-defaulted exposures regardless of term</b>						
Less than 50%	120.2	120.2	-	146.3	146.3	-
50% to 80%	93.0	93.0	0.1	142.2	142.2	-
80% to 100%	14.1	14.1	-	20.0	20.0	0.1
Greater than 100%	8.4	4.4	-	11.1	6.1	-
Unsecured	179.7	-	0.2	199.7	-	0.3
	<b>415.4</b>	<b>231.7</b>	<b>0.3</b>	<b>519.3</b>	<b>314.6</b>	<b>0.4</b>
<b>Total BaCB</b>	<b>470.0</b>	<b>281.7</b>	<b>0.9</b>	<b>605.7</b>	<b>361.3</b>	<b>1.0</b>

	As at 30 June 2017			As at 31 December 2016		
	Exposure	Collateral <sup>1</sup>	Impairment provision	Exposure	Collateral <sup>1</sup>	Impairment provision
<b>Legacy Portfolio</b>						
<b>Non-default loans with ≤1 year until refinancing and all defaulted exposures regardless of term</b>						
Less than 50%	11.0	10.8	0.2	35.5	35.4	0.1
50% to 80%	26.8	26.8	-	52.6	52.6	-
80% to 100%	8.5	4.8	3.7	2.0	1.7	0.3
Greater than 100%	32.9	15.0	16.3	44.6	17.4	26.5
Unsecured	36.3	-	15.0	36.7	-	19.0
	<b>115.5</b>	<b>57.4</b>	<b>35.2</b>	<b>171.4</b>	<b>107.1</b>	<b>45.9</b>
<b>Non-default loans with &gt;1 year until refinancing and all non-loan non-defaulted exposures regardless of term</b>						
Less than 50%	267.1	267.1	-	334.2	334.2	-
50% to 80%	408.9	408.9	-	473.5	473.5	-
80% to 100%	133.1	133.1	0.2	52.7	52.7	-
Greater than 100%	63.9	27.4	-	73.5	34.7	-
Unsecured	588.8	-	3.2	621.2	-	1.6
	<b>1,461.8</b>	<b>836.5</b>	<b>3.4</b>	<b>1,555.1</b>	<b>895.1</b>	<b>1.6</b>
<b>Total Legacy Portfolio</b>	<b>1,577.3</b>	<b>893.9</b>	<b>38.6</b>	<b>1,726.5</b>	<b>1,002.2</b>	<b>47.5</b>

<sup>1</sup> Collateral is constrained to a maximum of 100% of the exposure to each customer to correctly reflect the maximum protection available to the Bank. For the purposes of determining capital and impairment, appropriate forced sale discounts are applied to collateral. As at 30 June 2017 £6.5m (2016: £2.9m) of the collateral is not held as first fixed legal charge.

### Impairment (including watchlist)

Corporate loans have three distinct categories. These are live, watchlist and default. Impaired assets comprise watchlist and default cases.

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 events and unsatisfactory account operation. Watchlist accounts are considered as being at risk and require close control, but not sufficiently so to warrant the raising of a specific bad and doubtful debt provision or meeting the regulatory definition of default.

After a period of satisfactory performance, customers may be removed from watchlist status. Prior to removal, satisfaction must be obtained that the relevant trigger events no longer apply. The decision to remove an account from watchlist status should be supported by appropriate MI at the point of removal depending upon the nature of the initial triggers.

Corporate customers may be treated as impaired when one or more defined impairment trigger events are evident. Provisioning adjustments are also recorded, as appropriate, against loans whose interest terms have changed such that revised future cash flows discounted at the original effective interest rate are less than the current carrying amount.

	As at 30 June 2017		As at 31 December 2016	
	BaCB	Legacy Portfolio	BaCB	Legacy Portfolio
<b>Gross loans and advances<sup>1</sup></b>	<b>389.4</b>	<b>1,413.0</b>	499.0	1,532.6
<b>of which impaired</b>	<b>19.1</b>	<b>121.5</b>	29.4	136.2
<b>Impaired as a % of gross loans and advances</b>	<b>4.9%</b>	<b>8.6%</b>	5.9%	8.9%
<b>Allowance for losses</b>	<b>0.9</b>	<b>38.6</b>	1.0	47.5
<b>Coverage – impaired assets</b>	<b>4.7%</b>	<b>31.8%</b>	3.4%	34.9%
<b>Coverage – total book</b>	<b>0.23%</b>	<b>2.73%</b>	0.20%	3.10%

<sup>1</sup> All ratios are based on gross loans and advances, which include other accounting adjustments.

The Bank manages recovery of customer arrears on a gross customer balance basis (excluding credit fair value adjustments and other accounting entries).

BaCB gross loans and advances have reduced in the period reflecting a mix of cases that have been repaid/rebanked and maturities/amortisations that have not been replaced with new advances. Impaired balances reduced by £10.3m (35.0%) in the period driven largely by an individual borrower transferring to Legacy portfolio.

Following the trend of prior years, Legacy Portfolio gross loans and advances have decreased in the period reflecting the deleverage activity from re-banking and non performing work outs. The deleverage of both impaired and not impaired assets in 2017 results in the proportion of impaired loans remaining relatively stable in the period at 8.6% (2016: 8.9%). Provision stock reduced by £8.9m in the period due to write-offs (£8.8m) and net (£0.1m) release in new and additional provisions.

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

	As at 30 June 2017		As at 31 December 2016	
	BaCB	Legacy Portfolio	BaCB	Legacy Portfolio
<b>Balance at start of period</b>	<b>29.4</b>	<b>136.2</b>	32.8	354.1
Classified as impaired during the period	<b>8.0</b>	<b>33.8</b>	21.9	115.9
Transferred to unimpaired during the period	<b>(4.3)</b>	<b>(13.2)</b>	(12.0)	(19.8)
Amounts written off during the period	-	<b>(8.8)</b>	(0.5)	(91.6)
Net repayments and other during the period	<b>(14.0)</b>	<b>(26.5)</b>	(12.8)	(222.4)
<b>Balance at the end of the period</b>	<b>19.1</b>	<b>121.5</b>	29.4	136.2

### Forbearance

The identification of financial difficulty is a key part of the process of deploying forbearance. For those customers that benefit from ongoing concessions (such as postponement of principal payments), the Bank retains the forbearance status for as long as the concession remains in place. In the event of one-off concessions (such as capitalisation of interest payments), the forbearance status is required to be removed 12 months after their occurrence, provided that the loan has been kept up to date during that period and all covenants continue to be met.

Forbearance concessions are considered to be objective evidence of impairment and include:

- a partial write off of debt, following which the account continues to be classified as impaired for at least six months; or
- a material postponement or forgiveness of interest or waiver or reduction of normal fees and charges; the accounts must remain impaired while such favourable terms are being applied.

The table below analyses the exposures subject to forbearance:

	As at 30 June 2017			As at 31 December 2016		
	Forborne	Non-forborne	Total	Forborne	Non-forborne	Total
<b>BaCB</b>						
Default	-	<b>0.9</b>	<b>0.9</b>	-	2.8	2.8
On watch list	<b>2.8</b>	<b>17.1</b>	<b>19.9</b>	11.8	17.9	29.7
Neither default nor on watch list	-	<b>449.2</b>	<b>449.2</b>	-	573.2	573.2
<b>Total BaCB</b>	<b>2.8</b>	<b>467.2</b>	<b>470.0</b>	11.8	593.9	605.7
<b>Legacy Portfolio</b>						
Default	<b>20.8</b>	<b>59.0</b>	<b>79.8</b>	22.3	94.7	117.0
On watch list	<b>15.8</b>	<b>27.7</b>	<b>43.5</b>	0.7	22.7	23.4
Neither default nor on watch list	-	<b>1,454.0</b>	<b>1,454.0</b>	-	1,586.1	1,586.1
<b>Total Legacy Portfolio</b>	<b>36.6</b>	<b>1,540.7</b>	<b>1,577.3</b>	23.0	1,703.5	1,726.5
<b>Total BaCB and Legacy Portfolio</b>	<b>39.4</b>	<b>2,007.9</b>	<b>2,047.3</b>	34.8	2,297.4	2,332.2

Overall forborne exposure has increased due to large cases being classed as forborne during the period. We currently expect these cases to return to the live book or be repaid. They are not deemed to require a specific provision.

## Corporate foundation IRB EAD by PD band

The following tables provide an analysis of the EAD and RWAs by risk grade including PD and LGD for the corporate book under the Internal Ratings Based (IRB) approach.

As at 30 June 2017

Internal grades	PD range %	Mapped external rating	Exposure value at pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m
<b>Corporates</b>								
1	0.0 to 0.03	A	-	-	-	-	-	-
2	0.03 to 0.06	A-	-	-	-	-	-	-
3	0.06 to 0.16	BBB+	470.4	466.8	0.14%	36.5%	45.5%	212.4
4	0.16 to 0.26	BBB	180.3	174.6	0.22%	37.2%	52.7%	92.0
5	0.26 to 0.40	BBB-	42.2	37.6	0.33%	36.0%	70.7%	26.6
6	0.40 to 0.65	BBB-	142.2	128.4	0.51%	44.8%	131.8%	169.2
7	0.65 to 1.10	BB+	14.8	14.0	0.85%	40.4%	100.0%	14.0
8	1.10 to 1.90	BB	19.0	17.7	1.50%	43.7%	121.5%	21.5
9	1.90 to 3.30	BB-	1.5	1.2	3.00%	43.6%	116.7%	1.4
10	3.30 to 10.00	B	18.6	18.1	6.00%	38.5%	148.1%	26.8
11	10.00 to 15.00	B-	0.4	0.4	13.00%	45.0%	225.0%	0.9
12	15.00 to 20.00	CCC+	0.1	0.1	18.00%	45.0%	200.0%	0.2
13	20.00 to 99.99	CCC	0.1	0.1	22.00%	45.0%	300.0%	0.3
14	100.00	Default	3.0	2.9	100.00%	41.1%	-	-
<b>Total Corporates</b>			<b>892.6</b>	<b>861.9</b>	<b>0.73%</b>	<b>38.1%</b>	<b>65.6%</b>	<b>565.3</b>

As at 31 December 2016

Internal grades	PD range %	Mapped external rating	Exposure value at pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m
<b>Corporates</b>								
1	0.00 to 0.03	A	-	-	-	-	-	-
2	0.03 to 0.06	A-	-	-	-	-	-	-
3	0.06 to 0.16	BBB+	517.0	507.1	0.14%	36.6%	41.6%	211.0
4	0.16 to 0.26	BBB	223.9	218.0	0.22%	38.7%	55.5%	121.0
5	0.26 to 0.40	BBB-	159.7	144.6	0.33%	42.5%	75.3%	108.9
6	0.40 to 0.65	BBB-	7.1	6.2	0.51%	40.3%	50.0%	3.1
7	0.65 to 1.10	BB+	19.7	14.9	0.85%	40.6%	83.2%	12.4
8	1.10 to 1.90	BB	21.7	20.7	1.50%	43.0%	115.5%	23.9
9	1.90 to 3.30	BB-	8.0	7.2	3.00%	44.0%	100.0%	7.2
10	3.30 to 10.00	B	22.4	21.4	6.00%	38.5%	121.5%	26.0
11	10.00 to 15.00	B-	0.4	0.3	13.00%	45.0%	233.3%	0.7
12	15.00 to 20.00	CCC+	0.1	0.1	18.00%	45.0%	200.0%	0.2
13	20.00 to 99.99	CCC	0.6	0.6	22.00%	36.3%	183.3%	1.1
14	100.00	Default	4.5	4.3	100.00%	36.3%	-	-
<b>Total Corporates</b>			<b>985.1</b>	<b>945.4</b>	<b>0.86%</b>	<b>38.3%</b>	<b>54.5%</b>	<b>515.5</b>

### 2.2.2 Investment securities

There have been no changes to policies regarding investment securities, collateral management or impairment of investment securities during the first half of 2017. The Bank only invests in Treasury assets which comply with the Treasury Credit Risk Policy and Treasury Credit Risk Control Standard. Within the Treasury investment security portfolio nearly all exposures had an external credit rating equivalent to Fitch A or above at the end of June 2017.

### 2.2.3 Loans and advances to banks

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

### 2.2.4 Derivative financial instruments

During 2017 the Bank continued to clear all new derivative transactions through a central clearing counterparty. The Bank also continues to seek agreement from a remainder of counterparties to re-book existing derivative transactions through its central clearing counterparty. In

accordance with IFRS 13, a credit value adjustment (CVA) of £1.2m was recorded (31 December 2016: £1.1m).

## 2.2.5 Wholesale credit risk

The Bank's Treasury portfolio is held primarily for liquidity management purposes and, in the case of derivatives, for the purpose of managing market risk. Exposures to the UK government and Bank of England account for 55.0% (2016: 60.0%) of all Treasury exposures. The remaining exposures are split 18.0% (2016: 19.0%) to mortgage backed securities, 17.0% (2016: 13.0%) to financial institutions and 11.0% (2016: 8.0%) non-domestic sovereign and qualifying multi-lateral development bank bonds. The composition of the Treasury credit risk exposures remained broadly unchanged during the first half of 2017.

### Treasury foundation IRB EAD by PD band

The following tables provide an analysis of the EAD and RWAs by risk grade including PD and LGD for the Treasury assets under the Internal Ratings Based (IRB) approach.

As at 30 June 2017

Internal grades	PD range %	Mapped external rating	Exposure value at pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m
<b>Institutions</b>								
1 / 2	0.00 to 0.04	AAA to AA	-	-	-	-	-	-
3	0.04 to 0.06	AA-	361.4	155.9	0.05%	45.0%	51.8%	80.7
4	0.06 to 0.08	A+	-	-	-	-	-	-
5	0.08 to 0.20	A	354.5	237.8	0.09%	45.0%	47.0%	111.8
6	0.20 to 0.30	A- to BBB+	924.3	146.9	0.28%	45.0%	94.9%	139.4
7	0.30 to 1.00	BBB to BBB-	0.1	0.1	0.66%	45.0%	200.0%	0.2
8	1.00 to 5.00	BB+ to BB-	0.1	0.1	2.04%	45.0%	100.0%	0.1
9	5.00 to 99.99	B+ to C	-	-	-	-	-	-
10	100.00	Default	-	-	-	-	-	-
<b>Total institutions</b>			<b>1,640.4</b>	<b>540.8</b>	<b>0.13%</b>	<b>45.0%</b>	<b>61.4%</b>	<b>332.2</b>

As at 31 December 2016

Internal grades	PD range %	Mapped external rating	Exposure value at pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m
<b>Institutions</b>								
1 / 2	0.00 to 0.04	AAA to AA	41.3	41.3	0.03%	45.0%	10.9%	4.5
3	0.04 to 0.06	AA-	352.5	212.7	0.05%	45.0%	23.6%	50.1
4	0.06 to 0.08	A+	-	-	-	-	-	-
5	0.08 to 0.20	A	487.3	257.0	0.09%	45.0%	23.5%	60.4
6	0.20 to 0.30	A- to BBB+	422.7	69.1	0.28%	45.0%	52.5%	36.3
7	0.30 to 1.00	BBB to BBB-	13.4	2.2	0.66%	45.0%	86.4%	1.9
8	1.00 to 5.00	BB+ to BB-	0.1	0.1	2.04%	45.0%	100.0%	0.1
9	5.00 to 99.99	B+ to C	-	-	-	-	-	-
10	100.00	Default	-	-	-	-	-	-
<b>Total institutions</b>			<b>1,317.3</b>	<b>582.4</b>	<b>0.09%</b>	<b>45.0%</b>	<b>26.3%</b>	<b>153.3</b>

The increase in RW% and RWAs mainly reflects the integration of a temporary model adjustment (£148.0m) onto the PD ranges.

## 3. Liquidity and funding risk

### 3.1 Overview

The Board determines the level of liquid resources required to support the Bank's business objectives through the risk appetite and undertaking an Internal Liquidity Adequacy Assessment Process (ILAAP). This process reviews the liquidity risk management framework; assesses the qualitative and quantitative liquidity and funding risks to which the Bank is exposed, including under stressed conditions; evaluates the liquidity and funding requirements of the Bank's financial projections; and concludes on the adequacy of its liquid resources.

The ILAAP and compliance with the Overall Liquidity Adequacy Rule (OLAR) is reviewed and approved by the Board and is reviewed by the PRA as part of the Liquidity Supervisory Review and Evaluation Process (L-SREP). Following the L-SREP, the PRA issues findings and provides individual guidance on the appropriate level of liquidity resources the Bank should retain within Pillar 2. The LCR is the primary regulatory standard for liquidity and the Bank's individual liquidity guidance, set with reference to the liquidity coverage ratio (LCR). The LCR is being introduced on a phased basis and UK banks are now required to maintain a minimum of 90% of LCR and rising to 100% in 2018.

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; and
- assessing market conditions for stress and contingency planning.

The Bank has an established funding base, predominantly comprising Retail and commercial deposits. The Bank closely monitors and manages its liquidity position, maintaining a regulatory liquidity buffer appropriate for the Bank's funding profile in order to ensure the Bank meets its financial obligations as and when they fall due. In a more severe stress, the Bank would in the first instance invoke its own Contingency Funding Plan (CFP). The Bank can then invoke its Recovery Plan, maintained under UK regulatory rules implementing the European Bank Recovery and Resolution Directive (BRRD), which documents a number of potential management actions.

### 3.2 Liquidity Risk Management Framework and risk policies

Liquidity management information is provided on a regular basis to the Liquidity Management Forum (LMF), ALCO and the Board which details the Bank's compliance with its primary liquidity risk metrics, which include:

- liquidity coverage ratio (LCR), 175.5% (2016: 213.5%) which represents a surplus to regulatory requirements. The strong liquidity position aligns to the Bank's risk strategy to maintain a prudent liquidity position, although the surplus to regulatory requirements may vary due to cash flow mismatches and fluctuations in the Bank's funding profile over time;
- customer loan/deposit ratio, 90.6% (2016: 86.7%) – the ratio of customer loans (excluding credit commitments) to customer deposits; and
- encumbrance ratio, 15.2% (2016: 17.8%) – per the EBA definition, asset encumbrance ratio = (carrying amount of encumbered assets and collateral)/(total assets and collateral). 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.

### 3.3 Liquid asset portfolios

Total liquidity resources as at 30 June 2017 were £9,561.1m (2016: £8,240.3m). The Bank is focused on maintaining a high percentage of liquid assets which are high-quality and the table below analyses the Bank's liquidity portfolio by product and unencumbered liquidity value. The Bank categorises its liquidity portfolio into primary and secondary (other liquid assets and contingent liquidity).

Primary liquid assets include cash and balances at central banks, gilts and other high quality government bonds. The reduction reflects a combination of Retail and corporate deposit outflow and wholesale funding activities.

Secondary liquidity comprises unencumbered liquid investment securities not included as part of primary liquidity as well as other forms of contingent liquidity sources. The increase in secondary liquidity in 2017 includes the eligibility of Platform originated mortgages and creation of the Silk Road 4 securitisation, as well as reflecting a combination of amortisation of assets, sale and management of secured funding collateral requirements to support the Bank's funding profile.

	As at 30 June 2017	As at 31 December 2016
Operational balances with central banks	1,580.2	2,571.4
Gilts	1,095.6	676.2
Central government and multilateral development bank bonds	408.6	568.5
<b>Total primary liquid assets</b>	<b>3,084.4</b>	3,816.1
Other liquid assets	1,291.5	727.2
Contingent liquidity	5,185.2	3,697.0
<b>Total liquidity</b>	<b>9,561.1</b>	8,240.3
<b>Average balance</b>	<b>8,610.0</b>	9,061.2

The Bank uses a 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. Liquid assets have reduced in the period in line with a reduction in the liquidity risk profile since the year end.

#### 3.3.1 Wholesale funding

Wholesale funding is used to supplement Retail and corporate deposits 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 medium term notes, as shown in the table below:

	As at 30 June 2017	As at 31 December 2016 (Re-presented)
Subordinated debt <sup>1,2</sup>	478.9	472.6
Secured funding	732.7	1,197.6
Repos	489.1	990.6

Market borrowing	4.1	4.1
MTNs	405.6	405.4
<b>Total wholesale funding</b>	<b>2,110.4</b>	<b>3,070.3</b>

<sup>1</sup> Re-presented to include accrued interest and fair value.

<sup>2</sup> Subordinated debt will be cancelled and converted to equity as part of the Restructuring and Recapitalisation exercise, subject to regulatory approval (See the Restructuring and Recapitalisation section in this document).

The reduction in wholesale funding reflects the repayment of secured funding (Leek 19 securitisation) and a reduction in repos in the period. Gilt repos make up £322.3m of total repo funding.

The following table sets out the Bank's contractual wholesale funding by maturity, with the maturity of securitisations based on call dates:

	As at 30 June 2017	As at 31 December 2016 (Re-presented)
Repayable in less than 1 month	326.4	837.4
Repayable between 1 and 3 months	405.6	-
Repayable between 3 and 6 months	66.7	528.9
Repayable between 6 and 9 months	-	405.4
Repayable between 9 and 12 months	100.0	67.9
Repayable between 1 and 2 years	-	-
Repayable between 2 and 5 years <sup>1,2</sup>	1,007.9	1,024.6
Repayable in more than 5 years <sup>1,2</sup>	203.8	206.1
<b>Total external funding</b>	<b>2,110.4</b>	<b>3,070.3</b>

<sup>1</sup> Re-presented to include accrued interest and fair value.

<sup>2</sup> Subordinated debt will be cancelled and converted to equity as part of the Restructuring and Recapitalisation exercise, subject to regulatory approval. (See the Restructuring and Recapitalisation section in this document). The £478.9m is split 2-5 years (£275.1m) and >5 years (£203.8m).

The above funding can be found within the Deposits by banks, Debt securities in issue and Other borrowed funds lines in the Bank's balance sheet.

### 3.4 Encumbrance

An asset is defined as encumbered if it has been pledged as collateral against an existing liability or to collateralise an exposure that the Bank may have, restricting access to that asset in the event of resolution or bankruptcy. An encumbered asset would be no longer available to the Bank for use in secured funding, to satisfy collateral needs or to be sold to reduce the funding requirement. The encumbrance table is presented based on median values of the last four quarters and therefore will not correspond to the balance sheet asset total which is presented on a point-in-time basis.

Encumbered Assets						
As at 30 June 2017	As a result of covered bonds	As a result of securitisations	Other	Total	Unencumbered Assets	Total
Equity investments	-	-	-	-	45.8	45.8
Debt securities	-	368.2	1,033.5	1,401.7	1,831.1	3,232.8
Other assets	1,285.1	422.5	955.5	2,663.1	20,788.9	23,452.0
<b>Assets of the reporting institution</b>	<b>1,285.1</b>	<b>790.7</b>	<b>1,989.0</b>	<b>4,064.8</b>	<b>22,665.8</b>	<b>26,730.6</b>

Encumbered Assets						
As at 31 December 2016	As a result of covered bonds	As a result of securitisations	Other	Total	Unencumbered Assets	Total
Equity investments	-	-	-	-	45.8	45.8
Debt securities	-	425.9	1,079.2	1,505.1	2,147.4	3,652.5
Other assets	1,217.9	1,120.1	1,135.0	3,473.0	20,779.4	24,252.4
<b>Assets of the reporting institution</b>	<b>1,217.9</b>	<b>1,546.0</b>	<b>2,214.2</b>	<b>4,978.1</b>	<b>22,972.6</b>	<b>27,950.7</b>

## 4. Market risk

### 4.1 Overview

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

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

reduce earnings volatility.

As the Bank does not operate a trading book and its net currency positions are below the required threshold, it does not have any Pillar 1 market risk requirement. All market risk exposures are addressed under the Prudential Regulation Authority (PRA) Pillar 2 framework, which is captured as part of its ICG requirement.

The primary market risk metric employed by the Bank to manage directional interest rate risk and the yield curve risk is the sensitivity of the Bank's net interest rate exposure to one basis point parallel shift in interest rates (PV01). The PV01 is the 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) by one basis point. Market risk analysis includes daily parallel shifts in yield curve rates of +/- 100bps with the resultant change in NPVs representing the potential change in portfolio values.

Market risk exposures and the primary drivers of market risk have been maintained within the Bank's risk appetite which was updated at the end of 2016, as part of the annual risk management framework and also to include regulatory feedback. Interest rate risk when expressed in terms of PV01 averaged £(21.2k) during the year of 2017 with a low of £(51.0k) and a high of £3.0k. A reduction in both the holding and duration of sovereign bond exposures has contributed to a further reduction in swap spread risk which has fallen to a PV01 of £(744.0k) (31 December 2016: £(892.0k)). There has also been a similar reduction in the Bank's other credit spread exposures which primarily reflect holdings in Warwick Finance Residential Mortgages Number One plc (Warwick Finance One) and Warwick Finance Residential Mortgages Number Two plc (Warwick Finance Two) securitisations. A combination of repayments and an outright sale has seen the notional holding of mortgage backed securities (MBS) fall from £1,318.0m at 31 December 2016 to £880.0m at 30 June 2017.

## 5. Capital management

### 5.1 Overview

Capital resources are 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 manages and calculates its capital adequacy in accordance with CRD IV, implemented in the European Union through publication of Capital Requirements Regulation (CRR) and a further iteration of the Capital Requirements Directive (CRD). Together this package of requirements is known as CRD IV and came into force from 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 is seeking to enhance its credit modelling capability in a number of key portfolios and is in discussion with the PRA with regards to the approval and implementation of these enhancements during 2017.

As at 30 June 2017, the Bank had Pillar 1 requirements equivalent to 8.0% of total RWAs and a Pillar 2a requirement equivalent to 15.0% of total RWAs. Of the total ICG requirement of 23.0% of total RWAs, the Bank must currently meet a minimum of 17.3% with CET1 capital. The Bank had insufficient capital resources as at 30 June 2017 to meet its total ICG requirement of £1,457.2m.

Key capital highlights are:

- CET1 ratio has decreased to 9.8% as at 30 June 2017 (31 December 2016: 11.0%); a decrease in risk weighted assets of £336.4m has been more than offset by a reduction in CET1 of £116.6m.
- The Bank's leverage ratio is 2.4%, down 0.2% from 31 December 2016, reflecting the reduction in CET1 capital driven by the statutory loss in H1 2017. The Bank is not currently subject to the 3% minimum requirement as it has Retail deposit levels below £50bn, the threshold at which it becomes a binding requirement.
- The Bank is in breach of its ICG, being the PRA's statement as to the regulatory capital it expects the Bank to hold, due to the Bank's ongoing losses. The Bank continued to meet the Pillar 1 requirement throughout H1 2017.
- The Bank does not currently have sufficient capital resources to withstand a severe stress scenario under its current in force PRA buffer.

For any forward looking statements on capital refer to the Detailed Financial Review and the Restructuring and Recapitalisation section.

### 5.2 Risks

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

### 5.3 Capital Stress Testing

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

- annual strategic planning process;
- ICAAP; and
- forecasting exercises.

Stress testing is embedded within the Bank's strategic planning process, with stressed scenarios and sensitivities applied to the Bank's latest forecasts at least on an annual basis or more frequently as required. This enables the Bank's senior management and Board to assess the Bank's latest Plan or forecast under adverse scenarios to ensure it remains within risk appetite. Where outcomes fall outside of risk appetite, management actions are identified and embedded to return the position to within the risk appetite or they are risk accepted.

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

Individual business areas prepare business plans as part of the Strategic Planning process. Stress testing models are utilised to stress 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 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 currently has limited resiliency to a severe stress event.

The Bank was not included in the 2016 Bank of England stress tests, as these tests are 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 firms that 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.

The Bank remains a non-member of the UK concurrent stress testing regime. However, as part of its annual planning process, the Bank undertakes appropriate stress testing and the results are discussed with the regulator as part of the ICAAP submission.

#### 5.4 Capital resources CRD IV

	As at 30 June 2017	As at 31 December 2016
<b>Common Equity Tier 1 (CET1): instruments and reserves</b>		
Permanent share capital and the related share premium account	1,759.5	1,759.5
Retained earnings	(1,315.1)	(896.4)
Available for sale and cash flow hedge reserves	61.8	94.6
Defined benefit reserves	9.5	9.5
Other Reserves <sup>1</sup>	410.0	410.0
<b>CET1 before regulatory adjustments</b>	<b>925.7</b>	<b>1,377.2</b>
<b>CET1: regulatory adjustments</b>		
Prudential valuation in trading book	(0.8)	(5.4)
Intangible assets (net of related tax liability)	(90.4)	(100.1)
Defined benefit pension	(19.0)	(15.3)
Deferred tax assets not arising from temporary differences	-	-
Cash flow hedge reserves	(38.7)	(56.4)
Expected loss shortfall	(16.8)	(44.4)
Losses for the period	(139.7)	(418.7)
<b>Total regulatory adjustments to CET1</b>	<b>(305.4)</b>	<b>(640.3)</b>
<b>CET1</b>	<b>620.3</b>	<b>736.9</b>
<b>Additional Tier 1 (AT1) capital: instruments</b>		
<b>Total regulatory adjustments to AT1 capital</b>	<b>-</b>	<b>-</b>
<b>Total Tier 1 capital (T1 = CET1 + AT1)</b>	<b>620.3</b>	<b>736.9</b>
<b>Tier 2 (T2) capital: instruments and provisions</b>		
Capital instruments	446.7	447.0
Credit risk adjustments	-	-
<b>T2 capital before regulatory adjustments</b>	<b>446.7</b>	<b>447.0</b>
<b>Total regulatory adjustments to T2 capital</b>	<b>-</b>	<b>-</b>
<b>T2 capital</b>	<b>446.7</b>	<b>447.0</b>
<b>Total capital (TC = T1 + T2)</b>	<b>1,067.0</b>	<b>1,183.9</b>

<sup>1</sup> Other reserves include the capital redemption reserve created as a result of the Bank's Liability Management Exercise in 2013.

#### 5.5 Capital ratios and Risk Weighted Assets

	As at 30 June 2017	As at 31 December 2016
<b>Capital ratios</b>		

Common Equity Tier 1 ratio	9.8%	11.0%
Tier 1 ratio	9.8%	11.0%
<b>Total capital ratio</b>	<b>16.8%</b>	<b>17.7%</b>

#### Risk weighted assets

Credit risk	5,703.7	5,944.0
Market risk	-	-
Operational risk	636.0	732.1
<b>Total risk weighted assets</b>	<b>6,339.7</b>	<b>6,676.1</b>

#### Segmental analysis of credit risk weighted assets

Retail	1,872.5	1,919.9
Optimum	596.0	899.8
BaCB	491.8	485.3
Legacy Portfolio	1,082.0	1,140.6
Treasury and Other	1,661.4	1,498.4
<b>Total credit risk weighted assets</b>	<b>5,703.7</b>	<b>5,944.0</b>

CET1 ratio has decreased to 9.8% from 11.0% as at 30 June 2017. This reflects a reduction in CET1 of £0.1bn, partially offset by a decrease in risk weighted assets of £0.3bn. The reduction in CET1 reflects a £139.7m statutory loss after tax for the period.

RWAs have reduced from £6.7bn to £6.3bn, primarily within Optimum RWAs following the removal of the remaining temporary model adjustment for Optimum mortgages not included within the Calico synthetic securitisation. Operational Risk RWAs have decreased by £0.1bn following the annual recalculation of the Pillar 1 operational risk requirement subsequent to the 2016 year end results.

#### 5.6 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 Exposure at Default (EAD). 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 provisions.

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 exposure classes not applicable to the Bank, and which have not 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:

#### As at 30 June 2017

IRB exposure class	Capital requirement £m	Risk weighted asset £m	Exposure at default £m	Average risk weight %	Average exposure at default £m
Institutions	26.6	332.2	540.8	61.4%	598.7
Corporates	45.2	565.4	862.0	65.6%	899.8
Retail secured by immovable property	152.5	1,905.7	15,963.5	11.9%	16,042.5
Qualifying revolving Retail exposures	29.7	370.9	1,851.4	20.0%	1,896.2
Retail other non-SME	11.4	143.1	157.9	90.6%	172.6
Securitisation positions	56.4	704.4	2,146.9	32.8%	2,416.0
<b>Total IRB</b>	<b>321.8</b>	<b>4,021.7</b>	<b>21,522.5</b>	<b>18.7%</b>	<b>22,025.8</b>
Specialised lending	62.1	776.0	955.4	81.2%	1,021.0

#### Standardised exposure class

Central government or central banks	-	-	3,002.7	-	3,633.6
Regional governments or local authorities	0.1	0.6	2.9	20.7%	3.0
Public sector entities	0.2	2.9	14.7	19.7%	14.7

Multilateral development banks	-	-	410.0	-	489.4
Institutions <sup>1</sup>	5.8	72.6	56.3	129.0%	63.4
Corporates	16.0	200.4	200.4	100.0%	228.5
Retail exposures	3.6	45.6	60.7	75.0%	61.9
Secured by mortgages on immovable property <sup>2</sup>	-	0.1	0.1	75.0%	0.1
Exposures in default	2.5	31.7	22.1	143.4%	16.3
Equity exposures	3.0	36.8	29.5	124.7%	43.0
Other items <sup>3</sup>	41.2	515.3	590.6	87.3%	499.4
Total standardised	72.4	906.0	4,390.0	20.6%	5,053.3
Total credit risk	456.3	5,703.7	26,867.9	21.2%	28,100.1

Total market risk	-	-	N/A	N/A	N/A
Operational risk	50.9	636.0	N/A	N/A	N/A
Total Pillar 1	507.2	6,339.7	N/A	N/A	N/A

<sup>1</sup> Institutions calculated under the standardised approach RWAs and capital requirements relating to the calculation of Credit Valuation Adjustments for derivatives.

<sup>2</sup> 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.

<sup>3</sup> 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 and Equipment, Tax).

## 5.7 Reconciliation of equity per balance sheet to total capital as at 30 June 2017

Balance sheet presentation	Balance per accounts	Regulatory presentation	Regulatory balance treatment	Cash flow hedge reserve	Regulatory treatment of deferred tax liability/asset	Fair Value and interest adjustments	Expected losses	Prudent valuation in trading book	Capital Resources
<b>Equity</b>									
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	(1,454.8)	Retained earnings	(1,315.1)	-	-	-	-	-	(1,315.1)
		Regulatory losses for the period	(139.7)	-	-	-	-	-	(139.7)
Available for sale reserve	23.1	Available for sale reserve	23.1	-	-	-	-	-	23.1
Cash flow hedging reserve	38.7	Cash flow hedging reserve	38.7	(38.7)	-	-	-	-	-
Defined benefit pension reserve	9.5	Defined benefit pension reserve	9.5	-	(19.0)	-	-	-	(9.5)
Capital redemption reserve	410.0	Other reserves	410.0	-	-	-	-	-	410.0
		<b>Total Equity</b>	<b>786.0</b>	<b>(38.7)</b>	<b>(19.0)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>728.3</b>
<b>Non-Equity</b>									
Other borrowed funds	478.9	Capital instruments	478.9	-	-	(32.2)	-	-	446.7
Intangible assets	(90.4)	Intangible assets (net related tax liability)	(90.4)	-	-	-	-	-	(90.4)
Credit risk adjustment <sup>1</sup>	85.1	Expected loss shortfall	85.1	-	-	-	(101.9)	-	(16.8)
		Prudent valuation	-	-	-	-	-	(0.8)	(0.8)
		<b>Total Non-Equity</b>	<b>473.6</b>	<b>-</b>	<b>-</b>	<b>(32.2)</b>	<b>(101.9)</b>	<b>(0.8)</b>	<b>338.7</b>
<b>Total balances subject to own funds calculations</b>			<b>1,259.6</b>	<b>(38.7)</b>	<b>(19.0)</b>	<b>(32.2)</b>	<b>(101.9)</b>	<b>(0.8)</b>	<b>1,067.0</b>

<sup>1</sup> Credit risk adjustment is made up of impairment provision and credit related fair value adjustments, relating to exposures calculated under the IRB approach to credit risk which are applicable for the calculation of EL gap per CRR. Therefore the impairment provision number included in the table above relates to IRB exposures only, and is a subset of the Bank's total impairment and fair value.

## 5.8 Leverage ratio

### Leverage ratio common disclosure

<b>As at 30 June 2017</b>	As at 31 December 2016
<b>On-balance sheet exposures (excluding derivatives and SFTs)</b>	

1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	24,383.9	26,999.5
2	(Asset amounts deducted in determining Tier 1 capital)	(165.9)	(221.6)
3	Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	24,218.0	26,777.9
<b>Derivative exposures</b>			
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	186.7	318.8
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	52.0	42.9
EU -5a	Exposure determined under Original Exposure Method	-	-
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	244.7	316.7
7	(deductions of receivables assets for cash variation margin provided in derivatives transactions)	-	-
8	(Exempted CCP leg of client-cleared trade exposures)	-	-
9	Adjusted effective notional amount of written credit derivatives	-	-
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	-	-
11	Total derivative exposures	483.4	678.4
<b>Securities financing transaction exposures</b>			
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	1,433.2	1,436.1
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	(1,283.9)	(1,347.4)
14	Counterparty credit risk exposure for SFT assets	41.3	36.1
EU-14a	Derogation for SFTs: Counterparty credit risk exposure in accordance with Article 429b (4) and 222 of regulation (EU) No 575/2013	-	-
15	Agent transaction exposures	-	-
EU-15a	(Exempted CCP leg of client-cleared SFT exposure)	-	-
16	Total securities financing transaction exposures	190.6	124.8
<b>Other off-balance sheet exposures</b>			
17	Off-balance sheet exposures at gross notional amount	2,306.6	2,289.6
18	(Adjustments for conversion at credit equivalent amounts)	(1,414.6)	(1,471.0)
19	Total off-balance sheet exposures	892.0	818.6
<b>Exempted exposures in accordance with CRR Article 429 (7) and (14) (on and off balance sheet)</b>			
EU- 19a	(Exemption of intragroup exposures (solo basis) in accordance with Article 429(7) of Regulation EU No 575/2013 (on and off balance sheet))	-	-
EU-19b	(Exposures exempted in accordance with Article 429(14) of Regulation (EU)No 575/2013 (on and off balance sheet))	-	-
<b>Capital and total exposures</b>			
20	Tier 1 capital	620.3	736.9
21	<b>Total leverage ratio exposures</b>	<b>25,784.0</b>	<b>28,399.7</b>
<b>Leverage ratio</b>			
22	Leverage ratio	2.4%	2.6%
<b>Choice on transitional arrangements and amount of derecognised fiduciary items</b>			
EU-23	Choice on transitional arrangements for the definition of the capital measure	-	-
EU-24	Amount of derecognised fiduciary items in accordance with Article 429(11) or Regulation (EU) No 575/2013	-	-

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

## Disclosure on qualitative items

<b>1</b>	<b>Description of the processes used to manage the risk of excessive leverage</b>
	The Bank is not subject to a regulatory minimum in relation to the leverage ratio; however, leverage ratio remains embedded within the Bank's Planning and Reporting processes. The leverage ratio is part of the Bank's risk appetite framework, and is part of the management information provided to the Asset and Liability Committee (ALCO) and Capital Management Forum (CMF) and is a key consideration in the Bank's Strategic Planning process. Additionally, the leverage ratio is stressed as part of the Bank's ICAAP.
<b>2</b>	<b>Description of the factors that had an impact on the leverage ratio during the period to which the disclosed leverage ratio refers</b>
	The Bank's leverage ratio is 2.4%, down 0.2% from 31 December 2016 reflecting the reduction in Tier 1 capital driven by the statutory loss in H1 2017. Leverage ratio exposures have reduced by £2.6bn primarily as a result of contraction in the Bank's balance sheet.

## INDEPENDENT REVIEW REPORT TO THE CO-OPERATIVE BANK

### Introduction

We have been engaged by the Bank to review the condensed set of financial statements in the Interim Financial Report for the six months ended 30 June 2017 which comprises the Bank income statement, the Bank statement of comprehensive income, the Bank balance sheet, the Bank statement of cash flows, the Bank statement of changes in equity and the related explanatory notes 1 to 15. We have read the other information contained in the Interim Financial Report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report should be read in conjunction with the Independent Auditor's Report to the Members of The Co-operative Bank plc on pages 137 to 144 of the 2016 Annual Report and Accounts, where our assessment of the risks of material misstatement, as they relate to the year ended 31 December 2016, are presented.

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

### Directors' Responsibilities

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

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

### Our Responsibility

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

### Scope of Review

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

### Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the Interim Financial Report for the six months ended 30 June 2017 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

### Emphasis of Matter – Going Concern

In forming our conclusion on the Interim Financial Report, which is unmodified, we have considered the adequacy of the disclosures made in note 1.3 to the Interim Financial Report concerning the Bank's ability to continue as a going concern. In that section, the directors set out the risks associated with the successful execution of the Bank's Restructuring and Recapitalisation, the Bank's Plan and the Bank's 2017 May Outlook. The matters explained in note 1.3 to the Interim Financial Report represent material uncertainties which may cast significant doubt upon the Bank's ability to continue as a going concern. The condensed set of financial statements does not include the adjustments that would result if the Bank was unable to continue as a going concern.

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

## THE BANK INTERIM FINANCIAL REPORT

### THE BANK INCOME STATEMENT

For the period ended 30 June 2017

All amounts are stated in £m unless otherwise indicated

	Note	Period to 30 June 2017	Period to 30 June 2016
Interest receivable and similar income	4	297.4	351.6
Interest expense and similar charges	4	(181.6)	(245.8)
<b>Net interest income</b>		<b>115.8</b>	105.8
Fee and commission income		37.2	44.3
Fee and commission expense		(20.5)	(24.2)
<b>Net fee and commission income</b>		<b>16.7</b>	20.1
Income from investments		0.1	0.2
Other operating income	5	42.9	71.3

<b>Operating income</b>		<b>175.5</b>	197.4
<b>Operating expenses</b>			
Operating expenses	6	(307.7)	(360.5)
Provision for customer redress		(4.5)	(18.9)
<b>Total operating expenses</b>		<b>(312.2)</b>	(379.4)
<b>Operating losses before net impairment gains</b>		<b>(136.7)</b>	(182.0)
Net impairment gains on loans and advances	8	1.4	4.6
<b>Operating loss</b>		<b>(135.3)</b>	(177.4)
Share of post-tax gains from joint ventures		0.1	0.4
<b>Loss before taxation</b>		<b>(135.2)</b>	(177.0)
Income tax	7	(4.5)	44.9
<b>Loss for the financial period</b>		<b>(139.7)</b>	(132.1)
<b>Loss per share (basic and fully diluted)</b>		<b>(30.94)p</b>	(29.26)p

Notes 1 to 15 form part of these financial statements.

## THE BANK STATEMENT OF COMPREHENSIVE INCOME

For the period ended 30 June 2017

All amounts are stated in £m unless otherwise indicated

	Period to 30 June 2017	Period to 30 June 2016
<b>Loss for the period</b>	<b>(139.7)</b>	(132.1)

### Items that may be recycled to profit and loss:

Changes in cash flow hedges		
Net changes in fair value recognised directly in equity	(30.7)	60.9
Transfers from equity to income or expense	7.1	7.5
Income tax	5.9	(17.8)
Changes in available for sale assets		
Net changes in fair value recognised directly in equity	(9.4)	83.7
Transfers from equity to income or expense	(11.5)	(134.8)
Income tax	5.8	5.6

### Items that may not be recycled to profit and loss:

Changes in defined benefit pension reserve		
Recognition of defined benefit plan	-	81.7
Income tax	-	(21.2)
Other comprehensive (expense)/income for the financial period, net of income tax	(32.8)	65.6
<b>Total comprehensive expense for the financial period</b>	<b>(172.5)</b>	(66.5)

Notes 1 to 15 form part of these financial statements.

## THE BANK BALANCE SHEET

As at 30 June 2017

All amounts are stated in £m unless otherwise indicated

	Note	As at 30 June 2017	As at 31 December 2016
<b>Assets</b>			
Cash and balances at central banks		1,774.7	2,848.2
Loans and advances to banks		1,081.8	836.9
Loans and advances to customers	8	18,933.7	19,452.7
Fair value adjustments for hedged risk		103.0	131.6
Investment securities – loans and receivables	9	13.4	13.8
Investment securities – available for sale	9	2,486.6	3,538.1
Derivative financial instruments		285.7	425.5

Non-current assets classified as held for sale		6.5	5.3
Equity shares		23.3	46.8
Investments in joint ventures		6.1	6.0
Investment properties		2.2	2.2
Property, plant and equipment		36.7	35.4
Intangible assets		90.4	100.1
Other assets		85.8	96.7
Prepayments and accrued income		39.2	28.7
Net retirement benefit asset	11	25.3	20.3
<b>Total assets</b>		<b>24,994.4</b>	<b>27,588.3</b>
<b>Liabilities</b>			
Deposits by banks		917.8	1,198.6
Customer accounts		20,897.5	22,425.1
Customer accounts – capital bonds		4.7	11.8
Debt securities in issue		1,167.0	1,625.4
Derivative financial instruments		358.5	444.5
Other borrowed funds		478.9	472.6
Other liabilities		34.5	45.9
Accruals and deferred income		113.8	115.3
Provisions for liabilities and charges	10	218.7	276.4
Deferred tax liabilities	7	2.7	14.2
Net retirement benefit liability		14.3	-
<b>Total liabilities</b>		<b>24,208.4</b>	<b>26,629.8</b>
<b>Capital and reserves attributable to the Bank's equity holders</b>			
Ordinary share capital		22.6	22.6
Share premium account		1,736.9	1,736.9
Retained earnings		(1,454.8)	(1,315.1)
Available for sale reserve		23.1	38.2
Capital redemption reserve		410.0	410.0
Cash flow hedging reserve		38.7	56.4
Defined benefit pension reserve		9.5	9.5
<b>Total equity</b>		<b>786.0</b>	<b>958.5</b>
<b>Total liabilities and equity</b>		<b>24,994.4</b>	<b>27,588.3</b>

Notes 1 to 15 form part of these financial statements.

## THE BANK STATEMENT OF CASH FLOWS

For the period ended 30 June 2017

All amounts are stated in £m unless otherwise indicated

	Period to 30 June 2017	Re-presented <sup>1</sup> Period to 30 June 2016
<b>Cash flows used in operating activities:</b>		
Loss before taxation	(135.2)	(177.0)
Adjustments for:		
Interest payable in respect of other borrowed funds	21.8	22.6
Effect of exchange rate movements	(1.8)	(6.5)
Impairment gains on loans and advances	(1.4)	(4.6)
Depreciation and amortisation	18.1	16.7
Impairment of intangible assets	2.8	5.7
Interest amortisation	(6.7)	2.4
Fair value and interest accrual movements on investment securities	22.9	(105.8)
Impairment of property, plant and equipment	-	0.3
Gain on sale of equity shares	(22.8)	(58.1)
Profit on disposal of investment securities	(7.3)	(17.8)
Profit on disposal of property, plant, equipment and software	-	(2.1)
Loss on sale of loans and advances to customers	0.8	4.4

Unwind of fair value adjustments arising on transfer of engagements	61.3	94.7
	(47.5)	(225.1)
Increase in prepayments and accrued income	(10.5)	(11.0)
Decrease in accruals and deferred income	(1.5)	(3.2)
(Decrease)/increase in deposits by banks	(280.8)	151.4
Decrease in customer accounts and capital bonds	(1,534.7)	(724.0)
Decrease in debt securities in issue	(519.8)	(344.8)
Increase in loans and advances to banks	(225.7)	(365.3)
Decrease in loans and advances to customers	525.5	95.2
Net movement of other assets and other liabilities	46.1	(241.8)
<b>Net cash flows used in operating activities</b>	<b>(2,048.9)</b>	<b>(1,668.6)</b>
<b>Cash flows from investing activities:</b>		
Purchase of tangible and intangible fixed assets	(19.0)	(27.0)
Proceeds from sale of property, plant and equipment	3.9	3.4
Purchase of investment securities	(136.8)	(161.2)
Proceeds from sale of equity shares	25.3	41.8
Proceeds from sale and maturity of investment securities	1,156.6	1,340.8
<b>Net cash flows from investing activities</b>	<b>1,030.0</b>	<b>1,197.8</b>
<b>Cash flows used in financing activities:</b>		
Interest paid on other borrowed funds	(11.3)	(22.6)
Costs incurred in relation to Restructuring and Recapitalisation	(24.2)	-
<b>Net cash flows used in financing activities</b>	<b>(35.5)</b>	<b>(22.6)</b>
<b>Decrease in cash and cash equivalents</b>	<b>(1,054.4)</b>	<b>(493.4)</b>
<b>Cash and cash equivalents at the beginning of the financial period</b>	<b>3,266.3</b>	<b>3,139.7</b>
<b>Cash and cash equivalents at the end of the financial period</b>	<b>2,211.9</b>	<b>2,646.3</b>
Cash and balances with central banks	1,736.7	2,239.7
Loans and advances to banks	475.2	406.6
<b>Cash and cash equivalents at the end of the financial period</b>	<b>2,211.9</b>	<b>2,646.3</b>

<sup>1</sup> The comparative figures have been re-presented to more fairly reflect their nature.

Notes 1 to 15 form part of these financial statements.

## THE BANK STATEMENT OF CHANGES IN EQUITY

For the period ended 30 June 2017

All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Bank							
	Share capital	Share premium	Available for sale reserve	Cash flow hedging reserve	Capital redemption reserve	Defined benefit pension reserve	Retained earnings	Total equity
<b>Period from 1 January 2017 to 30 June 2017</b>								
Balance at the beginning of the period	22.6	1,736.9	38.2	56.4	410.0	9.5	(1,315.1)	958.5
Total comprehensive expense for the period	-	-	(15.1)	(17.7)	-	-	(139.7)	(172.5)
<b>Balance at the end of the period</b>	<b>22.6</b>	<b>1,736.9</b>	<b>23.1</b>	<b>38.7</b>	<b>410.0</b>	<b>9.5</b>	<b>(1,454.8)</b>	<b>786.0</b>
<b>Period from 1 January 2016 to 30 June 2016</b>								
Balance at the beginning of	22.6	1,736.9	55.6	34.6	410.0	-	(896.4)	1,363.3

the period								
Total comprehensive (expense)/income for the period	-	-	(45.5)	50.6	-	60.5	(132.1)	(66.5)
Balance at the end of the period	22.6	1,736.9	10.1	85.2	410.0	60.5	(1,028.5)	1,296.8

Notes 1 to 15 form part of these financial statements.

## NOTES TO THE BANK INTERIM FINANCIAL STATEMENTS

### For the period ended 30 June 2017

All amounts are stated in £m unless otherwise indicated

#### 1. Basis of preparation and significant accounting policies

##### 1.1 Basis of preparation

This consolidated Interim Financial Report for the period ended 30 June 2017 has been prepared in accordance with both the Disclosure and Transparency Rules of the Financial Conduct Authority and IAS 34 'Interim Financial Reporting', as adopted by the European Union. The 2017 Interim Financial Report should be read in conjunction with the Bank's 2016 Annual Report and Accounts, which have been prepared in accordance with IFRS as adopted by the European Union.

The information contained within this report for the period ended 30 June 2017 does not constitute statutory accounts as defined by Section 434 of the Companies Act 2006. A copy of the statutory accounts for the year ended 31 December 2016 has been delivered to the Registrar of Companies. The auditor's report on those accounts was unqualified, and did not contain a statement under section 498(2) or (3) of the Companies Act 2006, but did make reference to an emphasis of matter in relation to going concern (see note 1.3 for further detail).

The 2017 Interim Financial Report was approved by the Board of Directors on 9 August 2017.

##### 1.2 Significant accounting policies

The accounting policies adopted in the preparation of the 2017 Interim Financial Report are consistent with, and are a continuation of, those policies followed in the preparation of the 2016 Annual Report and Accounts.

Significant additions and changes to underlying methodologies are discussed within the critical judgements and estimates section.

Information on pronouncements that will be relevant to the Bank in future periods is provided in the 2016 Annual Report and Accounts.

##### Update on IFRS 9 (Financial Instruments)

IFRS 9 was endorsed for adoption in the EU on 22 November 2016 and will be formally implemented by the Bank with effect from 1 January 2018 in line with the Standard's requirements to apply for annual periods beginning on or after 1 January 2018. The Bank's current view on the three phases of IFRS 9 (classification and measurement, impairment and hedging) was provided on pages 151 to 153 of the Bank's 2016 Annual Report and Accounts.

The most complex area of judgement relates to the implementation of the impairment requirements of IFRS 9, moving to an 'expected credit loss' methodology from an 'incurred loss' methodology. The Bank has commenced its parallel run of the methodologies, which is due to continue for the remainder of 2017. The extent to which expert judgement is required to be applied is anticipated to be determined by the parallel run. Such expert judgement may ultimately comprise intra or extra model adjustments. Model refinement is expected as part of the parallel run and as any further authoritative guidance is issued. The Bank will provide details of the quantitative impact of applying the impairment requirements of IFRS 9 once it is practicable to provide reliable estimates. A quantitative impact assessment will be disclosed in the Bank's 2017 Annual Report and Accounts following the completion of the parallel run in the second half of 2017.

The Bank will provide details of the quantitative impact of applying the classification and measurement requirements of IFRS 9 once it is practicable to provide reliable estimates. The parallel run of the classification and measurement requirements of IFRS 9 is taking place in the second half of 2017, which is expected to provide reliable quantitative impact information which will be disclosed in the Bank's 2017 Annual Report and Accounts.

Whilst the disclosure requirements of micro hedge accounting under IFRS 9 are different to that under IAS 39, the adoption of an IFRS 9 basis for micro hedge accounting is not expected to have a significant impact on the Bank's financial statements on transition on 1 January 2018. A parallel run of the micro hedge accounting requirements of IFRS 9 is taking place in the second half of 2017.

##### Update on IFRS 15 (Revenue from Contracts with Customers) and IFRS 16 (Leases)

IFRS 15 was issued in May 2014 and is effective for financial years beginning on or after 1 January 2018 and IFRS 16 was issued in January 2016 and is effective for financial years beginning on or after 1 January 2019.

The Bank is reviewing the requirements of the new Standards to ensure that the Bank has implemented the appropriate methodology and approach to meet the requirements of the Standards at the point of transition, while recognising evolving industry practice.

Further updates on the Bank's IFRS 15 and 16 implementation progress will be provided in the Bank's 2017 Annual Report and Accounts.

### **1.3 Going concern**

In line with provision C1.3 of the 2016 UK Corporate Governance Code, the Directors are required to assess the prospects of the Bank with a particular focus on the 12 month period following the publication of the financial statements.

When considering the going concern status of the Bank, the Directors have referenced the Financial Reporting Council's Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity, which explicitly covers the going concern basis of accounting and material uncertainties.

The assessment of the appropriateness of the going concern basis of accounting for the Bank's 2017 Interim Financial Report has been subject to thorough consideration involving analysis and discussion by management, Executive and Board Committees and the Board, in line with our governance process and discussions with the Bank's regulators.

The Directors have assessed the going concern status using a framework focusing on the Bank's capital, liquidity, performance versus the Bank's Plan (including the roll-forward reforecasting exercise, the 2017 May Outlook), continued regulatory support and other material issues.

For further context in relation to this going concern statement, please refer to the Principal Risks and Uncertainties (PRU) and Risk Management sections of the 2017 Interim Financial Report and the 'Risk Factors' referred to in that section. All of the risks and uncertainties described therein are considered as qualifications to the Bank's prospects over the period of assessment described below.

The going concern status of the Bank is dependent on the Bank successfully delivering its Plan and, where applicable, the 2017 May Outlook, including the implementation of the Restructuring and Recapitalisation.

#### **Restructuring and Recapitalisation**

The Bank announced on 26 January 2017 that it expected its CET1 ratio (in the absence of any management actions) to fall and remain below 10% over the medium term and that it was unlikely to meet its Individual Capital Guidance (ICG) over the then applicable planning period (to the year ending 31 December 2020). The Bank's ability to generate capital and loss absorbing capacity organically has been constrained by: (i) the impact of interest rates that are and have been lower than previously forecast, reducing the Bank's ability to generate income; and (ii) higher than anticipated transformation and conduct redress and remediation costs.

On 13 February 2017, the Bank announced that it was commencing a formal sale process (FSP), inviting offers for 100% of its issued share capital, and was also considering, as an alternative to the FSP, ways of raising equity capital in order to meet the longer term capital requirements applicable to all UK banks. Further updates in respect of the FSP were issued between 24 March 2017 and 26 June 2017, when the FSP was discontinued. On 9 March 2017, alongside publication of the Annual Report and Accounts 2016, the Bank disclosed further details of an alternative proposal to raise an additional £700m to £750m of CET1 resources before transaction costs, and that this might be achieved via a liability management exercise involving the potential exchange of the Bank's debt securities for equity (taking into account the Bank's creditor hierarchy) alongside an additional primary equity capital raise to enable the Bank to achieve Tier 1 ICG compliance from 2017 onwards. Furthermore, the Bank indicated that it was anticipating a c.£250m Tier 2 issuance during 2018, with the objective of achieving full ICG compliance from 2018 and to meet all capital and interim MREL requirements in 2019, with further MREL qualifying debt issuances in 2020 and 2021.

Since the Bank's announcement on 9 March 2017, considerable progress has been made in securing the Bank's long-term future.

On 26 June 2017, the Bank announced that in light of the advanced nature of the discussions with a group of existing investors (the Principal Investors) regarding a prospective equity capital raise and recapitalisation, the Bank had decided to discontinue the FSP.

On 28 June 2017, as an update to its announcement dated 26 June 2017, the Bank announced that the Board had decided to support an equity capital raise and recapitalisation proposal (being the outline of the Restructuring and Recapitalisation) from the Principal Investors and had entered into the Lock-Up Agreement whereby the Principal Investors and the Bank committed to take certain steps to implement the Restructuring and Recapitalisation.

On 28 July 2017, the Bank announced that, as at 5pm on 28 July 2017, investors which held 91% of the Notes (80% of the 2023 Notes and 99% of the 2025 Notes) had entered into the Lock-Up Agreement. Investors which held 80% of the Bank's ordinary shares had also agreed to support the Restructuring and Recapitalisation, including 20% indirectly held by Co-operative Group Limited, subject to certain conditions.

The success of the Restructuring and Recapitalisation depends on satisfying several conditions including shareholder, bondholder and regulatory approvals.

#### **Updates to the 2017-2021 Strategic Plan**

The Bank undertakes an annual strategic planning process that produces a detailed five year strategic plan. The Bank completed this annual exercise in February 2017 and has a strategic plan covering the years 2017-2021 (the Plan). Since the Plan was adopted by the Bank on 13 February 2017, there have been significant developments that have affected the Bank's outlook for its business and the prospects of achieving some of the key components of the Plan (or the timing of when they are expected to be achieved). In response to these changes, the Bank has undertaken a formal update to the Plan, the 2017 May Outlook which seeks to incorporate known changes to underlying assumptions including the Restructuring and Recapitalisation activity.

The proposed Restructuring and Recapitalisation is an important step to the Bank: (i) reducing and, in due course, removing the risk of the Bank being subject to enforcement action by the Authorities in relation to its non-compliance with the regulatory capital and loss-absorbing capacity

requirements described above, and (ii) implementing the Plan which the PRA accepted on 13 February 2017 and implementing the 2017 May Outlook which the PRA accepted on 27 June 2017. The PRA's continued acceptance of the Bank's Plan and the 2017 May Outlook is an important element of the Bank's assessment of its going concern status.

## **Capital**

Total consolidated CRD IV capital resources as at 30 June 2017 are £1.1bn (31 December 2016: £1.2bn), with CET1 capital after regulatory deductions of £0.6bn (31 December 2016: £0.7bn). At 30 June 2017 the Bank's consolidated CET1 ratio stands at 9.8% (31 December 2016: 11.0%). The Bank has received confirmation from the PRA in July 2017 that Calico Finance Number One Limited (Calico) no longer achieves significant risk transfer (SRT) to third parties within the meaning of the CRR. As a consequence, the Bank will no longer receive any RWA benefit from the Calico transaction. Following this SRT determination and the demonstrable adverse effect on the capital position of the Bank, the PRA has no objection to the Bank effecting a regulatory call of notes (Calico Notes) issued by Calico, subject to the transaction's terms and conditions. The impact of Calico not meeting SRT requirements would have seen a reduction in the Bank's CET1 ratio of c.0.8% as at 30 June 2017.

Although the Bank meets its minimum Pillar 1 regulatory capital requirements and expects to continue to do so (based on the Bank's own economic assumptions), the combination of the statutory and operating losses incurred by the Bank since 2012 and the upcoming maturity of the £400m 5.125% Notes due 20 September 2017 issued by the Bank, means that the Bank needs to build its capital in advance of this debt maturing in order to move towards meeting current and longer-term UK bank regulatory capital requirements, including enhanced regulatory capital requirements expected of all UK banks, such as MREL.

As at 30 June 2017, the Bank did not meet its ICG, Pillar 2b or interim MREL requirements set by the PRA, a position the PRA has accepted as part of its acceptance of the Bank's Plan and the 2017 May Outlook. The Bank's targeted Pillar 2a reduction, together with the assumed successful implementation of the Restructuring and Recapitalisation and the 2017 May Outlook is expected internally by the Bank to result in the Bank achieving its target of meeting full ICG during 2018.

The Bank's strategy aims to build an efficient, financially sustainable and capital resilient UK bank, focused on Retail and SME customers, differentiated by an ethically led brand and a customer centric proposition. The strategy is designed to achieve a surplus to the Bank's PRA buffer in the latter part of 2019 (based on the Bank's own internal assessment of future minimum Pillar 2a and 2b regulatory capital requirements and subject to future SREP). In addition, the 2017 May Outlook also assumes that the Bank will issue further MREL qualifying debt in 2020 and 2021 so as to meet the Bank's assessment of its ongoing MREL requirement. Furthermore, delivery of the 2017 May Outlook, including the successful implementation of the Restructuring and Recapitalisation, is expected to improve the Bank's leverage ratio to levels in excess of 3% over the life of the Plan.

Without successful completion of the Restructuring and Recapitalisation, the projected CET1 headroom to the consolidated and solo Pillar 1 regulatory minimum is not considered to be sufficient to withstand the impact of the likely ongoing cost of future planned Tier 2 and MREL qualifying debt instruments. Without the further CET1 issuance included in the Restructuring and Recapitalisation, the Bank does not expect to meet its ICG and PRA buffers before the end of the 2021 planning period.

The Bank continues to monitor the regulatory capital horizon for any emerging regulation that could impact its ability to deliver the Plan. This includes, but is not limited to, any updates with regards to the implementation of leverage ratio targets for the UK banking sector.

## **Capital Requirements Regulation**

The Bank is currently not fully compliant with the CRR provisions related to the use of an Internal Ratings Based (IRB) approach to modelling its credit risk capital requirements. A review by the PRA took place during 2015 and identified areas of non-compliance and inadequate procedures relating to use of an IRB approach, requiring improvement and a remediation plan to rectify under supervisory guidance. These areas include a redesign of model risk policy, redevelopment of the Bank's IRB models, and the strengthening of the overall control environment. In March 2016 the Bank received a formal communication from the PRA regarding the levying of an additional Pillar 2a requirement to cover these risks, and this remains within the Bank's Pillar 2a requirements, confirmed as part of the Bank's revised ICG requirements communicated by the PRA in November 2016. This has been factored into the Plan. It is the Bank's objective, subject to successful completion of a remediation plan by the end of 2017, to seek and obtain PRA approval of such remediation by the end of 2017 and to have this fixed requirement removed from its ICG during the first quarter of 2018.

A failure to address model risk non-compliance would potentially result in regulatory action such that the Bank's permission to use an IRB approach could be removed by the PRA, resulting in (amongst other things) the use of a standardised approach to modelling credit risk. This could expose the Bank to a material increase in the calculation of its minimum Pillar 1 regulatory capital requirements and, given that many of the Bank's regulatory capital requirements are calculated by reference to the Bank's RWAs, there may be a consequential requirement to hold additional regulatory capital, the creation of an additional ICG deficit and/or a reduction in the Bank's CET1 capital ratio.

Any formal introduction of current proposals from the Basel Committee to implement floors for PD, LGD and CCF in Retail mortgages could also impact the planned allocation of capital to such assets through the life of the Plan.

## **Liquidity**

The Bank's liquid asset ratio at 30 June 2017 was 12.3% (31 December 2016: 13.8%).

As at 30 June 2017 the Bank had a surplus stock of high quality liquid assets to its regulatory Pillar 1 LCR and regulatory add-ons. A surplus to the Bank's internal liquidity risk appetite was held at 30 June 2017, and the Bank continues to monitor closely and take actions to maintain an appropriate liquidity position ahead of the planned Restructuring and Recapitalisation and deployment of management actions included within

the 2017 May Outlook.

During the six months to 30 June 2017, Retail and BaCB customer liabilities have fallen by £1.4bn, including both targeted deposit reductions and some higher than anticipated customer withdrawals. The Bank's strategy is to manage its Retail and corporate deposits to broadly match balance sheet assets and to reduce the cost of liabilities. The reduction in corporate deposits includes the planned withdrawal of larger corporate accounts, using tariff changes to manage the re-banking of customers, in line with the Bank's strategy of focusing on the Retail and SME sectors. The reduction in Retail deposits in 2017 also reflects customer reaction to the Bank's announcements of its Restructuring and Recapitalisation processes, and subsequent pricing activity to deliver more positive deposit performance.

The Bank expects to continue to manage its liquidity such that it will stay above the current and future LCR regulatory minima across the Plan.

### **Other regulatory matters**

Since early 2014 the Bank has run major programmes of IT remediation, including the migration of a majority of the Bank's IT infrastructure to an IBM managed service platform, with further migrations planned. Collectively these programmes have substantially addressed a range of deficiencies in the Bank's IT estate including, notably, the inability to prove disaster recovery capability for all critical business processes. Whilst the PRA's and FCA's general policy is not to communicate their assessment of their position in relation to the Threshold Conditions, in March 2017 the FCA confirmed to the Bank that the various IT remediation activities undertaken in 2015 and 2016 had brought the Bank back into compliance with their Threshold Condition requirements for non-financial resources. The PRA has not communicated to the Bank its assessment of the Bank's position in relation to their Threshold Conditions.

Irrespective of the successful implementation of the Restructuring and Recapitalisation, the Bank will not be compliant with certain other PRA and FCA regulatory requirements and the Bank would be subject to any enforcement action the Authorities may take in respect of such non-compliance. The Bank's deficiencies against regulatory requirements and expectations have existed for some time and will continue for some years to come while the Bank implements its strategy. The Bank has been subject to a heightened degree of regulatory supervision since 2013. The successful implementation of the Bank's strategy depends on the Authorities not taking enforcement action against the Bank regarding any continuing and intervening deficiencies to required regulatory standards.

### **Risks and uncertainties**

The key risks and uncertainties described below should be read in conjunction with the Risk Factors document included at <http://www.co-operativebank.co.uk/investorrelations> (the Risk Factors), published in connection with the proposed Restructuring and Recapitalisation of the Bank. The key risks and uncertainties associated with the Bank's continuing use of the going concern basis of accounting include, but are not limited to:

1. The Board has announced a Restructuring and Recapitalisation of the Bank, which may or may not proceed. The 2017 May Outlook accepted by the PRA on 27 June 2017 (subject to certain final regulatory approvals by the PRA and other parties) and approved by the Board on 11 July 2017 anticipates various important management actions, including successfully raising approximately £700m of CET1 capital (depending on the actual amount of retail cash consideration paid as part of the Restructuring and Recapitalisation and excluding costs and expenses incurred by the Bank), sufficient to meet the Bank's projected full ICG requirement in 2018. The Restructuring and Recapitalisation contained within the Plan and 2017 May Outlook carries significant execution risk and material uncertainty exists with regards to the eventual outcome. This includes the finalisation of Restructuring and Recapitalisation actions, obtaining necessary regulatory, shareholder and public debt holder approvals, the absence of materially detrimental litigation pertaining to the Restructuring and Recapitalisation, and prevailing market conditions. Accordingly there cannot be certainty that the proposed actions will be completed when planned or needed, on favourable terms, or at all;
2. Irrespective of the successful implementation of the Restructuring and Recapitalisation, there is a risk that the Authorities may exercise their discretion and take enforcement action against the Bank at any time in relation to its various non-compliance with its regulatory requirements. These key non-compliances are meeting its ICG, Combined Buffer, PRA Buffer, MREL and CRR requirements (relating to the use of an IRB Approach to modelling its credit risk capital requirements);
3. Failure to successfully implement or a delay in implementing the Plan and, where applicable, the 2017 May Outlook, may adversely impact the Bank's business, operating results, financial condition and prospects, its regulatory capital resources and its ability to comply with its regulatory capital requirements. In addition, the Bank's Plan and 2017 May Outlook are based on underlying assumptions that are subject to significant risks and uncertainties.
4. There are risks that the Bank will be unable to raise the required capital and issue Tier 2 debt and MREL qualifying debt on acceptable terms, when planned or at all, and that the Bank will be unable to meet its full ICG when planned, or at all. Should this occur the Bank of England and the PRA can agree to accept a revised issuance plan, use their respective powers to require some other remediating action on the part of the Bank, or in the absence of any of these the Bank of England may exercise its resolution powers under the Banking Act;
5. Whilst the principles of sectionalisation of the Pace pension scheme have been agreed with Co-operative Group and the Pace trustees, this is subject to a number of conditions (including the negotiation and execution of a definitive sectionalisation agreement), and there remains a risk that sectionalisation may not be completed within the timescales required, on favourable terms, or at all. As long as the Bank remains a participating employer in Pace until sectionalisation is completed, the Bank could be the 'last man standing' in the event of the failure or exit from Pace of one or more of the other participating employers meaning that some or all of the entire of the Pace Scheme's liabilities would need to be borne by the Bank. In addition, a material difference to current estimates of the funding of the pension scheme, or the Bank being forced to pay for a greater proportion than currently envisaged, could increase the Bank's Pillar 2a capital requirements or cause additional cash outflow through increased contributions;

6. The Bank announced on 28 July 2017 it will seek to exercise its right to terminate the Calico Finance Number One synthetic securitisation through a regulatory call. If the Bank is unable to successfully effect this regulatory call the Bank would not benefit from the assumed annual interest savings and the viability of contemplated further whole-loan disposals or securitisations of Optimum assets that include Calico referenced assets may be jeopardised;
7. The Bank anticipates making a further reduction of Optimum assets through whole-loan disposals and/or securitisations. There is a risk that the Bank will be unable to deleverage its Optimum assets in a capital efficient manner, or may incur greater than expected costs or experience delays in relation to such deleveraging;
8. There are several risks associated with the changes in the Bank's relationship with Co-operative Group. The Bank's relationship with Co-operative Group will be materially changed by the Restructuring and Recapitalisation, the termination and run-off of the relationship agreement between the Bank, Co-operative Group and the Co-operative Banking Group Limited, dated 4 November 2013, and termination of the co-existence principles agreed between the Bank and Co-operative Group in 2013, particularly if other commercial arrangements between the Bank and Co-operative Group terminate, such as the Bank's participation in Co-operative Group's membership scheme.

In addition, the Bank's differentiated customer proposition depends in part on its continued use of the 'Co-operative' name. Though Co-operative Group has acknowledged the Bank's ownership of 'The Co-operative Bank', a failure to agree consensual outcomes on the objections each of the Bank and Co-operative Group have made to the other's applications to register related trademarks, or the evolution of their respective branding generally could lead to potential legal, financial and reputational risk to the Bank.

Furthermore, the Bank continues to be operationally dependent on Co-operative Group and its affiliates to provide a number of services including critical IT services and on-supply certain services and has significant counterparty exposure to Co-operative Group;

9. The Bank has chosen to use a small number of third-party service providers to support aspects of its IT and operations, notably providers of IT hosting and management services, systems, software, data and other assets for its critical infrastructure and operational capabilities. These third-party service providers, some of which supply their services under long-term contracts, may be expensive or difficult to replace, particularly at short notice if they are unable or unwilling to provide services;
10. The PRA's acceptance of the 2017 May Outlook is premised on the Bank achieving in the medium term a competitive cost-income ratio, in line with the Bank's peer group. The 2017 May Outlook assumes the Bank is able to deliver the remaining transformation, remediation and change programmes and the cost reduction initiatives already underway without material deviation from planned timescales and costs. Any deficiencies in the appropriate governance and related programme management processes to assist with the satisfactory delivery would have an adverse effect on the Bank's financial position compared with that anticipated in the 2017 May Outlook; and
11. More generally, the further materialisation of particular challenges and external factors similar to those faced by other financial institutions, which prevent the Bank from delivering its strategy and meet the targets in the Plan and the 2017 May Outlook, include, but are not limited to:
  - adverse general economic conditions in the UK and adverse developments in the UK or global financial markets, including economic or political outcomes negotiated as part of the UK leaving the EU or a break-up of the single European currency; and
  - unforeseen regulatory change (including future changes to its regulatory capital requirements driven by regulatory stress-testing results).

## Conclusion

As outlined above, there are significant execution risks in respect of the Bank successfully completing the Restructuring and Recapitalisation. Further, the Bank believes that, if the Restructuring and Recapitalisation is not successfully implemented, the most likely outcome is that the Bank's ordinary shares and the subordinated notes will be subjected to a mandatory write-down either as a preliminary step to, or in the course of the Bank's entry into, Special Resolution. The Board considers that the risks outlined above represent material uncertainties, which may cast significant doubt upon the Bank's ability to continue as a going concern. In the event that one or more of these key risks and material uncertainties were to materialise the Bank may be unable to continue realising its assets and discharging its liabilities in the normal course of business. After making enquiries of management, the Board has concluded that the Bank can have reasonable confidence in the delivery of the Plan and the 2017 May Outlook, and therefore on the Bank's ability to continue as a going concern. These enquiries and considerations have included contemplating the successful raising of new equity capital from existing providers, including a liability management exercise, and the resulting projections of the income statement, balance sheet, capital and liquidity in the 2017 May Outlook, together with the PRA's assessment that, subject to certain contingencies, the Restructuring and Recapitalisation and 2017 May Outlook are acceptable.

The Board notes that the Bank also remains reliant on the continued acceptance of the PRA regarding its inability to meet CRR, ICG and PRA buffer requirements, during and beyond the period of the going concern assessment.

Consequently the Bank has adopted the going concern basis in preparing the 2017 Interim Financial Report, which does not include the adjustments that would result if the Bank were unable to continue as a going concern.

## 2. Critical judgements and estimates

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

Estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the

estimate is revised and in any future periods affected.

The judgements and assumptions that are considered to be the most important to the Bank's financial condition for the period ended 30 June 2017 are those relating to loan impairment provisions, conduct risk provisions, deferred tax, defined contribution accounting for the Pace scheme, separation provision, EIR and group relief receivable.

## **a. Loan impairment provisions**

### **i. Overview**

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

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

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

The methodology for loan impairment for unsecured, secured residential and corporate segments is explained on pages 161 to 162 in the 2016 Annual Report and Accounts and has not fundamentally changed in the period to 30 June 2017.

### **ii. Collective provisions**

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

#### **a) Retail unsecured and secured residential**

The Bank's collective provision for unsecured and secured Retail personal advances is £43.7m (31 December 2016: £61.3m).

A key estimate within the unsecured models is the probability that impaired accounts move to a default status during the outcome period. The model uses historical actual data over a defined period of time to arrive at an average probability of accounts moving to default. If the maximum probability of default (PD) had been used for each category of arrears and for each product, this would increase the collective provision by £3.0m for all of the unsecured portfolios.

A key estimate of the secured impairment model provisioning is forced sales discount. The forced sales discount is an average and is calculated using historical actual data over a defined outcome period. If the maximum forced sales discount for the outcome period was used to calculate the provision across the secured portfolios excluding Optimum it would increase by £0.5m.

A key estimate is the collateral value. A 10% decrease to the indexed collateral used in the model would increase the provision by £1.0m.

#### **b) BaCB**

The Bank's collective provision against corporate loans has remained stable at £0.5m (31 December 2016: £0.5m). A key estimate is default rates. The impact of increasing the default rates by 10% is an increase in the collective provision of £0.1m. The impact of increasing other parameters that affect the loss rate by 10% is not significant.

#### **c) Legacy Portfolio**

The Bank's collective provision against Legacy Portfolio loans has increased to £4.0m (31 December 2016: £1.3m). A key estimate is default rates. The impact of increasing the default rates by 10% is an increase in the collective provision of £0.5m. The impact of increasing other parameters that affect the loss rate by 10% is not significant.

#### **d) Optimum**

In addition to the above, collective provisions of £11.9m (31 December 2016: £12.5m) are held in the Optimum segment.

A key estimate of the secured impairment model provisioning is forced sales discount. The forced sales discount is an average and is calculated using historical actual data over a defined outcome period. If the maximum forced sales discount for the outcome period was used to calculate the provision it would increase by £0.8m.

A key estimate is the collateral value. A 10% decrease to the indexed collateral used in the model would increase the provision by £5.8m.

### **iii. Individual provisions**

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

#### **a) BaCB**

The Bank's individual impairment provision on BaCB loans totals £0.4m (31 December 2016: £0.5m).

## b) Legacy Portfolio

The Bank's individual impairment provision on Legacy Portfolio loans totals £34.6m (31 December 2016: £46.2m). The provision has decreased, reflecting the Bank's strategic deleveraging of assets. For further information on credit risk and impairment, see the Bank's risk management disclosures.

## b. Conduct risk provisions

### i. Overview

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

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

### ii. Payment Protection Insurance (PPI)

A provision of £83.7m (31 December 2016: £90.4m) has been recorded in respect of potential customer redress relating to past sales of PPI. The provision is in respect of the total expected cost of carrying out this work and paying compensation, making total provisions raised to date of £469.0m (31 December 2016: £459.8m).

Overall complaint redress performance in the half year to 30 June 2017 has increased due to higher publicity and the publication of the FCA policy statement PS17/03 which also introduced new requirements to contact customers whose PPI complaints had previously been rejected that are in scope of the Plevin ruling. A £9.2m increase has been recognised to reflect the Bank's estimates of both the higher volumes and impacts of the FCA Consultation Paper PS17/03.

The key assumptions within the calculation of the current provision are complaint volumes, uphold rates, administration costs and average redress.

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

Description of estimate	Current position	Future expected	Sensitivity on current position
Number of inbound valid <sup>1</sup> complaints	107k	24k	1,000 = £2.4m
Proactive mailings <sup>2</sup>	45k	11k	1,000 = £1.8m
Response rate to proactive mailings	60%	73%	1% = £1.3m
Average uphold rate per valid <sup>1</sup> complaint	59%	72%	1% = £0.8m
Average redress per upheld complaint	£3,449	£2,713	£100 = £2.1m

<sup>1</sup> Valid complaints excludes those complaints for which no PPI policy exists

<sup>2</sup> Future expected proactive mailings relate to the PS17/03 Plevin mailing requirements

These assumptions remain subjective, in particular due to the uncertainty associated with future claims levels. The resulting provision represents the best estimate of all future expected costs of PPI redress, however, it is possible the eventual outcome may differ from the current estimate and if this were to be material an adjustment to the provision will be made.

### iii. Other conduct/compliance related provisions

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

## c. Deferred tax

The Bank has recognised a deferred tax asset of £nil (31 December 2016: £nil) and a deferred tax liability of £2.7m (31 December 2016: £14.2m). Further information on the accounting treatment of deferred tax and future rates of corporation tax can be found on page 170 in the 2016 Annual Report and Accounts.

## d. Defined contribution accounting for the Pace scheme

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

## e. Separation provision

A provision of £17.7m (31 December 2016: £27.3m) is held against separation costs directly relating to the Bank's obligation to separate from Co-operative Group. A reasonably possible change in overall estimates of costs for key separation provision judgements, relating to both the rates paid for resources and time taken to complete the programme, could increase the provision by £3.2m.

## f. Effective Interest Rate

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

In calculating the EIR adjustment to apply to mortgage balances, the most significant assumption in terms of impact and volatility is the assumed standard variable rate which will be in effect at the end of a fixed rate product term. This is determined with reference to expected base rate rises, with a proportion of future increases assumed to pass through to the Bank's standard variable rate. As a measure of the sensitivity a 0.5% increase in the assumed standard variable rate in place after the expiry of the fixed rate period for all products would result in a £11.7m (21.4%) increase in the EIR adjustment required to the loans and advances to customers balance as at 30 June 2017.

#### g. Group relief receivable

The Bank receives payment from Co-operative Group when Co-operative Group realises the benefit of the losses surrendered and at the corporation tax rate at which the benefit is realised. The value of the asset is sensitive to a number of assumptions including the forecast repayments provided by Co-operative Group for the periods to 2019; Co-operative Group's capital expenditure qualifying for capital allowances in future periods; Co-operative Group's taxable profits in future periods; the Bank's extrapolation of the forecast repayments for the periods after 2019; changes in tax legislation including the rate of corporation tax and the rates at which capital allowances on qualifying capital expenditure are available; and Co-operative Group's capacity to claim the tax losses. The Interim 2017 consolidated financial statements include a group relief receivable of £75.7m (31 December 2016: £84.1m). If Co-operative Group's capacity to realise benefit in 2016-2019 from the previously surrendered losses decreases by 5%, the value of the group relief receivable will decrease by £4.5m.

Further detail can be found on page 171 of the 2016 Annual Report and Accounts.

An amendment to the documents governing the receivable has been made as part of the Restructuring and Recapitalisation. For more details, please see note 13 to these Interim Financial Statements.

### 3. Segmental information

The Bank is managed through six operating segments, comprising: Retail, Business and Commercial Banking (BaCB), Treasury, Legacy Portfolio, Optimum and Other. Revenues are attributed to the segment in which they are generated.

Further details of the operating segments are provided in the Detailed Financial Review.

	Retail	BaCB	Treasury	Legacy Portfolio	Optimum	Other	Total
<b>Period to 30 June 2017</b>							
Net interest income/(expense)	165.9	19.3	(4.7)	(1.8)	(6.5)	(0.2)	172.0
Losses on asset sales	-	-	-	(1.1)	-	-	(1.1)
Non-interest income/(expense)	12.2	8.5	18.2	0.7	(0.6)	(1.0)	38.0
<b>Operating income/(expense)</b>	<b>178.1</b>	<b>27.8</b>	<b>13.5</b>	<b>(2.2)</b>	<b>(7.1)</b>	<b>(1.2)</b>	<b>208.9</b>
Impairment (losses)/gains on loans and advances	(0.5)	-	-	2.6	(0.7)	-	1.4
<b>Income/(expense) net of impairment</b>	<b>177.6</b>	<b>27.8</b>	<b>13.5</b>	<b>0.4</b>	<b>(7.8)</b>	<b>(1.2)</b>	<b>210.3</b>
Operating expenditure – staff							(82.0)
Operating expenditure – non-staff							(118.8)
Operating project expenditure							(8.3)
<b>Operating result</b>							<b>1.2</b>
Conduct risk							(4.7)
Remediation project expenditure							(34.8)
Strategic project expenditure							(10.7)
Severance							(2.5)
Other exceptional items							(25.5)
Share of post-tax profits from joint ventures							0.1
Fair value amortisation							(58.3)
<b>Loss before taxation</b>							<b>(135.2)</b>
Income tax							(4.5)
<b>Loss for the financial period</b>							<b>(139.7)</b>

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

	Retail	BaCB	Treasury	Legacy Portfolio	Optimum	Other	Total
Re-presented period to 30 June 2016							
Net interest income/(expense)	171.1	26.4	5.5	0.6	(9.6)	7.5	201.5

Losses on asset sales	-	-	-	(11.2)	-	-	(11.2)
Non-interest income	14.1	6.7	14.3	3.9	1.5	6.9	47.4
Operating income/(expense)	185.2	33.1	19.8	(6.7)	(8.1)	14.4	237.7
Impairment gains/(losses) on loans and advances	3.3	(0.6)	-	5.6	(6.0)	(0.2)	2.1
Income/(expense) net of impairment	188.5	32.5	19.8	(1.1)	(14.1)	14.2	239.8
Operating expenditure – staff							(97.5)
Operating expenditure – non-staff							(125.3)
Operating project expenditure							(19.7)
Operating result							(2.7)
Conduct risk							(21.1)
Remediation project expenditure							(71.3)
Strategic project expenditure							(34.7)
Severance							(8.5)
Other exceptional items							58.1
Share of post-tax profits from joint ventures							0.4
Fair value amortisation							(97.2)
Loss before taxation							(177.0)
Income tax							44.9
Loss for the financial period							(132.1)

The 2016 comparatives have been re-presented as described in the Detailed Financial Review.

The table below represents the reconciliation of the management accounts presentation in the Detailed Financial Review and the segmental note back to the Bank income statement.

	Period to 30 June 2017	Re-presented period to 30 June 2016
<b>Net interest income</b>		
Total interest margin per Detailed Financial Review	172.0	201.5
Interest fair value unwind	(56.0)	(93.8)
Provision for customer redress	(0.2)	(1.8)
Other	-	(0.1)
Net interest income	115.8	105.8
<b>Non-interest income</b>		
Non-interest income per Detailed Financial Review	38.0	47.4
Losses on asset sales	(1.1)	(13.9)
Gain on sale of equity shares	22.8	58.1
Non-interest income	59.7	91.6
Comprising:		
Net fee and commission income	16.7	20.1
Income from investments	0.1	0.2
Other operating income	42.9	71.3
	59.7	91.6
<b>Operating expenses</b>		
Total operating costs per Detailed Financial Review	(200.8)	(222.8)
Projects and severance costs per Detailed Financial Review	(56.3)	(134.2)
Costs associated with Restructuring and Recapitalisation <sup>1</sup>	(48.3)	-
Interest fair value unwind	(2.3)	(3.2)
Provision for legal charges	-	(0.4)
Other	-	0.1
Operating expenses	(307.7)	(360.5)
<b>Provision for customer redress</b>		
Conduct risk per Detailed Financial Review	(4.7)	(21.1)
Provision for conduct risk included within interest income	0.2	1.8
Provision for legal charges included within operating expenses	-	0.4

Provision for customer redress	(4.5)	(18.9)
<b>Interest fair value unwind</b>		
Fair value amortisation for reportable segments per Detailed Financial Review	(58.3)	(97.2)
Interest margin unwind	56.0	93.8
Impairment unwind	-	0.2
Operating expenses unwind	2.3	3.2
Interest fair value unwind	-	-
<b>Impairment gains on loans and advances</b>		
Impairment gains on loans and advances per Detailed Financial Review	1.4	2.1
Impairment unwind	-	(0.2)
Gains on asset sales	-	2.7
Impairment gains on loans and advances	1.4	4.6
<b>Other exceptional items</b>		
Total other exceptional items for reportable segments	(25.5)	58.1
Gains on sale of equity shares included within non-interest income	(22.8)	(58.1)
Restructuring and Recapitalisation included within operating expenses	48.3	-
	-	-

<sup>1</sup> As at 30 June 2017 the Restructuring and Recapitalisation was in process, and therefore, all associated expenses to date have been recorded in the income statement. Upon successful completion of this process, an element of these costs may be reclassified from the income statement to equity. Should the Restructuring and Recapitalisation not complete, the expenses incurred will remain in the income statement.

The 2016 comparatives have been re-presented as described in the Detailed Financial Review.

As at							
30 June 2017	Retail	BaCB	Treasury	Legacy Portfolio	Optimum	Other	Total
<b>Segment total assets</b>	<b>14,683.9</b>	<b>354.8</b>	<b>5,741.9</b>	<b>1,355.7</b>	<b>2,504.6</b>	<b>353.5</b>	<b>24,994.4</b>
<b>Segment total liabilities</b>	<b>18,599.1</b>	<b>2,155.7</b>	<b>2,940.4</b>	<b>124.0</b>	<b>-</b>	<b>389.2</b>	<b>24,208.4</b>
Re-presented as at							
31 December 2016	Retail	BaCB	Treasury	Legacy Portfolio	Optimum	Other	Total
Segment total assets	14,844.6	434.9	7,794.1	1,471.4	2,604.0	439.3	27,588.3
Segment total liabilities	19,405.1	2,719.3	3,741.1	61.3	-	703.0	26,629.8

The 2016 comparatives have been re-presented as described in the Detailed Financial Review

#### 4. Net interest income

	Period to 30 June 2017	Period to 30 June 2016
<b>Interest receivable and similar income</b>		
On financial assets not at fair value through profit or loss:		
On loans and advances to customers	285.3	318.0
On loans and advances to banks	3.1	5.7
On investment securities	26.0	43.1
Net interest income on net defined benefit pension asset	0.3	-
<b>Total of financial assets not at fair value through profit or loss</b>	<b>314.7</b>	<b>366.8</b>
On financial assets at fair value through profit or loss:		
Net interest expense on financial instruments hedging assets	(19.5)	(18.0)
Net interest income on financial instruments not in a hedging relationship	2.2	2.8
<b>Total interest receivable and similar income</b>	<b>297.4</b>	<b>351.6</b>

	Period to 30 June 2017	Period to 30 June 2016
<b>Interest expense and similar charges</b>		
On financial liabilities not at fair value through profit or loss:		
On customer accounts	(63.9)	(81.3)
On subordinated liabilities, debt securities in issue and other deposits	(120.6)	(168.2)
Net interest expense on net defined benefit pension liability	(0.1)	-
<b>Total of financial liabilities not at fair value through profit or loss</b>	<b>(184.6)</b>	<b>(249.5)</b>
On financial liabilities at fair value through profit or loss:		

Net interest income on financial instruments hedging liabilities	4.7	4.0
Net interest expense on financial instruments not in a hedging relationship	(1.7)	(0.3)
<b>Total interest expense and similar charges</b>	<b>(181.6)</b>	<b>(245.8)</b>

Interest expense on subordinated liabilities, debt securities in issue and other deposits includes fair value unwind on debt securities in issue of £58.3m (30 June 2016: £94.7m), further details of which were provided in note 38 of the 2016 Annual Report and Accounts.

## 5. Other operating income

	Period to 30 June 2017	Period to 30 June 2016
Profit on sale of investment securities – loans and receivables	7.3	17.8
Gain on sale of equity shares <sup>1</sup>	22.8	58.1
Loss on sale of loans and advances to customers	(0.8)	(4.4)
Income/(expense) from derivatives and hedge accounting	14.2	(47.8)
Income from assets and liabilities held at fair value through profit and loss	1.4	17.1
Fair value movement on loans and advances to customers designated at fair value	(4.0)	13.8
Foreign exchange gains	1.8	6.5
Other	0.2	10.2
<b>Total other operating income</b>	<b>42.9</b>	<b>71.3</b>

<sup>1</sup> In the period to 30 June 2017, this gain has arisen as a result of the sale of the Bank's shares in Vocalink.

## 6. Operating expenses

	Period to 30 June 2017	Period to 30 June 2016
<b>Operating expenses include:</b>		
Staff costs	107.1	142.2
Administrative expenses	156.9	91.7

## 7. Income tax

	Period to 30 June 2017	Period to 30 June 2016
Current tax	4.3	(2.3)
Deferred tax	0.2	(42.6)
<b>Total tax charge/(credit)</b>	<b>4.5</b>	<b>(44.9)</b>

The tax on the Bank's loss before taxation differs from the theoretical amount that would arise using the corporation tax rate in the UK as follows:

	Period to 30 June 2017	Period to 30 June 2016
Loss before taxation	(135.2)	(177.0)
Tax calculated at a rate of 19.25% (30 June 2016: 20.00%)	(26.0)	(35.4)
Effects of:		
Expenses not deductible for tax purposes	10.6	2.9
Unrecognised deferred tax	10.3	(6.3)
Adjustment and unwind for group relief debtor	4.3	(1.8)
Impact of surcharge tax	3.5	(11.5)
Other differences	2.3	4.4
Impact of corporation tax rate change	(0.5)	2.8
	<b>4.5</b>	<b>(44.9)</b>

Amounts receivable from Co-operative Group for tax losses surrendered and changes in that amount are recorded as an adjustment to the tax expense. For further information on the group relief receivable, refer to note 2.

The movements on deferred tax are as follows:

	Period to 30 June 2017	Year to 31 December 2016
Deferred tax at the beginning of the period	(14.2)	(40.2)
(Charged)/credited to the income statement	(0.2)	34.6
Credited/(charged) to other comprehensive income	11.7	(8.6)
Deferred tax at the end of the period	<b>(2.7)</b>	<b>(14.2)</b>

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

Deferred tax assets totalling £424.6m (31 December 2016: £409.0m) have not been recognised where doubt exists over the availability of sufficient future taxable profits.

The UK corporation tax reduced from 20% to 19% (effective from 1 April 2017) and will reduce to 17% effective from 1 April 2020; the latter rate change was enacted on 15 September 2016. A banking surcharge tax of 8% also applies to the Bank (effective from 1 January 2016). Deferred tax has been calculated by reference to the most appropriate rate based on forecasts.

New legislation was enacted in 2016 with the effect that from 1 April 2016, only 25% of a Bank's taxable profits can be relieved by brought forward losses. The Government announced on 16 March 2016 that further changes to the rules on the utilisation of tax losses will be introduced effective from 1 April 2017; however, the new legislation has not yet been enacted.

## 8. Loans and advances to customers

	As at 30 June 2017	As at 31 December 2016
Gross loans and advances	19,028.8	19,575.0
Less: allowance for losses	(95.1)	(122.3)
	<b>18,933.7</b>	<b>19,452.7</b>

### Allowance for losses on loans and advances

	Retail		BaCB		Legacy Portfolio		Optimum		Total
	Individual	Collective	Individual	Collective	Individual	Collective	Individual	Collective	
<b>Period to 30 June 2017</b>									
At the beginning of the period	-	61.3	0.5	0.5	46.2	1.3	-	12.5	122.3
Reclassification between collective and individual	-	-	-	-	-	-	-	-	-
Charge/(release) against profits	-	1.7	-	-	(2.8)	2.7	-	0.5	2.1
Amounts written off	-	(19.3)	(0.1)	-	(8.8)	-	-	(1.1)	(29.3)
Unwind of discount allowance	-	-	-	-	-	-	-	-	-
<b>At the end of the period</b>	-	<b>43.7</b>	<b>0.4</b>	<b>0.5</b>	<b>34.6</b>	<b>4.0</b>	-	<b>11.9</b>	<b>95.1</b>

The £2.1m charge against profits as above reconciles to the net impairment gain as per the income statement, as shown below:

	Period to 30 June 2017
Charge against profits shown above	2.1
Amounts recovered against amounts previously written off	(3.5)
<b>Net impairment gain shown in income statement</b>	<b>(1.4)</b>

	Retail		BaCB		Legacy Portfolio		Optimum		Total
	Individual	Collective	Individual	Collective	Individual	Collective	Individual	Collective	
<b>Year to 31 December 2016</b>									
At the beginning of the period	2.8	101.5	1.0	0.8	118.4	7.5	9.9	3.3	245.2
Reclassification between collective and individual	(2.8)	2.8	-	-	-	-	(9.9)	9.9	-
Charge/(release) against profits	-	1.2	(0.1)	(0.3)	20.6	(6.2)	-	1.6	16.8
Amounts written off	-	(44.2)	(0.4)	-	(91.6)	-	-	(2.3)	(138.5)
Unwind of discount allowance	-	-	-	-	(1.2)	-	-	-	(1.2)
<b>At the end of the period</b>	-	<b>61.3</b>	<b>0.5</b>	<b>0.5</b>	<b>46.2</b>	<b>1.3</b>	-	<b>12.5</b>	<b>122.3</b>

## 9. Investment securities

### Analysis of investment securities by issuer

	As at 30 June 2017	As at 31 December 2016
Investment securities issued by public bodies:		
Government securities	1,186.7	1,661.5
Other public sector securities	254.3	173.7
<b>Total investment securities issued by public bodies</b>	<b>1,441.0</b>	<b>1,835.2</b>
Other debt securities:		
Other fixed and floating-rate notes	157.7	395.5
Mortgage backed securities	901.3	1,321.2
<b>Total investment securities issued by other issuers</b>	<b>1,059.0</b>	<b>1,716.7</b>
<b>Total investment securities</b>	<b>2,500.0</b>	<b>3,551.9</b>

Other fixed and floating-rate notes (FRNs) comprise:

- sterling denominated FRNs with contractual maturities ranging from eighteen months to four and a half years from the balance sheet date; and
- sterling denominated permanent interest bearing shares (PIBS) that have a call date of 18 December 2018.

## 10. Provisions for liabilities and charges

As at 30 June 2017	Property	FSCS	PPI	Conduct/	Separation	Other	Total
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	levies			legal			
At the beginning of the period	32.7	6.6	90.4	78.9	27.3	40.5	276.4
Provided/(released) in the period:							
Interest income	-	-	-	0.2	-	-	0.2
Operating expense	0.4	4.6	-	0.5	1.7	9.6	16.8
Provision for customer redress	-	-	9.2	(4.7)	-	-	4.5
Utilised during the year	(5.3)	-	(15.9)	(18.6)	(11.3)	(28.1)	(79.2)
<b>At the end of the period</b>	<b>27.8</b>	<b>11.2</b>	<b>83.7</b>	<b>56.3</b>	<b>17.7</b>	<b>22.0</b>	<b>218.7</b>
Provisions were analysed as follows:							
Amounts falling due within one year	18.5	6.6	46.7	49.7	17.3	20.7	159.5
Amounts falling due after one year	9.3	4.6	37.0	6.6	0.4	1.3	59.2
<b>Total provisions</b>	<b>27.8</b>	<b>11.2</b>	<b>83.7</b>	<b>56.3</b>	<b>17.7</b>	<b>22.0</b>	<b>218.7</b>

## Property

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

## Financial Services Compensation Scheme (FSCS) levies

In common with other regulated UK deposit takers, the Bank pays levies to the FSCS to enable the FSCS to meet claims against it. During 2008 and 2009 claims were triggered against the FSCS in relation to a number of financial institutions. The compensation paid out to consumers is currently funded through loans from HM Treasury. The Bank could be liable to pay a proportion of the outstanding borrowings that the FSCS has borrowed from HM Treasury. The ultimate FSCS levy to the industry as a result of the historic claims cannot currently be estimated reliably as it is dependent on various uncertain factors including the potential recoveries of assets by the FSCS and changes in the level of protected deposits and the population of FSCS members at the time.

By virtue of holding deposits protected under the FSCS scheme the Bank has an obligation to pay levies in respect of the interest cost for the 2016/17 and 2017/18 scheme years. The interest rate chargeable on the loan and levied to the industry is subject to a floor equal to the higher of HM Treasury's own cost of borrowing and GBP LIBOR with 12-month maturity.

The Bank has provided £11.2m as at 30 June 2017 (31 December 2016: £6.6m) for its share of the levies raised by the FSCS. The Bank's interest levy provision calculation includes estimates of the total FSCS levy in each levy year and estimates of the Bank's market participation in each levy year.

## Payment Protection Insurance (PPI)

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

The FSA issued a policy statement in August 2010, which amended the Disputes Resolution: Complaints section of the FSA Handbook, setting out new rules for handling complaints, including complaints of PPI mis-selling. The Bank must comply with the policy statement which requires complainants to receive adequate redress and the Bank to deliver fair outcomes and treat customers fairly, including non-complainants.

An additional provision of £9.2m was recognised in the period ending 30 June 2017 (30 June 2016: £33.5m), in respect of the total expected cost to the Bank of carrying out this work and paying compensation. The provision increase reflects the Bank's impact assessment of the FCA's Paper PS17/03, which introduced a new requirement to mail previously rejected complainants in scope for Plevin informing them of their new grounds for complaint, as well as the impact of increased media coverage driven by the FCA in relation to the proposed claim time bar end date of June 2019. As a result, the total provision raised by the Bank to date is £469.0m.

## Conduct/legal provisions

The Bank released £4.7m (30 June 2016: £14.6m) of provision for customer redress. £3.4m of this release relates to mortgages provisions where programmes are either coming to a close or provision modelling is more mature, allowing for greater accuracy of redress calculations. The remaining £1.3m release relates to a £1.6m release on incurred but not identified (IBNI) and a £0.2m release on CCA delivery costs, offset by £0.5m increased central portfolio delivery costs.

During the period, the Bank provided £0.2m (30 June 2016: £1.8m) in respect of interest income in relation to breaches of the technical requirements of the CCA. An additional £0.5m was also provided for in respect of increased litigation costs (30 June 2016: £0.4m).

## Other

Provisions have been recognised within other provisions above where the Bank is able reliably to estimate any financial liabilities associated with such discussions. The charge in the period primarily relates to fraud, a revised compensation structure for employees and professional fees.

## 11. Pensions

The Bank participates in two multi-employer schemes - Pace and the Britannia Pension Scheme (BPS) - of which the former is shared with Co-operative Group and other Group subsidiaries, and the latter is a scheme in which only the Bank and subsidiaries of the Bank participate. Both schemes have closed defined benefit sections, and small Bank-supported Employer Financed Retirement Benefit Schemes, all of which are closed to future benefit accrual. The Pace scheme is open to further contributions in its defined contribution section. Full details of the schemes are disclosed within the Bank's 2016 Annual Report and Accounts, on pages 192 to 198.

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

During 2017, the Bank continued discussions with Co-operative Group and the Pace Trustees, with the aim of separating its liabilities in the scheme from those of other participating employers.

The Bank has now agreed Heads of Terms with Co-operative Group and the Pace Scheme Trustees to sectionalise the Bank's element of the Pace scheme which will effectively separate its liabilities in the scheme from those of other participating employers and remove the Bank's 'last man standing' obligation to the rest of the Pace scheme.

Until sectionalisation completes, the Bank remains exposed to actuarial risks of the current and former employees of other entities. Therefore, until sectionalisation completes, the Bank does not have sufficient information to account for its participation in the defined benefit section of Pace and continues to account for this multi-employer scheme on a defined contribution basis as defined in the Bank's 2016 Annual Report and Accounts.

As part of the sectionalisation process the Bank will also resolve the outstanding issue of 'orphan liabilities'. These 'orphan liabilities' are predominantly the liabilities of deferred and pensioner members of the CIS Employees' Pension Scheme which were transferred into Pace on its establishment in 2006. The likeliest option to resolve this issue will be a pro rata allocation of 'orphan liabilities' between Co-operative Group and the Bank. This would see the Bank's estimated share of Pace rise from 15% to c.21%.

On 19 August 2014, the Bank agreed to meet £5.0m of the total Pace deficit contributions at that date for a period of one year only. As separation negotiations continue the Bank has paid a further £2.5m during 2017 (2016: £5.0m). The Bank's agreement on 19 August 2014 to meet £5.0m of the total Pace deficit contributions was predicated upon this contribution not setting a precedent for future discussions on the separation of accrued Pace assets and liabilities between Co-operative Group and the Bank.

The Pace triennial valuation as at 5 April 2013 was completed on 21 July 2014. The funding shortfall for the entire scheme had increased from £248.0m per the previous triennial valuation as at 5 April 2010 to £600.0m as at 5 April 2013. The level of funding for the Pace scheme is agreed between Co-operative Group and the Pace Trustees. Co-operative Group agreed a recovery plan with the Trustees of the scheme to contribute £25m per annum over 5 years from 1 July 2014 to 30 June 2019 (inclusive) to repay the £104.0m deficit calculated on an approximate basis as at 31 May 2014. The latest funding shortfall position calculated by the scheme actuary on an approximate basis as at 5 April 2015 was £304.0m. The triennial valuation as at 5 April 2016 has not yet been finalised.

### b) Britannia Pension Scheme

The Britannia Pension Scheme is accounted for on a defined benefit basis in the 2017 Interim Financial Report. As disclosed in the Bank's 2016 Annual Report and Accounts, a change to the scheme rules was effective from 30 June 2016 which allows the Bank to receive a refund of surplus at the end of the scheme's life when there are no members remaining. Therefore, the Bank continues to recognise a net pension asset in relation to this scheme.

The Bank updates the valuation of the Britannia Pension Scheme under IAS 19 annually. Therefore, the retirement benefits associated with the Britannia Pension Scheme recognised on the balance sheet are substantially unchanged as at 30 June 2017, aside from net interest income on the net pension asset, administration costs paid out of the scheme assets, and further contributions paid. Further details of the valuation are provided in note 33 on pages 192 to 198 of the Bank's 2016 Annual Report and Accounts.

The actuarial valuation of the Britannia Scheme as at 5 April 2014, completed in accordance with the scheme specific funding requirements of the Pensions Act 2004, showed the Britannia Scheme had an actuarial funding shortfall of £41.2m. In respect of the deficit, the Trustees of the scheme and the Bank have agreed that contributions will be paid totalling £50m, with £5m paid during 2016, and a further £5m paid in the period to 30 June 2017. The Scheme Actuary estimated the scheme's actuarial funding shortfall had increased to £137m as at 31 March 2016. With agreement of the Trustees, the Bank therefore provided security against the increased shortfall in the form of £165.1m AAA rated retained Warwick Finance Two securitisation notes, with a 17% haircut. This security becomes enforceable in the event that Bank does not meet its deficit recovery payments agreed with the Trustees, Bank insolvency or the Bank fails to adhere to terms of the security deed. Due to the removal of the asset restriction, no further liability has been recognised in regard to the funding arrangement. The latest funding shortfall position calculated by the scheme actuary on an approximate basis as at 5 April 2016 was £144.7m. The next valuation date for the scheme will be as at 5 April 2017.

### c) Employer Financed Retirement Benefit Schemes

The Bank has obligations to two Employer Financed Retirement Benefit Schemes (included in 'Net retirement benefit liability' on the face of the balance sheet): one in respect of former Bank Executives (referred to in previous disclosures as the Bank (unfunded) pension scheme) and a second in respect of former Britannia Executives. The assumptions used to determine the liabilities of the heritage Bank EFRBS are the same as those used in determining the Pace liabilities, and the assumptions used to determine the liabilities of the heritage Britannia EFRBS are the same as those used in determining the Britannia Pension Scheme liabilities.

The Bank updates the valuation of the EFRBS under IAS 19 annually. Therefore, the retirement benefits associated with the EFRBS recognised

on the balance sheet are unchanged as at 30 June 2017. Further details of the valuation are provided in note 33 on pages 192 to 198 of the Bank's 2016 Annual Report and Accounts.

## 12. Contingent liabilities

Details of contingent liabilities at 31 December 2016 were disclosed in note 34 in the 2016 Annual Report and Accounts. These included the following key areas: assets pledged, commitments under operating leases, indemnification agreement, conduct issues, sale of the Bank's share in Visa Europe Limited, regulatory and other investigations, legal proceedings, mortgage securitisation representations and warranties (including Warwick Finance One and Warwick Finance Two), pensions, and tax treatment of separation. There has been no change to the nature of the contingent liabilities in the period to 30 June 2017.

## 13. Related party transactions

Related party transactions for H1 2017 are the same in nature to those disclosed in note 36 in the 2016 Annual Report and Accounts. Other than those in the normal course of business with Co-operative Group, summarised below, there are no related party transactions reflected in the Bank's balance sheet or income statement as at 30 June 2017.

Certain aspects of the arrangements with Co-operative Group and other current investors in the Bank, relating to the Restructuring and Recapitalisation, may be considered to give rise to related party transactions in H2 2017 and future periods thereafter, which will differ in nature from the current arrangements. The arrangements are as follows:

- With a view to addressing the 'last-man standing' risk for the Bank, the Bank, Co-operative Group and the trustees of Pace entered into a legally binding agreement which, when implemented, will effect pensions separation within Pace such that the Bank will become responsible for its own section of Pace only, and will no longer have 'last-man standing' risk for the rest of Pace. See note 11 for more detail;
- Co-operative Group has agreed with the Bank to use its best efforts to implement the Restructuring and Recapitalisation and has entered into new agreements with the Bank such that: the relationship agreement will terminate and run off, and co-existence principles will terminate; the Bank undertakes to distinguish its branding from the branding of Co-operative Group; amendments to the Tax Deed set out certain arrangements with respect to the future sharing of tax benefits realised by Co-operative Group from tax losses surrendered to it historically by the Bank Group; and that the Bank shall reimburse Co-operative Group for up to £6 million of its advisers' fees incurred by it in connection with the Restructuring; and
- Golden Tree and Silver Point Capital, both of which are disclosed as related parties in note 36 in the 2016 Annual Report and Accounts as a result of their current interest in the Bank, have entered into certain arrangements with the Bank in connection with the Restructuring and Recapitalisation under a Lock-Up Agreement and backstop agreement, including agreements to subscribe shares in the Bank's new holding company and the payment by the Bank of premiums in return for their and other Principal Investors' backstop commitment.

For further detail, please refer to section 18 in the Shareholder Circular and Member Scheme Circular which sets out the resolutions that independent shareholders are being asked to vote on to approve these related party transactions.

## Balances with Co-operative Group

The tables below provide an analysis of balances with Co-operative Group and its undertakings at 30 June 2017 and 31 December 2016 and their location within the Bank's balance sheet.

	As at 30 June 2017			
	Loans and advances to customers	Other assets	Customer accounts	Other liabilities
Co-operative Group Limited and its subsidiaries <sup>1</sup>	2.5	75.7	(4.6)	(1.4)
The Co-operative Banking Group Limited and its subsidiaries	-	1.5	-	(0.1)
	2.5	77.2	(4.6)	(1.5)

	As at 31 December 2016			
	Loans and advances to customers	Other assets	Customer accounts	Other liabilities
Co-operative Group Limited and its subsidiaries <sup>1</sup>	-	84.2	(116.4)	-
The Co-operative Banking Group Limited and its subsidiaries	-	2.7	(1.7)	-
	-	86.9	(118.1)	-

<sup>1</sup> Co-operative Group Limited and its subsidiaries excludes The Co-operative Banking Group Limited and its subsidiaries sub-group

## 14. Fair values of financial assets and liabilities

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

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
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**As at 30 June 2017**
**Assets**

Cash and balances at central banks	-	-	1,774.7	-	-	-	1,774.7
Loans and advances to banks	-	-	1,081.8	-	-	-	1,081.8
Loans and advances to customers	3.9	199.8	18,730.0	-	-	-	18,933.7
Fair value adjustments for hedged risk	-	-	103.0	-	-	-	103.0
Investment securities	-	-	13.4	2,486.6	-	-	2,500.0
Derivative financial instruments	152.2	-	-	-	-	133.5	285.7
Equity shares	-	-	-	23.3	-	-	23.3
Other assets	-	-	85.8	-	-	-	85.8
<b>Total financial assets</b>	<b>156.1</b>	<b>199.8</b>	<b>21,788.7</b>	<b>2,509.9</b>	<b>-</b>	<b>133.5</b>	<b>24,788.0</b>
<b>Non-financial assets</b>							<b>206.4</b>
<b>Total assets</b>							<b>24,994.4</b>

**Liabilities**

Deposits by banks	-	-	-	-	917.8	-	917.8
Customer accounts	-	-	-	-	20,897.5	-	20,897.5
Customer accounts – capital bonds	-	4.7	-	-	-	-	4.7
Debt securities in issue	-	-	-	-	1,167.0	-	1,167.0
Derivative financial instruments	170.9	-	-	-	-	187.6	358.5
Other borrowed funds	-	-	-	-	478.9	-	478.9
Other liabilities	-	-	-	-	34.5	-	34.5
<b>Total financial liabilities</b>	<b>170.9</b>	<b>4.7</b>	<b>-</b>	<b>-</b>	<b>23,495.7</b>	<b>187.6</b>	<b>23,858.9</b>
<b>Non-financial liabilities</b>							<b>349.5</b>
<b>Total liabilities</b>							<b>24,208.4</b>
<b>Capital and reserves</b>							<b>786.0</b>
<b>Total liabilities and equity</b>							<b>24,994.4</b>

Whilst the Bank does not hold any derivative financial instruments that are considered 'derivatives held for trading purposes' as shown in the Bank's 2016 Annual Report and Accounts, IAS 39 requires derivative financial instruments that are not in a hedging relationship to be classified as 'held for trading'.

Fair value disclosures throughout this note have been calculated in accordance with IFRS 13, which values assets or liabilities individually rather than as a portfolio.

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
<b>As at 31 December 2016</b>							
<b>Assets</b>							
Cash and balances at central banks	-	-	2,848.2	-	-	-	2,848.2
Loans and advances to banks	-	-	836.9	-	-	-	836.9
Loans and advances to customers	4.1	188.9	19,259.7	-	-	-	19,452.7
Fair value adjustments for hedged risk	-	-	131.6	-	-	-	131.6
Investment securities	-	-	13.8	3,538.1	-	-	3,551.9
Derivative financial instruments	165.7	-	-	-	-	259.8	425.5
Equity shares	-	-	-	46.8	-	-	46.8
Other assets	-	-	96.7	-	-	-	96.7
<b>Total financial assets</b>	<b>169.8</b>	<b>188.9</b>	<b>23,186.9</b>	<b>3,584.9</b>	<b>-</b>	<b>259.8</b>	<b>27,390.3</b>
<b>Non-financial assets</b>							<b>198.0</b>
<b>Total assets</b>							<b>27,588.3</b>
<b>Liabilities</b>							
Deposits by banks	-	-	-	-	1,198.6	-	1,198.6
Customer accounts	-	-	-	-	22,425.1	-	22,425.1
Customer accounts – capital bonds	-	11.8	-	-	-	-	11.8
Debt securities in issue	-	-	-	-	1,625.4	-	1,625.4
Derivative financial instruments	194.6	-	-	-	-	249.9	444.5

Other borrowed funds	-	-	-	-	472.6	-	472.6
Other liabilities	-	-	-	-	45.9	-	45.9
Total financial liabilities	194.6	11.8	-	-	25,767.6	249.9	26,223.9
Non-financial liabilities							405.9
Total liabilities							26,629.8
Capital and reserves							958.5
Total liabilities and equity							27,588.3

#### a) Use of financial instruments

The use of financial instruments is essential to the Bank's business activities, and financial instruments constitute a significant proportion of the Bank's assets and liabilities. The main financial instruments used by the Bank, and the purposes for which they are held, are described on page 208 in the Bank's 2016 Annual Report and Accounts.

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

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

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

The carrying values of financial instruments measured at fair value are determined in compliance with the accounting policies in note 1 and according to the hierarchy as set out on page 210 in the Bank's 2016 Annual Report and Accounts.

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
<b>As at 30 June 2017</b>				
<b>Non-derivative financial assets</b>				
Held for trading:				
Loans and advances to customers	-	3.9	-	3.9
Designated at fair value:				
Loans and advances to customers	-	195.7	4.1	199.8
Available for sale financial assets:				
Investment securities	1,598.7	-	887.9	2,486.6
Equity shares	0.2	2.3	20.8	23.3
<b>Derivative financial assets</b>	-	285.7	-	285.7
<b>Non-financial assets</b>				
Investment properties	-	-	2.2	2.2
<b>Total assets carried at fair value</b>	<b>1,598.9</b>	<b>487.6</b>	<b>915.0</b>	<b>3,001.5</b>
<b>Non-derivative financial liabilities</b>				
Designated at fair value:				
Customer accounts – capital bonds	-	4.7	-	4.7
<b>Derivative financial liabilities</b>	-	358.5	-	358.5
<b>Total liabilities carried at fair value</b>	-	363.2	-	363.2

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
<b>As at 31 December 2016</b>				
<b>Non-derivative financial assets</b>				
Held for trading:				
Loans and advances to customers	-	4.1	-	4.1
Designated at fair value:				
Loans and advances to customers	-	184.0	4.9	188.9
Available for sale financial assets:				
Investment securities	2,230.7	-	1,307.4	3,538.1
Equity shares	0.2	27.3	19.3	46.8
Derivative financial assets	-	425.5	-	425.5
<b>Non-financial assets</b>				

Investment properties	-	-	2.2	2.2
<b>Total assets carried at fair value</b>	<b>2,230.9</b>	<b>640.9</b>	<b>1,333.8</b>	<b>4,205.6</b>

#### Non-derivative financial liabilities

Designated at fair value:				
Customer accounts – capital bonds	-	11.8	-	11.8
Derivative financial liabilities	-	444.5	-	444.5
<b>Total liabilities carried at fair value</b>	<b>-</b>	<b>456.3</b>	<b>-</b>	<b>456.3</b>

### Level 3 – Valuation techniques using unobservable inputs

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

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

#### Loans and advances to customers

Loans and advances to customers include 25 year fixed rate mortgages of £4.1m (31 December 2016: £4.9m), which are fair valued through profit or loss using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has decreased the valuation by £0.1m in H1 2017 (H1 2016: increased by £0.1m). A reasonable change in the assumptions would not result in a material change in the valuation.

#### Investment securities – available for sale

Investment securities – available for sale include RMBS of £887.9m (31 December 2016: £1,307.4m), which are fair valued through other comprehensive income. The Bank uses an independent third party valuation agent to provide prices which it obtains from large financial institutions. These prices are indicative values only and do not represent an offer to purchase the securities.

The Bank owns a significant portion of the RMBS issuance and the trading volume of the remaining portions in the market is not readily available. These RMBS represent the Bank's interest in unconsolidated structured entities.

A 1% increase or decrease in the price of the notes will result in the value increasing or decreasing by approximately £8.9m respectively.

#### Equity shares

Equity shares include the Bank's US Dollar denominated convertible preference shares in Visa International, which are classified as available for sale, with any movements in fair value being recognised through other comprehensive income (excluding foreign exchange gains and losses). The fair value of the Visa International shares has been calculated by taking the period end NYSE share price and discounting for illiquidity and clawback.

If the illiquidity premium to the discount rate was assumed to be double, it would result in a reduction in the overall fair value of the equity shares of £3.7m (17.8%) at 30 June 2017. Therefore, this valuation model is not deemed to be materially sensitive to this input, with a 100% increase resulting in a 17.8% change in valuation.

#### Investment properties

Investment properties within level 3 are valued by using the original price, index linked at the balance sheet date using the relevant house price index.

Movements in fair values of instruments with significant unobservable inputs (level 3) were:

	Fair value at the beginning of the period	Purchases and transfers inout	Sales, transfers and repayments	Other comprehensive income	Income statement	Fair value at the end of the period
<b>Period to 30 June 2017</b>						
Loans and advances to customers	4.9	-	(0.7)	-	(0.1)	4.1
Investment securities	1,307.4	-	(423.6)	1.5	2.6	887.9
Equity shares	19.3	-	-	1.5	-	20.8
Investment properties	2.2	-	-	-	-	2.2
	<b>1,333.8</b>	<b>-</b>	<b>(424.3)</b>	<b>3.0</b>	<b>2.5</b>	<b>915.0</b>

#### Year to 31 December 2016

Loans and advances to customers	5.5	-	(0.8)	-	0.2	4.9
Investment securities	1,599.8	-	(306.5)	9.0	5.1	1,307.4
Equity shares	51.2	16.1	(58.2)	13.5	(3.3)	19.3

Investment properties	2.1	-	(0.1)	-	0.2	2.2
	1,658.6	16.1	(365.6)	22.5	2.2	1,333.8

### c) Fair values of financial assets and liabilities not carried at fair value

The carrying values of financial instruments measured at amortised cost are determined in compliance with the accounting policies in note 1.

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

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

	Total carrying value	Fair Value			Items where fair value approximates carrying value	Total
		Level 1	Level 2	Level 3		
<b>As at 30 June 2017</b>						
<b>Financial assets</b>						
Cash and balances at central banks	1,774.7	-	-	-	1,774.7	1,774.7
Loans and advances to banks	1,081.8	-	1,081.9	-	-	1,081.9
Loans and advances to customers	18,730.0	-	-	16,825.2	1,302.1	18,127.3
Fair value adjustments to hedged risk	103.0	-	-	-	103.0	103.0
Investment securities	13.4	-	12.7	-	-	12.7
Other assets	85.8	-	-	-	85.8	85.8
<b>Financial liabilities</b>						
Deposits by banks	917.8	-	912.7	-	-	912.7
Customer accounts	20,897.5	-	-	5,904.0	15,016.0	20,920.0
Debt securities in issue	1,167.0	1,076.0	116.9	-	-	1,192.9
Other borrowed funds	478.9	-	217.2	-	-	217.2
Other liabilities	34.5	-	-	-	34.5	34.5

	Total carrying value	Fair Value			Items where fair value approximates carrying value	Total
		Level 1	Level 2	Level 3		
<b>As at 31 December 2016</b>						
<b>Financial assets</b>						
Cash and balances at central banks	2,848.2	-	-	-	2,848.2	2,848.2
Loans and advances to banks	836.9	-	836.9	-	-	836.9
Loans and advances to customers	19,259.7	-	-	17,381.7	1,366.3	18,748.0
Fair value adjustments to hedged risk	131.6	-	-	-	131.6	131.6
Investment securities	13.8	12.8	-	-	-	12.8
Other assets	96.7	-	-	-	96.7	96.7
<b>Financial liabilities</b>						
Deposits by banks	1,198.6	-	1,198.6	-	-	1,198.6
Customer accounts	22,425.1	-	-	6,172.6	16,296.2	22,468.8
Debt securities in issue	1,625.4	1,058.8	663.6	-	-	1,722.4
Other borrowed funds	472.6	-	363.6	-	-	363.6
Other liabilities	45.9	-	-	-	45.9	45.9

Key considerations in the calculation of fair values for loans and receivables and financial liabilities at amortised cost are consistent as those set out on page 215 in the Bank's 2016 Annual Report and Accounts.

### Unwind of merger fair value adjustments

On the merger of the Bank and Britannia Building Society in August 2009 an exercise was undertaken to fair value the respective assets and liabilities of Britannia Building Society. These fair value adjustments are unwound on an EIR basis over the expected lives of the assets and liabilities. As at 30 June 2017, the remaining merger fair value unwinds are no longer considered to be material primarily due to the redemption of the Leek 19 debt securities in issue, on 21 June 2017, as described on page 216 in the Bank's 2016 Annual Report and Accounts.

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

## Securitisation vehicles

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

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

The Bank retains substantially all of the risks and rewards of ownership. The Bank benefits to the extent to which surplus income generated by the transferred mortgage portfolios exceeds the administration costs of those mortgages. The Bank continues to bear the credit risk of these mortgage assets, on account of holding subordinated notes issued by the securitisation vehicles.

Leek 19 was called on 21 June 2017 and therefore there are no balances remaining relating to this entity.

In H1 2017, £1.4bn of mortgages were sold beneficially by the Bank to Silk Road Finance Number Four plc. These issued notes from the securitisation were all retained by the Bank and therefore are not shown in the consolidated balance sheet of the Bank.

## Covered Bond Limited Liability Partnerships

Moorland Covered Bonds LLP was established as a result of a £1.4bn covered bond retained issuance. Loans and advances to customers of £1.9bn were transferred to Moorland Covered Bonds LLP. The transfer was funded by a loan of £1.4bn and capital contribution of £0.5bn. During October 2011 the £1.4bn loan was repaid. Following additional capital contribution repayment and on achieving Regulated Covered Bond status there was a public issuance of notes in November 2011 totalling £0.6bn. At the period end the Bank held a loan of £0.6bn (31 December 2016: £0.6bn) and a capital contribution of £0.8bn (31 December 2016: £0.6bn) with Moorland Covered Bonds LLP.

Moorland Covered Bonds LLP does not have ordinary share capital. The Bank's interest in Moorland Covered Bonds LLP is in substance no different from a wholly owned subsidiary and consequently it is fully consolidated in the Bank's accounts. The table below shows the carrying values and fair values of the assets transferred to the covered bond and their associated liabilities:

	Carrying amount of transferred loans and advances to customers	Carrying amount of fixed and floating rate notes	Fair value of transferred loans and advances to customers	Fair value of fixed and floating rate notes	Net fair value position
<b>As at 30 June 2017</b>					
Moorland Covered Bonds LLP	1,369.3	597.7	1,346.5	659.5	687.0
<b>As at 31 December 2016</b>					
Moorland Covered Bonds LLP	1,208.5	597.4	1,188.9	669.8	519.1

## Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Bank's day-to-day operations.

	Carrying amount of assets not derecognised	Carrying amount of associated liabilities	Fair value of assets not derecognised	Fair value of associated liabilities	Net fair value position
<b>As at 30 June 2017</b>					
Investments securities sold under repurchase agreements	1,037.6	889.4	1,037.6	889.4	148.2
<b>As at 31 December 2016</b>					
Investments securities sold under repurchase agreements	1,260.1	1,169.3	1,260.1	1,169.3	90.8

Associated liabilities are included within deposits by banks. Assets sold under repurchase agreements include mortgage backed securities (£713.8m of assets and associated liabilities of £567.0m) and UK government gilts (£323.8m of assets and associated liabilities of £322.3m).

## 15. Post balance sheet events

It is a requirement of IAS 10 (Events after the balance sheet date) that this Financial Report reflects events arising after 30 June 2017. The following events have occurred between 30 June 2017 and 9 August 2017 (the date of approval of this Financial Report) and represent 'non-adjusting' post balance sheet events:

## Restructuring and Recapitalisation

The Restructuring and Recapitalisation is discussed on pages 5 to 6. On 14 July 2017, the Bank announced the launch of the creditors' scheme of arrangement and the members' scheme of arrangement through the publication of the Practice Statement Letter. On 27 July 2017, the High Court of Justice granted the Bank permission to convene meetings of the Bank's Tier 2 Noteholders and shareholders, in order to allow them to

consider the creditors' and members' schemes of arrangement relating to and implementing the Restructuring and Recapitalisation. The following meetings will be convened:

- (i) Members' Scheme Court Meeting of the ordinary shareholders, to be held on 21 August 2017;
- (ii) General Meeting of the ordinary shareholders, to be held on 21 August 2017;
- (iii) Creditors' Scheme Court Meeting of the holders of the Notes which are not Retail Noteholders, to be held on 21 August 2017; and
- (iv) 2023 Noteholders' Meeting of the holders of 2023 Notes, to be held on 21 August 2017.

On 28 July 2017, the Bank announced that investors which hold 91% of the Notes (80% of the 2023 Notes and 99% of the 2025 Notes) have entered into the Lock-Up Agreement. Investors which hold 80% of the Bank's ordinary shares have also agreed to support the Restructuring and Recapitalisation, including 20% indirectly held by Co-operative Group Limited, subject to certain conditions. The Restructuring and Recapitalisation is expected to complete in early September.

### **Calico Regulatory Call Option**

The Bank has received confirmation from the PRA in July that Calico Finance Number One Designated Activity Company (Calico) no longer achieves significant risk transfer (SRT) to third parties within the meaning of the CRR. As a consequence, the Bank will no longer receive any RWA benefit from the Calico transaction. Following this SRT determination and the demonstrable adverse effect on the capital position of the Bank, the PRA has no objection to the Bank effecting a regulatory call of notes (Calico Notes) issued by Calico, subject to the transaction's terms and conditions. The impact of Calico not meeting SRT requirements would have seen a reduction in the Bank's CET1 ratio of c.0.8% as at 30 June 2017.

Accordingly, the Bank intends to exercise the regulatory call option under the CDS entered into between the Bank and Calico in relation to the Calico Notes. Such termination will lead to a redemption in full of the Calico Notes which remain outstanding as at the date of redemption. The Bank anticipates executing the redemption of the Calico Notes on 21 September 2017, following prior formal notices as governed by the terms and conditions of the Calico Notes and the CDS at the appropriate time.

### **Tier 2 Notes**

On 4 August 2017, the Bank gave notice that it has requested (i) the UKLA to cancel the listing of the Bank's Tier 2 notes and (ii) the London Stock Exchange to cancel the admission to trading, which will only be effective following the implementation of the Restructuring and Recapitalisation, expected to occur in early September 2017. These cancellations are subject to regulatory approval.

### **Investor enquiries:**

Jonathan Berger, Head of Investor Relations: +44 (0) 7595 567 502

### **Media enquiries:**

Lesley McPherson, Director of Communications: +44 (0) 7725 903 270

David Masters, Lansons: +44 (0) 7825 427 514

Tony Langham, Lansons: +44 (0) 7979 692 287

### **About The Co-operative Bank**

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

**Note:** all figures contained in this interim financial report are unaudited.