The Co-operative Bank plc

Pillar 3 Disclosures for the year ended 31 December 2013

Contents

Tables

1. Overview

1.1 Background

The European Union Capital Requirements Directive (CRD) came into effect on 1 January 2007. Commonly referred to as Basel II, the legislative framework introduced capital adequacy standards governing how much capital all banks and building societies must hold to protect their members, depositors and shareholders.

In the UK, implementation of the Directive has been through rules introduced by the Financial Services Authority (FSA), now the Prudential Regulation Authority (PRA). These rules dictate the disclosure requirements relevant to banks and building societies, and are prescribed within Chapter 11 of the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU). These are known as Pillar 3 disclosures because they complement the minimum capital requirements in Pillar 1 and the supervisory review process in Pillar 2. The Pillar 3 disclosures are aimed at promoting market discipline by providing information on risk exposures and the management of those risks.

On 1 January 2008 the FSA granted The Co-operative Bank and its subsidiaries (the Bank) a waiver to use the Basel II Internal Ratings Based (IRB) approach to credit risk. This allows the Bank to calculate capital requirements for some of the Retail, Corporate and Treasury asset classes using internally developed models that reflect the credit quality of the assets. In December 2013, the PRA confirmed that the IRB waiver and any conditions that are contained in the waiver have been approved as a permission under the Capital Requirements Regulation (CRR).

Asset class	Portfolio	IRB exposure classes	CRD approach
Retail	Mortgages (including Buy to Let Mortgages)	Retail – residential mortgages	Retail IRB
	Loans	Retail – other	Retail IRB
	Credit cards, overdrafts	Retail – qualifying revolving retail exposures	Retail IRB
Corporate	Corporate (total assets >£350k)	Corporates	Foundation IRB
	Business Banking	Corporates	Foundation IRB
	Registered social landlords (RSL)/housing associations	Corporates	Foundation IRB
	Specialised lending	Corporates	Foundation IRB (slotting approach)
Treasury	Central governments and central banks	Central governments and central banks	Foundation IRB
	Financial institutions	Institutions	Foundation IRB
	Structured investments/ credit trading funds	Corporates	Foundation IRB (securitisation ratings based approach)
	Securitisation	Corporates	Foundation IRB (securitisation ratings based approach)

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

Following the merger between Britannia Building Society and the Bank on 1 August 2009, the capital requirements for Corporate and Treasury Credit have been determined using the Bank rating system for all exposures. Early harmonisation was appropriate due to the large number of common exposures and the heritage Britannia commercial lending income producing real estate models have now been replaced with new slotting models covering the combined portfolio of the business.

For prime retail mortgages there has been a programme of harmonisation, with Exposure at Default (EAD) models now structurally aligned between the brands and further model harmonisation is scheduled for 2014 and 2015.

1.2 Basis and frequency of disclosures

This document sets out the Pillar 3 disclosures for the Bank as at 31 December 2013. This is consistent with the basis under which the Bank produces its Annual Report. These disclosures have been prepared to give information on the basis of calculating Basel II requirements and on the management of risks faced by the Bank in accordance with the rules laid out in BIPRU Chapter 11, unless otherwise stated. In meeting these disclosure requirements, the Bank has considered recommendations made by the Enhanced Disclosure Task Force (EDTF) which seeks to give enhanced information above and beyond the minimum Pillar 3 disclosure requirements. These are set out in more detail in Section 3 Changes in disclosures.

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

1.2 Basis and frequency of disclosures continued

These disclosures may differ from similar information in the Annual Report and Accounts 2013 prepared in accordance with International Financial Reporting Standards; the information in these disclosures may therefore not be directly comparable with that information. All figures are as at 31 December 2013, the Bank's year end, unless otherwise stated.

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

1.3 Location and verification

These disclosures have been subject to internal verification and reviewed by the Bank's Board Audit Committee (BAC) on behalf of the Board but have not been, and are not required to be, subject to independent external audit. They are published on the Bank's website.

1.4 Remuneration

In order to comply with the disclosure requirements of CRD III and the PRA's Remuneration Code, the responsibilities and decision-making process for determining remuneration policy, the link between pay and performance and the design and structure of remuneration, including the performance pay plans, have been disclosed in the 2013 Annual Report and Accounts on pages 60 to 68. The 2013 Annual Report and Accounts are published on the Bank's website https://www.co-operativebank.co.uk/investorrelations/financialresults.

1.5 Scope of disclosures

The Pillar 3 disclosures in this document relate to the Bank (PRA firm reference number 121885). The Bank also includes the business combination that occurred in 2009 from the merger with the Britannia Building Society. The subsidiary undertakings included within these disclosures are:

Operating company	Nature of business	Consolidated capital regulatory returns	Solo consolidated capital returns
The Co-operative Bank plc	Banking	Yes	Yes
Co-operative Commercial Limited	Investment company	Yes	No*
Unity Trust Bank plc (held through Co-operative Commercial Limited)	Banking	Yes	No*
Britannia Treasury Services Limited	Holding company	Yes	Yes
Platform companies	Mortgage origination	Yes	Yes
Mortgage Agency Services Number One, Two, Four – Six Limited	Mortgage lending (acquired)	Yes	Yes
Western Mortgage Services Limited	Mortgage administration	Yes	Yes
Asset finance companies	Leasing	Yes	Yes
Britannia Asset Management Limited	Holding company	Yes	Yes
Britannia Development and Management Company Limited	Property investments	Yes	Yes
Britannia Life Direct Limited	Financial services	Yes	Yes
Illius Properties Limited	Property investments	Yes	No*
Britannia International Limited	Isle of Man based retail deposits	Yes	No*
Moorland Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	Yes	No
Leek Finance (Number Seventeen – Twenty Two) plcs	Securitisation vehicles	Yes	No
Silk Road Finance (Number One – Three) plcs	Securitisation vehicles	Yes	No
Cambric Finance Number One plc	Securitisation vehicle	Yes	No
Meerbrook Finance (Number One – Four, Six, Eight) Limited	Securitisation vehicles	Yes	No
Calico Finance Number One Limited	Securitisation vehicle	Yes	No
Southside Regeneration Limited	Property holding company	Yes	No*

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

A further breakdown of these companies is provided on page 247 of the Annual Report and Accounts.

1.5 Scope of disclosures continued

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

- Britannia International, where dividend payments are subject to local regulatory approvals;
- Securitisation vehicles and Covered Bond LLP with assets being ring-fenced within such entities; and
- Unity Trust Bank plc which being separately regulated needs to maintain a minimum prescribed level of capital.

1.6 Summary of key capital ratios

These disclosures are primarily in accordance with Basel II requirements as set within the UK by BIPRU (that was still in force at 31 December 2013). Key CRD IV (which came into force from 1 January 2014) disclosures have also been made within this document. The Bank's key capital ratios are included below:

Basel II/CRD III capital position

	2013	2012 restated
Capital ratios		
Core Tier 1 ratio	**9.2%**	7.4%
Total capital ratio	**10.1%**	12.8%
Risk Weighted Assets (£bn)	**14.0**	17.9

CRD IV fully-loaded capital position

	2013	2012 restated
Capital ratios		
Common Equity Tier 1 (CET1) ratio	**7.2%**	5.0%
Total capital ratio	**8.6%**	9.0%
Risk Weighted Assets (£bn)	**15.1**	18.8
Leverage ratio	**2.4%**	1.8%

2. Matters arising during the year

2.1 Recapitalisation and the Liability Management Exercise

During the year the Bank carried out a refinancing exercise with the aim of increasing the level of capital held. This exercise involved issuing new shares and new debt in exchange for cash and extinguishing existing debt and preference shares.

Background

The Bank received a letter from the Financial Services Authority (FSA), in January 2013 addressed to the Board, notifying it of a revised Individual Capital Guidance (ICG) and greatly increased Capital Planning Buffer (CPB) to be held exclusively in Core Tier 1 capital. Whilst the Bank had capital sufficient to meet the revised ICG[1], the letter acknowledged that the size of the CPB meant that the Bank would be in breach of this from the outset. The letter requested that the Board prepare, and present to the Prudential Regulation Authority (PRA), as the successor to the FSA, by the end of April 2013, a credible plan that would restore the Bank's capital strength to an appropriate level and a timeline for delivery.

Accordingly, the Bank initiated a capital planning process (the Pennine Plan) to consider the shortfall and actions to address it and the plan was discussed with the PRA during its evolution.

In March 2013, the Interim Financial Policy Committee (FPC) of the Bank of England recommended that the PRA should take steps to ensure that all major UK banks and building societies, including the Bank, held capital resources equivalent to at least 7% of their Risk Weighted Assets (assessed using the Basel III definition of equity capital) by December 2013.

This requirement, together with the Basel III requirement for CET1 to remain above 4.5% at all times and a leverage ratio of 3%, was fed into an enhanced version of the Pennine Plan in May (an initial plan having been submitted to the PRA as requested). The levels of expected loss in the corporate lending portfolio and other risks were also reassessed, which indicated that the Bank was likely to breach its ICG requirement later in 2013.

After discussion with the PRA, this work culminated in the Bank and the Co-operative Group announcing on 17 June 2013 that the Bank required additional aggregate CET1 of no less than £1.5bn, (of which at least £1bn should be raised in 2013) and the Recapitalisation Plan was launched.

The enhanced Pennine Plan was updated to include the CET1 and the Tier 2 capital to be raised as part of the Recapitalisation Plan. The resultant plan did not expect to achieve full compliance with CPB at any time in the five year planning period, but did expect to achieve ICG compliance by the end of the planning period. The required minimum CET1 ratios of 7% in normal conditions and 4.5% under stress were expected to be met in 2013. The completion of the LME raised £1.2bn before costs and the 2013 year end CET 1 ratio stood at 7.2%.

The Recapitalisation Plan

The £1.5bn Recapitalisation Plan consisted of three elements:

a) The Liability Management Exercise (LME) to generate c.£1.2bn of new CET1;

b) The commitment of The Co-operative Banking Group to contribute £333m of CET1 by the end of 2014; and

c) £40m of CET1 generated from interest savings on the securities surrendered in the LME.

1. Capital resources would still have been in surplus to ICG had the restatement detailed in note 3 to the Annual Report and Accounts been made at the time.

Details

a) The LME

A core part of the Recapitalisation Plan was achieved through successful completion of the LME on 20 December 2013. This involved the following elements:

i. The issuance of £0.2bn of new subordinated debt and £0.6bn of new ordinary shares in exchange for extinguishing £1.3bn of existing debt and preference shares and additional contributions from bondholders of £0.1bn;

ii. The cancellation of £0.4bn of existing ordinary share capital, which resulted in the creation of a capital redemption reserve of the same value; and

iii. The sale of investment assets that were used as economic hedges for the existing debt, generating a profit of £11m. These assets had been accounted for as available for sale, and therefore there was an equivalent reduction in the available for sale reserve.

b) The contribution of £333m by The Co-operative Banking Group. This is due or paid up as follows:

i. £20m paid in December 2013;

ii. £50m paid in January 2014;

iii. £100m due by 30 June 2014; and

iv. £163m due by 31 December 2014.

c) The balance of the £1.5bn is interest saved in 2014 on securities surrendered as part of the LME.

Elements a) and b) together created additional CET1 in the following ways:

i. New ordinary shares – a total of £0.8bn of new ordinary shares were issued to both existing bondholders and The Co-operative Banking Group. This was recorded as share capital and share premium as shown in the following table;

ii. Income – £0.7bn was recognised in the income statement. This arose because the value of existing debt and preference shares and contributions received (£1.3bn and £0.4bn) was greater than the value of the new debt and shares issued (£0.2bn and £0.8bn). In accordance with company law, which requires that share premium is determined by reference to the value of debt extinguished, £0.6bn of this income was transferred from retained earnings to share premium; and

iii. These increases in CET1 were offset by associated costs of £52m of the LME.

The effects of these transactions are shown in the following table and can be seen in the statement of changes in equity in the Annual Report and Accounts, along with the other borrowed funds and share capital notes.

Additional Capital

As announced on 24 March 2014, the Bank is in the process of raising additional CET1 – see the Annual Report and Accounts for more information on this.

2.1 Recapitalisation and the Liability Management Exercise continued

Overall impact of the recapitalisation transactions

Effect of the Recapitalisation Plan on profit and reserves (£m)	Profit	Effect on reserves					
		Retained earnings	Share capital	Share premium	Available for sale reserve	Capital redemption reserve	Net effect on reserves
Issuance of new debt and ordinary shares in exchange for existing debt and contributions	707.7	707.7	12.5	777.5	–	–	1,497.7
Sale of assets hedging pre-LME debt positions	11.1	11.1	–	–	(11.1)	–	–
Effect of transactions with a profit impact (before costs)	**718.8**	**718.8**	**12.5**	**777.5**	**(11.1)**	**–**	**1,497.7**
Costs associated with LME transaction	(30.5)	(30.5)	–	(21.3)	–	–	(51.8)
Effect of transactions with a profit impact (after costs)	**688.3**	**688.3**	**12.5**	**756.2**	**(11.1)**	**–**	**1,445.9**
Other LME transactions (with no profit impact):							
Cancellation of share capital (capital redemption reserve created)	–	–	(410.0)	–	–	410.0	–
Transfer of retained earnings to share premium account	–	(594.8)	–	594.8	–	–	–
Total effect of recapitalisation transactions on profit and reserves	**688.3**	**93.5**	**(397.5)**	**1,351.0**	**(11.1)**	**410.0**	**1,445.9**

Impact on regulatory capital

As at 31 December 2013, the Recapitalisation Plan generated an additional £1.2bn of CET1 on a regulatory basis pre costs, as calculated below. Further CET1 will be generated during 2014 as a result of interest savings and receipt of the contribution due from The Co-operative Banking Group (which cannot be counted for regulatory purposes until received).

The table includes a reconciliation to the effect on statutory reserves as at 31 December 2013.

Effect of Recapitalisation Plan on CET1 (£m)	Retained earnings	Share capital/ redemption reserve	Share premium	Effect on capital and reserves
Effect as at 31 December 2013 before costs	133.8	9.8	1,062.0	1,205.6
Costs associated with LME transaction	(30.5)	–	(21.3)	(51.8)
CET1 raised as at 31 December 2013	**103.3**	**9.8**	**1,040.7**	**1,153.8**
Contribution due from The Co-operative Group during 2014	–	2.7	310.3	313.0
Effect of interest savings during 2014	40.0	–	–	40.0
CET1 raised as at 31 December 2014	**143.3**	**12.5**	**1,351.0**	**1,506.8**
Reconciliation to statutory reserves as at 31 December 2013:				
Remove effect of interest savings (2014 impact)	(40.0)	–	–	(40.0)
Include effect of discounting (statutory impact for 2013)	(9.8)	–	–	(9.8)
Effect on statutory reserves as at 31 December 2013	**93.5**	**12.5**	**1,351.0**	**1,457.0**
Available for sale reserve impact (not CET1)				(11.1)
Total effect on statutory reserves as at 31 December 2013				**1,445.9**

2.2 Restatement of fixed assets and intangibles

Historically the intangible asset for the core IT banking system replacement had been recorded in the books of CFS Management Services Ltd (CFSMS), (a service company which was a fellow Co-operative Banking Group subsidiary), with appropriate recharge to the Bank via intercompany balances payable. The development of the core IT banking system was funded by the Bank. CFSMS had limited other assets with which to absorb any potential losses that may have arisen due to difficulties in development.

The Directors have reviewed and reconsidered the accounting treatment of the intangible asset in development and all other assets held on the balance sheet of CFSMS which were used solely by the Bank. The Directors have concluded that the Bank was substantially exposed to the risks and rewards of these assets and that, therefore, after considering the funding of the asset and CFSMS's lack of assets to absorb losses, the appropriate accounting treatment would be to hold these assets on the balance sheet of the Bank. This has been reflected in the Bank and Company Annual Report and Accounts.

Details of this restatement are provided in note 3 of the Annual Report and Accounts.

3. Changes to disclosures

The Bank continues to review its disclosures ensuring that quality and transparency of information is provided to market participants. The Bank started to implement recommendations of the EDTF within its 2012 year end disclosures and has, to the fullest extent possible, implemented these recommendations for 2013 either within its financial statements or these Pillar 3 disclosures. Further information regarding the EDTF recommendations can be found at http://www.financialstabilityboard.org/publications/r_121029.pdf.

Areas of non-compliance

- EDTF 8 – An overarching stress testing framework is being developed during 2014. The Bank will use this framework to provide disclosures in line with EDTF recommendation 8 within its 2014 year end disclosures.
- EDTF 19 – Disclosures are in accordance with last year.

Further details of where the Bank has complied with the EDTF recommendations are discussed below.

Table 1 EDTF disclosures

Type of risk	Recommendation	Disclosure	Section in Pillar 3	Section in Risk Management	Other sections of the accounts
General	1	Risks to which the business is exposed	7		Strategic review
	2	Definition of risk terminology, principles and appetite	4, 7		Strategic review
	3	Top and emerging risks and the changes during the reporting period	7	Other risks 4–10	Strategic review
	4	Analysis of future regulatory developments affecting our business model and the Bank's profitability	6		
Risk governance and risk management	5	The Bank's risk management organisation, process and key functions	4		Strategic review
	6	Risk culture and risk governance and ownership	4		Strategic review
	7	Key risks, risk appetite and risk management	4, 7		Strategic review
	8	Stress testing and the underlying assumptions	8	Liquidity risk 2	Strategic review
Capital adequacy	9	Minimum Pillar 3 disclosure requirements	5		
	10	Reconciliation of accounting balance sheet to regulatory balance sheet	Table 8a, 1.2		
	11	Flow statement of movements in regulatory capital since the previous reporting period including changes in Common Equity Tier 1, Tier 1 and Tier 2 Capital	5		
	12	Discussion of targeted level of capital and how this will be established	2, 5, 6		Capital management
	13	Analysis of Risk Weighted Assets	5.3		Capital management
	14	Analysis of capital requirements for each Basel asset class	Table 5a		
	15	Analysis of credit risk for each Basel asset class	5, 7		
	16	Flow statement reconciling the movements in Risk Weighted Assets for each Risk Weighted Asset type	Table 6		Capital management
	17	Discussion of Basel credit risk model performance	7.2.6, 7.2.13		
Liquidity and funding	18	Analysis of the Bank's liquid asset buffer	7.3	Liquidity risk 2.3.1	
	19	Encumbered and unencumbered assets analysed by balance sheet category			Note 41 fair values
	20	Consolidated total assets, liabilities and off-balance sheet commitments analysed by remaining contract maturity at the balance sheet date		Liquidity risk 2.4	
	21	Analysis of the Bank's sources of funding		Liquidity risk 2.3	
Market risk	22	Relationship between the market risk measures for trading and non-trading portfolios and the balance sheet		Market risk 3.1	
	23	Discussion of trading significant trading and non-trading market risk factors	7.4	Market risk 3.1	
	24	VaR assumptions, limitations and validation		Market risk 3.1.2.1	
	25	Description of the primary risk management techniques employed by the Bank		Market risk 3	

3. Changes to disclosures continued

Type of risk	Recommendation	Disclosure	Section in Pillar 3	Section in Risk Management	Other sections of the accounts
Credit risk	26	Analysis of the aggregate credit risk exposures		Credit risk 1.2, 1.3, 1.4	
	27	Describe the policies for identifying impaired and non-performing loans	7	Credit risk 1.3	
	28	Reconciliation of the opening and closing balances of non-performing or impaired loans in the period		Credit risk 1.3	Note 18 Loans and advances to customers
	29	Analysis of counterparty credit risk that arises from derivative transactions	7.2.1	Credit risk 1.3.4	
	30	Discussion of credit risk mitigation, including collateral held for all sources of risk		Credit risk 1.3	
Other risk	31	Description of other risks	7	Other risks 4–10	
	32	Discussion of publicly known risk events	7	Introduction to risk management	Note 34 Provisions for liabilities and charges, note 37 Contingent liabilities and commitments

4. Risk management policies and objectives

4.1 Overview

2013 was a year of substantive change in the risk function. In conjunction with redefining the Risk Management Framework and constructing an effective three lines of defence model in the second half of 2012, the previous and present Chief Risk Officers (CROs) began a process of significantly strengthening the capability of the risk leadership team and the second line function. This enhanced risk function, which has been in place since first quarter 2013, has been responsible for the identification of previously un-remediated policy, process and control failings. The identification of these issues led to improvements across multiple risk disciplines, most particularly in the areas of operational, conduct, liquidity and credit risk. The further identification of risks and the subsequent improvements in policy, process and control are still on-going. Whilst further identification of risks and subsequent improvements in policy, process and control are still on-going, the state of play in the risk space is substantially improved over the prior structure.

A key element in the redefined Risk Management Framework is the reiteration that risk is not the responsibility of any one part of the institution or group of employees but rather the responsibility of all. This requirement, for a core risk culture driving our business, is one of the key improvements being embedded across the Bank.

The challenge for 2014 and beyond will be the retention of key staff to maintain and build the capability of the function to support the simplification and transformation of the Bank in a controlled manner, as well as a continuing focus on embedding a stronger risk culture across the institution.

4.2 Risk Management Framework

Until the second half of 2013, The Co-operative Banking Group maintained common governance, organisational and risk management structures, which had been developed and implemented across its subsidiaries including the Bank.

The Bank put in place its own revised, updated and independent Risk Management Framework and policies, which have been adopted by the Bank Executive and the Board. The Bank's new Risk Management Framework reflects the previous system in many respects, but it continues to be refined to meet the Bank's specific requirements.

As a result of the new Risk Management Framework, the Bank has determined its principal risks, and the level of acceptable risks, as stipulated in the Bank's risk appetite statement, thus ensuring that there is an adequate system of risk management so that the levels of capital and liquidity held are consistent with the risk profile of the business.

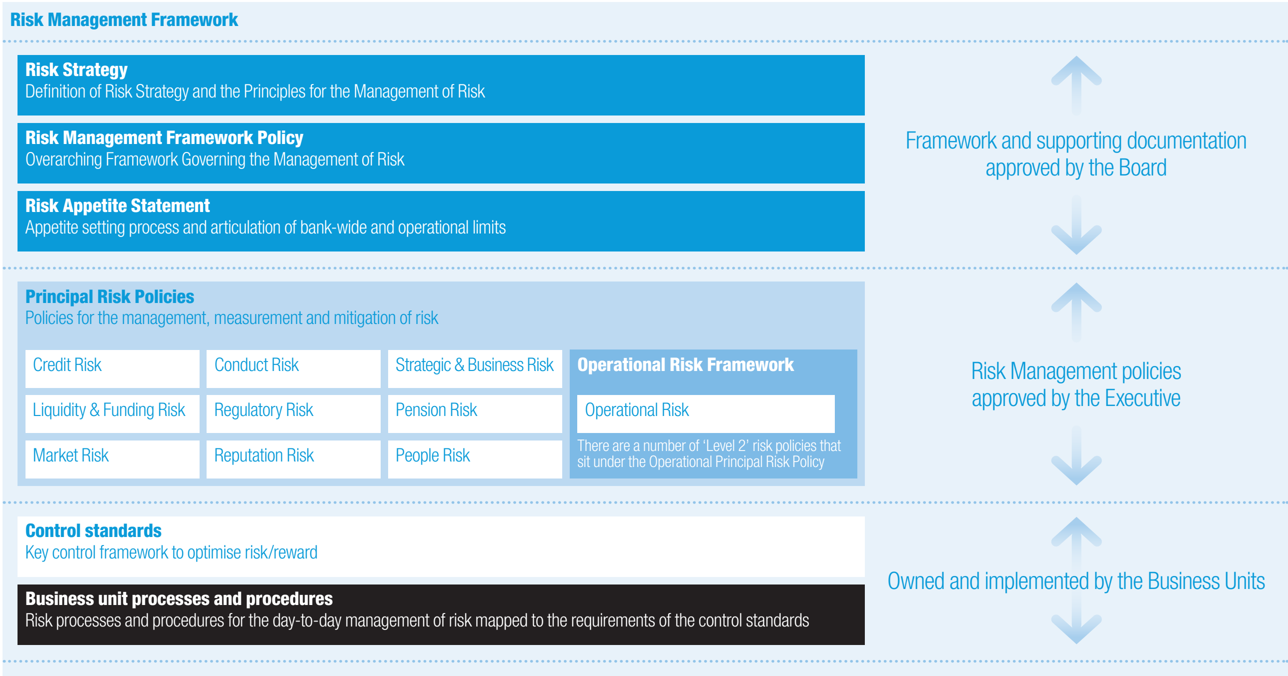
The Bank has also replicated the 'three lines of defence' governance model, previously adopted by the Board of Directors of The Co-operative Banking Group. This is to ensure appropriate responsibility and accountability is allocated to the management, whilst recognising that the system is designed to manage rather than eliminate risk of failure to achieve business objectives.

The three lines of defence are:

- The Bank's business teams and first line management act as the first line of defence and are responsible for identifying where a business unit is exposed to risks, including from the development of new products, processes or other business change. They also manage the risks that reside within their business units on a day-to-day basis, implementing effective monitoring and control processes to ensure that the Bank's business' risk profile is understood and maintained within the Board defined risk appetite;
- The Bank's compliance and risk functions act as the second line of defence. They oversee and challenge the implementation and monitoring of the Risk Management Framework and consider current and emerging risks across the Bank. They also review and challenge the delegated authority framework and oversee appropriate escalation of breaches, mitigating actions and reporting to the Executive Risk Committee (ERC); and
- The Bank's internal audit function acts as the third line of defence. They are responsible for independently verifying that the principal risk control framework has been implemented as intended across the business, and independently challenge the overall management of the framework to provide assurance to the Board Audit Committee (BAC) and senior management on the adequacy of both the first and second lines.

4.2 Risk Management Framework continued

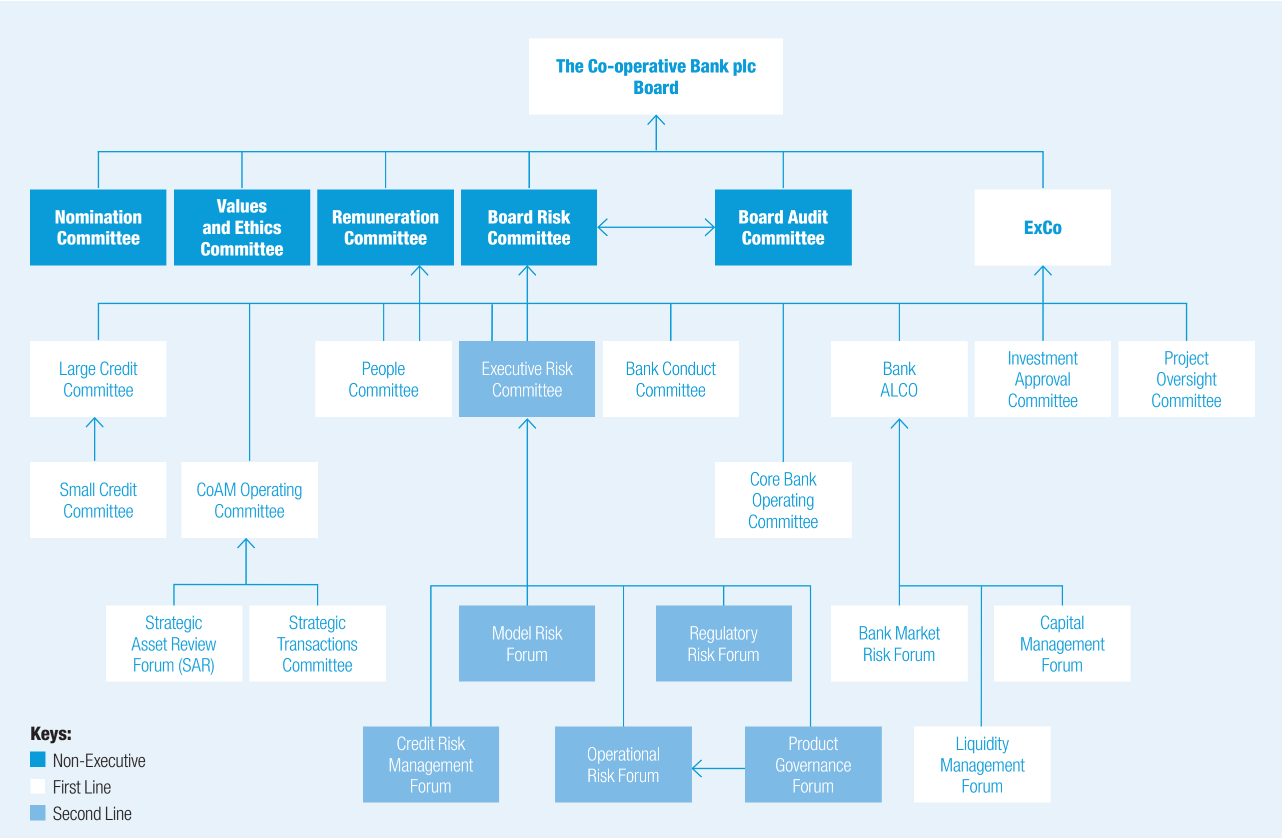
The Bank manages risk through the Bank's Risk Management Framework; a hierarchy of strategies, policies and standards which are designed to support the Bank's risk based decision making which comprises six components as set out below:



This is discussed in more detail in the Risk Management Framework section of the Annual Report and Accounts.

4.3 Risk management structure

The diagram below illustrates the Bank's risk management committee structure:



First line committees are responsible for ensuring that the risk and control environment is established and maintained in day-to-day decision making. The second line committees give oversight and challenge to the first line and review and approve the component parts of the Risk Management Framework that are designed in the first line.

4.4 Governance and oversight of risk

Board and sub-committees

The Bank's risk governance structure is intended to strengthen risk evaluation and management whilst ensuring the Bank manages the regulatory environment as efficiently as possible. The risk focus of these committees is described below.

The Board

The responsibilities of the Board include:

- Setting the overall Bank risk strategy;
- Approving the design and implementation of risk management approaches, including the Risk Management Framework and the risk appetite statement and metrics that underpin them;
- Delegating authority for oversight of the Risk Management Framework, systems and high-level limits to the Board Risk Committee (BRC);
- Delegating authority for cascading the setting and approval of the more granular risk limits and tolerances to the Chief Executive Officer (CEO);
- Using the output of the semi-annual certification process, to approve the effectiveness of the Risk Management Framework with support from the Bank's internal audit function through their risk based review programme; and
- Reviewing and challenging BRC reports on the effectiveness of the Risk Management Framework and systems.

4.4 Governance and oversight of risk continued

Remuneration Committee

The Remuneration Committee establishes, implements and maintains remuneration policies, procedures and practices for the Executive Directors and members of the Senior Executive management team that are appropriate in the context of the Bank's long term business performance and are consistent with effective risk management principles.

Board Risk Committee (BRC)

The BRC's responsibilities include:

- Providing oversight and advice to the Board on current and potential risks and the overall Risk Management Framework including oversight on risk appetite, risk tolerance and risk management strategies;
- Reviewing and challenging the design of the Risk Management Framework, risk appetite limits and tolerances and making recommendations to the Board for approval;
- Reviewing and challenging the implementation of the Risk Management Framework through the semi-annual certification process and reviewing the quality and effectiveness of the Risk Management Framework, systems and function;
- Reviewing and challenging internal controls and process of risk management including the coverage of the risk taxonomy;
- Monitoring the Bank's performance and compliance against high-level risk appetite limits and tolerances;
- In co-operation with the BAC, monitoring identified risk control failings and weaknesses and management actions taken to resolve them; and
- Reporting on the effectiveness of the Risk Management Framework and systems to the Board.

Board Audit Committee (BAC)

The BAC's responsibilities include:

- Assisting the Board in carrying out its responsibilities relating to internal control, including control breaches and remediation;
- Exercising oversight of identified Risk Management Framework failings and weaknesses as well as management actions taken to resolve them; and
- Its main risk management responsibilities include reviewing the Annual Report and Accounts, Pillar 3 disclosures and accounting judgements and recommending to the Board for approval.

Nomination Committee

Duties include review and recommendations on the Board composition, succession planning for Executive Directors, Non-Executive Directors and certain Senior Executives as well as identifying and nominating candidates for Board vacancies and evaluation of candidates for the Board.

Value and Ethics Committee

The V&E Committee was constituted on 1 November 2013 demonstrating the Bank's commitment to promoting and conducting its business in accordance with the established values of the Co-operative Movement. This committee is responsible for recommending to the Board for its approval and adoption, the Co-operative values and ethical policies of the Bank.

Executive and management committees

The Executive has established sub-committees and senior management committees whose responsibilities include implementing the Risk Management Framework, identifying the key risks facing the business and assessing the effectiveness of planned management actions. These are detailed below.

Executive Committee (ExCo)

ExCo manages the business in line with the risk appetite statement. It also maintains oversight of risk management processes and management information. Its responsibilities include:

- Overseeing the establishment and maintenance of appropriate risk management systems and controls in line with the agreed Risk Management Framework;
- Supporting the CEO in developing, reviewing and approving detailed risk appetite limits and tolerances as delegated by the Bank; and
- Ensuring the implementation of the risk strategy set by the Bank's Board so as to deliver an effective risk management environment.

Large Credit Committee (LCC)

The LCC supports the CEO and has the following main responsibilities:

- Sanctioning large counterparty transactions; and
- Managing large exposure positions.

4.4 Governance and oversight of risk continued

Small Credit Committee (SCC)

The SCC is a sub-committee of the LCC and its core purpose is to independently sanction new and increased lending over set limits of authority.

Strategic Transactions Committee (STC)

Chaired by the CEO, the STC reviews, challenges and approves (where permitted within the authority delegated by the Board) strategic transactions designed to achieve the deleveraging of the balance sheet in line with the strategy outlined by the Board for the Non-core assets within the Co-operative Asset Management (CoAM) business.

Any deal sanctioned by the STC must be approved by the CEO and Chief Financial Officer (CFO) of the Bank or the Treasurer of the Bank (up to the limit of their delegated authority) and a risk assessment must be carried out by the CRO or Enterprise Risk Director.

Executive Risk Committee (ERC)

The ERC is chaired by the CRO. Its purpose is to provide a mechanism to ensure all the Bank's risks are reviewed, challenged and approved (with escalation to the BRC where required). Its responsibilities include:

- Monitoring all significant and emerging risks against risk appetite;
- Overseeing the development and implementation of stress testing and risk appetite across the Bank;
- Driving the detailed implementation of the Risk Management Framework approved by the Board;
- Supporting the CEO in developing the risk strategy, Risk Management Framework, and risk appetite statement with recommendations to the BRC and the Board for approval where required; and
- Monitoring the business' risk profile against the agreed limits and parameters and reporting on these to the BRC.

Bank Asset and Liability Committee (ALCO)

The ALCO is chaired by the CFO. It is primarily responsible for overseeing the management of capital, market, liquidity and funding risks. Its responsibilities include:

- Identifying, managing and controlling the Bank balance sheet risks in executing its chosen business strategy;
- Ensuring that the capital and liquidity position of the Bank is managed in line with policy and that adequate capital is maintained at all times;
- Overseeing and monitoring relevant risk control frameworks;
- Recommending relevant principal risk policies and detailed risk appetite limits to the CEO and the ERC for approval; and
- approval of all product pricing proposals.

To assist in carrying out these responsibilities, ALCO is supported by a Bank Market Risk Forum (BMRF), Liquidity Management Forum (LMF) and Capital Management Forum (CMF).

People Committee

The People Committee is chaired by the Human Resources Director. Its purpose is to:

- Review all people data within the Bank including headcount, contractors, absence, retention;
- Review the hiring of senior and critical roles;
- Review on at least a quarterly basis all talent data;
- Review all performance data on at least a half year basis;
- Understand the employee relations engagement plan;
- Ensure the colleague engagement approach is aligned to the strategic direction of the Bank;
- Oversee reward strategy, principles and oversight of all remuneration policies and decisions below the Executive level;
- Review and amend redundancy terms;
- Review absenteeism and monitor disciplinary proceedings;
- Monitor compliance with diversity and anti-discrimination legislation; and
- Monitor, review and implement appropriate succession plans in respect of senior members of the Bank's management teams.

4.4 Governance and oversight of risk continued

Core Bank Operating Committee

Chaired by the Executive Director of the Core Bank, the Core Bank Operating Committee is responsible for the delivery of the business plan covering all areas of the Core Bank scorecard and provides oversight of performance. The Core Bank Operating Committee drives first line management of risk across the Core Bank, ensures that a robust and effective control environment exists.

Co-operative Asset Management (CoAM) Operating Committee

Chaired by the Executive Director of CoAM, the CoAM Operating Committee is responsible for the delivery of the business plan and provides effective oversight of performance. The CoAM Operating Committee drives first line management of risk across CoAM, ensures that the correct governance processes are followed and that a robust and effective control environment exists.

Strategic Asset Review Forum (SAR)

A forum established at the discretion of the LCC and SCC for CoAM and non performing facilities. Its function is to set strategies on a case by case basis and sanction within its authority.

Product Governance Forum

The Product Governance Forum provides independent review and challenge of product proposals, to ensure effective identification, assessment and mitigation of risks prior to launch.

Operational Risk Forum (ORF)

The purpose of the ORF is to support the Operational Risk Director in the execution of his/her responsibilities including:

- Overseeing the design and maintenance of the Bank's operational risk framework;
- Overseeing the management of operational risk, providing review and challenge;
- Overseeing and monitoring the relevant risk control frameworks;
- Recommending to the CEO, CRO and ERC relevant underlying policies and detailed risk appetite limits for approval; and
- Ownership and oversight of the anti-money laundering regime.

Regulatory Risk Forum (RRF)

The core purpose of the RRF is to support the Regulatory Risk Director in carrying out his/her responsibilities, includes oversight of:

- Maintenance of the appropriate authorisations for the regulated entities within the Bank, including oversight of any variation to permission;
- Review and recommend to the ERC for approval of the regulatory risk policy and conduct risk policy;
- Review and approval of the Bank's regulatory risk control standard;
- Review and approval of the conduct risk control standard;
- Assessing and monitoring new products against the product approval risk policy and control standard and the conduct risk policy and conduct risk control standard, as appropriate;
- The Approved Persons regime;
- Regulatory reporting requirements;
- Conduct of business issues including fair treatment of customers;
- Financial promotions;
- The training and competence regime; and
- Any on-going regulatory engagement.

4.4 Governance and oversight of risk continued

Credit Risk Management Forum (CRMF)

The CRMF advises and supports the Credit Risk Director. Its responsibilities include:

- Designing the credit risk control implementation approach and credit control framework and recommending them to the ERC;
- Reviewing and recommending to the ERC the Bank's credit risk policy and credit measurement methodologies;
- Review and approve the credit risk control standard;
- Defining and recommending the credit risk appetite and limits to the ERC; and
- Reviewing and challenging the credit risk processes and procedures including the credit risk rating systems.

Model Risk Forum (MRF)

The Model Risk Forum responsibilities include:

- Setting and approving the model review process and standards;
- Reviewing and recommending to the CEO and ERC the Bank's model risk policy for approval;
- Review and approval of the model risk control standard; and
- Defining the review schedule for existing models and other tasks as identified in the model risk policy.

Bank Market Risk Forum (BMRF)

The role of the BMRF is to review, challenge and monitor the market risk profile for the Bank, in line with applicable policies and within risk appetite.

Liquidity Management Forum (LMF)

The role of the LMF is to enable detailed discussion on all aspects of the Bank's liquidity risk management, monitoring and control including operational issues in respect of covered bond and residential mortgage backed security funding activities. It also recommends actions to be taken in order to ensure that the Bank's liquidity position remains within the agreed levels.

Capital Management Forum (CMF)

The role of the CMF is to review, challenge and monitor the Bank's capital adequacy, in line with capital policy and within risk appetite. The CMF is responsible for making recommendations to ALCO as appropriate.

Investment Approval Committee

The purpose of the Investment Approval Committee is to oversee and challenge the execution of all significant investments, divestments and major capital expenditure proposals as contained within the Bank's Five Year Business Plan, in accordance with the authorities delegated to it by ExCo, ensuring:

- That all investments are being made in accordance with the Bank's Five Year Business Plan;
- The strategic investment portfolio remains balanced when considering investment demands against scare resources;
- Executive sponsors are empowered to deliver within defined constraints; and
- Decisions taken are done so in accordance with the requirements of The Co-operative Bank plc Risk Management Framework and all applicable Bank PDC Risk Policies and Control Standards.

Project Oversight Committee

The purpose of the Project Oversight Committee is to oversee and challenge the delivery of the Change Portfolio for the Bank, in accordance with the authorities delegated to it by Bank ExCo, ensuring:

- There is clarity of delivery outcomes;
- That benefits are delivered within agreed time, cost and quality thresholds;
- Sponsors have the necessary executive support to deliver successfully; and
- Key risks and issues threatening delivery are receiving the appropriate levels of intervention.

4.4 Governance and oversight of risk continued

Bank Conduct Committee

The purpose of the Bank Conduct Committee is to provide end to end oversight of business conduct and the customer experience, ensuring:

- There is a business model, strategy and culture that places the fair treatment of the customer at the heart of all business activities;
- Full support of the Values and Ethics Committee;
- The Bank meets all regulatory requirements in respect of conduct risk matters;
- The Bank has an adequate, implemented and embedded Risk Management Framework in respect of conduct risk;
- Design and marketing of products to meet the customer needs in the simplest and most cost effective way;
- Advertising of products and services that is fair and clear;
- The right product solution is matched to the customer's needs and that the customer's understands what they have bought; and
- The account servicing meets customer needs and the standards set by the Bank (and that those standards are set at the right level).

Further details of their responsibilities can be found in the Risk Management section of the Annual Report and Accounts.

4.5 Risk function (second line)

The Bank maintains an independent risk management function, reporting to the CRO, that is responsible for ensuring that an appropriately robust Risk Management Framework is in place and techniques and measures adopted. These responsibilities include but are not limited to:

- Providing the Board and Executive with an independent second line view of the Bank's risk profile through the ERC and CRO reports;
- Challenging of the Bank's risk appetite to support the setting of the Bank operating limits which are appropriate and maintain the success and solvency of the Bank;
- Monitoring and challenging risk management information submitted to first and second line committees and to consider current and emerging risks across the Bank;
- Overseeing the Risk Management Framework and supporting consistent and effective implementation;
- Providing review and challenge of the delegated authorities proposed by the first line;
- Overseeing breaches of limits and ensuring appropriate escalation, mitigation and reporting;
- Reviewing the proposed control remediation programmes and action plans designed to bring risk exposure back within risk appetite where it has been exceeded; and
- Independently monitoring the semi-annual certification process and report on the control effectiveness to the ERC and BRC.

5. Capital adequacy – Basel II

During 2013 the Bank has made progress towards improving the capital position and reducing the overall risk profile of the Bank. Completion of the LME together with reduction in the balance sheet and Risk Weighted Assets (RWAs) has resulted in an improvement in the capital position, however due to the materialisation of additional conduct risks and the costs of separation, the Directors now consider the Bank will need additional capital.

As announced on 24 March 2014, the Bank is in the process of raising additional CET1. See the Annual Report and Accounts for further information.

- Core Tier 1 ratio has increased to 9.2% from 7.4% as at 31 December 2012. This reflects a decrease in Core Tier 1 of £45.4m and a decrease in RWAs of £3.9bn.
- CRD IV fully-loaded CET1 has increased to 7.2% from 5.0% as at 31 December 2012 and 3.0% as at 30 June 2013.
- CRD IV fully-loaded leverage ratio as at 31 December 2013 is 2.4%.

The Bank is not currently compliant with its Individual Capital Guidance (ICG), being the PRA's statement as to the regulatory capital it expects the Bank to hold, although the Bank does meet its Pillar 1 requirement.

As at 31 December 2013 the Basel II capital framework was applicable to the Bank, tables in this chapter are presented on this basis. From 1 January 2014 CRD IV, which implements the Basel III capital framework, came into force. The capital position on a CRD IV basis is shown in section 6.

5.1 Capital resources – Basel II

The following table shows the capital resources of the Bank.

Table 2 Total capital resources Basel II

	2013 £m	2012 restated £m
Core Tier 1 Capital before regulatory adjustments:		
Permanent share capital	**9.8**	410.0
Retained earnings	**1,118.6**	1,813.4
Minority interests	**33.6**	32.0
Losses for the year	**(738.2)**	(508.1)
Share premium account	**1,049.5**	8.8
Total Core Tier 1 Capital before regulatory adjustments	**1,473.3**	1,756.1
Regulatory adjustments to Core Tier 1 Capital:		
Intangible assets	**(110.7)**	(262.5)
50% of excess of expected losses over impairment (net of tax)	**(47.5)**	(159.7)
50% of securitisation positions	**(27.3)**	(0.7)
Total Core Tier 1 Capital after regulatory adjustments	**1,287.8**	1,333.2
Other Tier 1 Capital:		
Non-cumulative irredeemable preference shares	**–**	60.0
Regulatory adjustments to other Tier 1 Capital:		
50% of tax on excess of expected losses over impairment	**11.0**	51.8
50% of material holdings	**(2.3)**	(2.0)
Total Tier 1 Capital after regulatory adjustments	**1,296.5**	1,443.0
Tier 2 Capital before regulatory adjustments:		
Revaluation reserves	**2.0**	2.0
Collective provisions	**0.9**	0.7
Subordinated notes and perpetual subordinated bonds	**196.3**	1,112.1
Excess on limits for Tier 2 Capital	**–**	(50.2)
Total Tier 2 Capital before regulatory adjustments	**199.2**	1,064.6
Regulatory adjustments to Tier 2 Capital:		
50% of excess of expected losses over impairment (gross of tax)	**(58.6)**	(211.5)
50% of securitisation positions	**(27.3)**	(0.7)
50% of material holdings	**(2.3)**	(2.0)
Total Tier 2 Capital after regulatory adjustments	**111.0**	850.4
Total capital resources	**1,407.5**	2,293.4

5.1 Capital resources – Basel II continued

Under the IRB approach, a deduction is made for expected losses in excess of impairment provisions made on customer lending. In accordance with guidance from the PRA to the British Bankers' Association (BBA), 50% is deducted from Core Tier 1 Capital net of tax and 50% from Tier 2 Capital gross of tax. Other Tier 1 Capital is adjusted by the remaining 50% tax on the excess of expected losses over impairment.

Capital resources before deductions

Core Tier 1 Capital before regulatory deductions has decreased by £283m. In summary this movement represents the £1,154m Core Tier 1 Capital raised as part of LME, as detailed in section 2.1, less the underlying loss after tax (before LME) of £1,436m. Statutory losses after tax for the year were £748m after £688m profit arising from LME.

The further £313m, payable by The Co-operative Banking Group during 2014, together with £40m interest saving during 2014 will complete the total benefit to Core Tier 1 Capital of £1.5bn by 31 December 2014.

The impact of LME on permanent share capital, retained earnings and share premium are explained in detail in section 2.1. All preference shares, subordinated notes and perpetual subordinated bonds reported in 2012 have been redeemed as part of LME. £196.3m of new Tier 2 Capital is recognised as at 31 December 2013, which is £206.0m issued in December 2013 less £9.7m allocation of LME costs.

Deductions

As detailed in section 2.2 balance sheet comparatives for 2012 have been restated for intangible fixed assets in development and all other assets held on the balance sheet which were used solely by the Bank. The intangibles deduction from capital resources has correspondingly been restated. In the interim results to 30 June 2013 these intangible assets were on the balance sheet of CFSMS but the amount attributable to the Bank was deducted from the Bank's capital resources.

The total intangible assets deduction from Core Tier 1 Capital has reduced from £262.5m at 31 December 2012 to £110.7m as at 31 December 2013. The reduction reflects the £148.4m write-off of assets in 2013.

Excess of expected loss over impairments, a deduction from Tier 1 and Tier 2 Capital, has decreased from £319.4m at end 2012 to £95.0m in 2013. This is primarily due to a significant increase in credit impairments.

Table 3 Reconciliation to statutory balance sheet

	2013 £m	2012 £m
Total Equity per balance sheet	**1,777.3**	1,850.2
Regulatory adjustments:		
Ordinary shares not recognised until cash consideration paid in 2014	**(303.2)**	–
Minority interests	**–**	(0.4)
Retained earnings	**–**	–
Available for sale reserve	**14.1**	(30.0)
Cashflow hedging reserve	**(14.9)**	(63.7)
Core Tier 1 Capital before regulatory deductions	**1,473.3**	1,756.1

5.1 Capital resources – Basel II continued

Table 4 Movement in Basel II capital during the year

	£m
Core Tier 1 Capital after regulatory adjustments as at 31 December 2012	1,333.2
Permanent share capital	(400.2)
Retained earnings	(186.7)
Minority interests	1.6
Losses for the period	(738.2)
Share premium account	1,040.7
Intangible assets	151.8
50% of excess of expected losses over impairment (net of tax)	112.2
50% of securitisation positions	(26.6)
Core Tier 1 Capital after regulatory adjustments as at 31 December 2013	**1,287.8**
Other Tier 1 Capital after regulatory adjustments as at 31 December 2012	109.8
Non-cumulative irredeemable preference shares	(60.0)
50% of tax on excess of expected losses over impairment	(40.8)
50% of material holdings	(0.3)
Other Tier 1 Capital after regulatory adjustments as at 31 December 2013	**8.7**
Total Tier 1 Capital after regulatory adjustments as at 31 December 2013	**1,296.5**
Tier 2 Capital after regulatory adjustments as at 31 December 2012	850.4
Revaluation reserves	–
Collective provisions	0.2
Subordinated notes and perpetual subordinated bonds	(915.8)
50% of excess of expected losses over impairment (gross of tax)	152.9
50% of securitisation positions	(26.6)
50% of material holdings	(0.3)
Excess on limits for Tier 2 Capital	50.2
Tier 2 Capital after regulatory adjustments as at 31 December 2013	**111.0**
Total capital resources as at 31 December 2013	**1,407.5**

The £410m capital redemption reserve created as a result of the cancellation of share capital is included within the movement in retained earnings.

5.2 Capital requirements – Pillar 1

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 document exposures are reported as EAD. For IRB exposures, EAD is defined as the amount estimated to be outstanding at the time of default. This includes undrawn commitments after credit conversion factors and the result of netting and potential future exposures for derivatives. For standardised exposures, EAD includes undrawn commitments post credit conversion factor and is net of provisions.

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

We have not restated our RWAs for 2012 in this or any of the following tables. The impact of restating RWAs would have been a c.£60m decrease in RWAs and is therefore not considered material.

5.2 Capital requirements – Pillar 1 continued

Table 5a Pillar 1 capital requirements 2013

	2013				
IRB exposure class	**Capital requirement £m**	**Risk Weighted Asset £m**	**Exposure at Default £m**	**Average risk weight %**	**Average Exposure at Default £m**
Central government and central bank	–	0.4	8,510.8	–	8,469.0
Institutions	40.1	501.4	2,839.1	18	4,153.9
Corporates	93.0	1,163.0	2,133.2	55	2,380.7
Securitisations	29.6	369.7	1,816.5	20	1,878.5
Retail mortgages	362.1	4,526.8	21,406.3	21	22,326.4
Qualifying revolving	56.8	709.8	2,450.3	29	2,188.0
Other retail exposures	49.7	620.7	578.2	107	661.1
Total IRB	631.3	7,891.8	39,734.4	20	42,057.6
Specialised lending	220.5	2,756.2	4,495.3	61	5,138.2
Standardised exposure class					
Central government and central bank	–	–	–	–	–
Regional governments or local authorities	2.2	27.2	135.8	20	135.5
Administrative bodies and non-commercial	7.3	91.2	97.5	94	95.1
Multilateral development banks	–	–	20.0	–	20.0
Institutions	5.0	62.1	314.6	20	309.0
Corporates	98.9	1,236.6	1,237.3	100	1,625.2
Secured by mortgages on residential property	0.7	9.1	26.1	35	20.2
Secured by mortgages on commercial real estate	0.1	0.9	0.9	100	0.9
Retail	5.1	63.3	84.4	75	61.6
Past due	7.6	95.6	74.8	128	99.5
Other items[1]	40.1	500.6	1,168.0	43	1,120.7
Total standardised	167.0	2,086.6	3,159.4	66	3,487.7
Total credit risk exposures	1,018.8	12,734.6	47,389.1	27	50,683.5
Interest rate position risk requirement	–	–	N/A	N/A	N/A
Counterparty risk capital component	–	–	N/A	N/A	N/A
Foreign currency position risk requirement	0.2	2.4	N/A	N/A	N/A
Total market risk exposures	0.2	2.4	N/A	N/A	N/A
Operational risk exposure	100.4	1,255.2	N/A	N/A	N/A
Total Pillar 1	1,119.4	13,992.2	N/A	N/A	N/A

1. Other items within the standardised approach include equity shares with a balance sheet value of £5.8m (2012: £5.7m) representing two separate investments. It is subject to the standardised approach as an immaterial portfolio and not considered material for Pillar 3 disclosure purposes relating to equity shares.

The IRB securitisation and retail mortgage lines in the above table reflect the impact of the Calico Finance Number One Limited (Calico) transaction on exposure as described in sections 5.3 and 7.2.12.

5.2 Capital requirements – Pillar 1 continued

Table 5b Pillar 1 capital requirements 2012

	2012				
IRB exposure class	Capital requirement £m	Risk Weighted Assets £m	Exposure at Default £m	Average risk weight %	Average Exposure at Default £m
Central government and central bank	–	0.4	7,330.0	–	6,777.0
Institutions	80.7	1,008.8	5,431.8	19	5,390.0
Corporates	131.1	1,638.7	2,800.1	59	3,301.2
Securitisations	7.6	94.7	422.8	22	587.8
Retail mortgages	409.8	5,122.6	24,539.3	21	25,066.7
Qualifying revolving	61.4	767.1	2,219.3	35	2,244.0
Other retail exposures	56.2	702.8	751.4	94	762.9
Total IRB	746.8	9,335.1	43,494.7	21	44,129.6
Specialised lending	305.5	3,818.9	5,615.6	68	4,351.2
Standardised exposure class					
Central government and central bank	–	–	–	–	–
Regional governments or local authorities	2.0	24.5	121.2	20	135.5
Administrative bodies and non-commercial	6.1	76.3	83.1	92	83.1
Multilateral development banks	–	–	–	–	–
Institutions	3.6	45.2	225.7	20	271.5
Corporates	166.3	2,077.7	2,076.0	100	2,820.4
Secured by mortgages on residential property	0.4	5.8	16.5	35	13.1
Secured by mortgages on commercial real estate	0.1	0.9	0.9	100	0.9
Retail	–	0.3	0.4	75	0.4
Past due	17.9	223.8	149.0	150	86.0
Other items[1]	29.3	366.3	1,036.0	35	1,026.9
Total standardised	225.7	2,820.8	3,708.8	76	4,437.8
Total credit risk exposures	1,278.0	15,974.8	52,819.1	30	52,918.6
Interest rate position risk requirement	29.1	363.8	N/A	N/A	N/A
Counterparty risk capital component	10.1	126.3	N/A	N/A	N/A
Foreign currency position risk requirement	0.2	2.5	N/A	N/A	N/A
Total market risk exposures	39.4	492.6	N/A	N/A	N/A
Operational risk exposure	115.3	1,441.3	N/A	N/A	N/A
Total Pillar 1	1,432.7	17,908.7	N/A	N/A	N/A

1. Other items within the standardised approach include equity shares with a balance sheet value of £5.8m (2012: £5.7m) representing two separate investments. It is subject to the standardised approach as an immaterial portfolio and not considered material for Pillar 3 disclosure purposes relating to equity shares.

5.3 Basel II Risk Weighted Assets

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

Table 6 Flow statement of Risk Weighted Assets

	£m
December 2012 (Basel II)	17,908.7
Operational risk	(186.1)
Trading risk	(363.9)
Counterparty risk	(126.3)
Credit risk standardised	(734.2)
Specialised lending	(1,062.7)
Credit Risk IRB	(1,443.3)
December 2013 (Basel II)	**13,992.2**
CRD IV adjustments	1,083.9
December 2013 (CRD IV)	**15,076.1**

Basel II RWAs have reduced by £3.9bn. On 28 January 2013, the Bank entered into a transaction to transfer a mezzanine portion of the risk in a portfolio of residential mortgage loans to third party investors, via a special purpose vehicle, Calico Finance Number One Limited. As a result of this transaction, RWAs initially reduced by c. £1.2bn. Further details on RWA movements are included in the Capital Management section of the Annual Report and Accounts.

5.4 Basel II capital ratios

Basel II Capital ratios for the year are as follows:

Table 7 Basel II capital ratios

Capital ratios	**2013 %**	Restated 2012 %
Core Tier 1	**9.2%**	7.4%
Tier 1	**9.3%**	8.1%
Total capital	**10.1%**	12.8%

Core Tier 1 Capital ratio has increased to 9.2% at 31 December 2013 from 7.4%. This reflects a decrease in Core Tier 1 Capital of £45.4m and a decrease in RWAs of £3.9bn. The increase in Core Tier 1 Capital is primarily driven by the proceeds of LME offset by the 2013 statutory loss. A breakdown of the reduction in RWAs is shown in Tables 5a and 5b.

Total capital ratio has decreased to 10.1% from 12.8% reflecting the extinguishing of existing additional Tier 1 and Tier 2 debt as part of the exchange, as well as Core Tier 1 Capital movements described above.

5.5 Balance sheet reconciliation

The tables below reconcile the statutory balance sheet included with the Annual Report and Accounts to Exposures at Default.

Table 8a Reconciliation of statutory balance sheet to gross drawn credit risk exposure

	Balance sheet assets under the regulatory scope of consolidation £m	Items deducted from own funds £m	Items related to market risk £m	Items related to counterparty credit risk (derivatives and Securities Financing Transactions (SFTs)) £m	Other adjustments[2] £m	Gross drawn credit risk exposure £m
	A	B1	B2	B3	C	A+B1+B2+ B3+C = D
Cash and balances with central banks	5,419	–	–	–	–	5,419
Trading and other financial assets at FVTPL	–	–	–	–	–	–
Loans and advances to banks	1,594	–	–	–	–	1,594
Loans and advances to customers[1]	30,429	–	–	–	1,034	31,463
AFS financial assets	2,732	–	–	–	5	2,737
Treasury bills/other eligible bills	1,767	–	–	–	–	1,767
Derivatives and SFTs (eg reverse repos)	556	–	–	–	–	556
Equity shares	6	–	–	–	–	6
Investments in group undertakings (eg insurance subs)	5	(5)	–	–	–	–
Goodwill and other intangible assets	111	(111)	–	–	–	–
Deferred tax assets	–	–	–	–	–	–
Retirement benefit assets	–	–	–	–	–	–
Other assets	777	–	–	–	145	922
Intercompany assets	–	–	–	–	–	–
Total balance sheet	43,396	(116)	–	–	1,184	44,464

1. Includes fair value adjustment for hedged risk of £107.6m.
2. Other adjustments represent items posted to the balance sheet that are not included in the exposure to be risk weighted. This includes provisions and mark to market, fair value and effective interest rate adjustments.

5.5 Balance sheet reconciliation continued

Table 8b Reconciliation of gross drawn credit risk exposure to Exposures at Default

	Gross drawn credit risk exposure £m	Off-balance sheet items under regulatory scope[1] £m	Gross credit risk exposure £m	Credit conversion factor %	Net credit risk exposure[2] £m	Value adjustments and provisions £m	Other regulatory adjustment £m	EAD £m
IRB approach	D	E	D+E = F	G	D+(E*G) = H	I	J	H+I+J = K
Central governments and central banks	8,511	–	8,511	–	8,511	–	–	8,511
Institutions	2,839	–	2,839	–	2,839	–	–	2,839
Corporates	6,041	801	6,842	73%	6,629	–	–	6,629[3]
Retail mortgages	22,514	(1,661)	20,853	93%	20,969	–	437	21,406
Qualifying revolving retail exposures	649	2,222	2,871	81%	2,450	–	–	2,450
Retail SME	–	–	–	–	–	–	–	–
Other retail	578	–	578	–	578	–	–	578
Equity claims	–	–	–	–	–	–	–	–
Securitisation positions	196	1,621	1,817	100%	1,817	–	–	1,817
Total	41,328	2,983	44,311		43,793	–	437	44,230
Standardised approach								
Central governments central banks	–	–	–	–	–	–	–	–
Regional governments or local authorities	95	183	278	22%	136	–	–	136
Administrative bodies and non-commercial undertakings	95	13	108	14%	97	–	–	97
Multilateral development banks	20	–	20	–	20	–	–	20
International organisations	–	–	–	–	–	–	–	–
Institutions	315	–	315	–	315	–	–	315
Corporates	1,158	187	1,345	32%	1,218	–	19	1,237
Retail	84	–	84	–	84	–	–	84
Secured by mortgages on residential property	26	–	26	–	26	–	–	26
Secured by mortgages on commercial real estate	1	–	1	–	1	–	–	1
Past due items	174	1	175	9%	174	(99)	–	75
Items belonging to regulatory high risk categories	–	–	–	–	–	–	–	–
Covered bonds	–	–	–	–	–	–	–	–
Securitisation positions	–	–	–	–	–	–	–	–
Short term claims on institutions and corporates	–	–	–	–	–	–	–	–
Collective investment undertakings	–	–	–	–	–	–	–	–
Other items	1,168	–	1,168	–	1,168	–	–	1,168
Total	3,136	384	3,520		3,239	(99)	19	3,159
Overall total	44,464	3,367	47,831		47,032	(99)	456	47,389

1. Off-balance sheet items Include mortgage pipeline offers, undrawn credit facilities, potential future exposure for derivatives, reduction in retail mortgage exposure and an increase in securitisation exposure due to the transfer of risk attributable to the Calico transaction.
2. This column includes the impact of the Calico securitisation which reduces retail mortgage exposure and increases the securitisation exposure.
3. This figure includes specialised lending of £4.5bn.

6. Capital adequacy – CRD IV

6.1 Compliance with capital requirements

Basel III has been implemented in the EU through the new CRR and a further iteration of the CRD. Together the new rules are known as CRD IV which came into effect from 1 January 2014. The European Banking Authority are 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.

In the December 2013 PS7/13 Policy Statement the PRA announced that, with the exception of available for sale unrealised gains, CRD IV deductions and filters would be implemented in full from 1 January 2014 and there would be no transition to full implementation for these items. Rules for grandfathering and phasing out of ineligible additional Tier 1 and Tier 2 are unchanged but these rules are no longer relevant to the Bank because instruments to which these rules would have applied have been exchanged as part of LME. All CRD IV disclosures are on a fully loaded basis except for the capital resources table which additionally shows the transitional position.

Fully-loaded CET1 is £142m higher than as at end 2012, primarily due to the impact of LME and lower deductions offset by the statutory loss. Transitional CET1 is equal to fully-loaded due to acceleration of transitional rules. Transitional CET1 for 2012 is shown as reported last year before acceleration of transitional rules.

6.2 Capital resources CRD IV

Table 9 Capital resources CRD IV 2012/2013

	2013		2012 (restated)	
	Year 1 CRD IV transitional rules £m	**CRD IV fully loaded rules £m**	Year 1 CRD IV transitional rules £m	CRD IV fully loaded rules £m
Common Equity Tier 1 Capital: instruments and reserves				
Permanent share capital and the related share premium account	**1,059.3**	**1,059.3**	418.8	418.8
Retained earnings	**1,118.6**	**1,118.6**	1,813.4	1,813.4
Available for sale and cash flow hedge reserves	**0.8**	**0.8**	93.7	93.7
Minority Interests[1]	**12.1**	**12.1**	32.0	11.5
Independently reviewed interim profits net of any foreseeable charge or dividend	**–**	**–**	–	–
Common Equity Tier 1 (CET1) Capital before regulatory adjustments	**2,190.8**	**2,190.8**	2,357.9	2,337.4
Common Equity Tier 1 (CET1) Capital: regulatory adjustments				
Prudential valuation in trading book	**(2.1)**	**(2.1)**	(7.0)	(7.0)
Intangible assets (net of related tax liability)[2]	**(110.7)**	**(110.7)**	–	(262.5)
Deferred tax assets not arising from temporary differences[3]	**–**	**–**	(1.4)	(14.1)
Cash flow hedge reserves	**(14.9)**	**(14.9)**	(63.7)	(63.7)
Expected loss shortfall[4]	**(238.3)**	**(238.3)**	–	(537.4)
Securitisation positions treated as deduction[5]	**–**	**–**	–	–
Losses for the year	**(738.2)**	**(738.2)**	(508.1)	(508.1)
Filter for unrealised gains on debt instruments held in the available for sale category[6]	**–**	**–**	(27.9)	–
Unrealised gains or losses on available for sale assets (revaluation reserve)[6]	**(2.0)**	**–**	(2.0)	–
Qualifying AT1 deductions that exceed AT1 Capital[7]	**–**	**–**	(477.2)	–
Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(1,106.2)**	**(1,104.2)**	(1,087.3)	(1,392.8)
Common Equity Tier 1 (CET1) Capital	**1,084.6**	**1,086.6**	1,270.6	944.6

6.2 Capital resources CRD IV continued

	2013		2012 (restated)	
	Year 1 CRD IV transitional rules £m	**CRD IV fully loaded rules £m**	Year 1 CRD IV transitional rules £m	CRD IV fully loaded rules £m
Additional Tier 1 (AT1) Capital: instruments				
Perpetual non-cumulative preference shares[8]	**–**	**–**	54.0	–
Minority interest[1]	**2.6**	**2.6**	–	2.5
Additional Tier 1 (AT1) Capital before regulatory adjustments	**2.6**	**2.6**	54.0	2.5
Additional Tier 1 (AT1) Capital: regulatory adjustments				
Intangible assets[2]	**–**	**–**	(262.5)	–
Expected loss shortfall (half)[4]	**–**	**–**	(268.7)	–
Total regulatory adjustments to Additional Tier 1 (AT1) Capital	**–**	**–**	(531.2)	–
AT1 adjustments in excess of AT1 Capital	**–**	**–**	477.2	–
Additional Tier 1 (AT1) Capital	**2.6**	**2.6**	–	2.5
Tier 1 Capital (T1 = CET1 + AT1)	**1,087.2**	**1,089.2**	1,270.6	947.1
Tier 2 (T2) Capital: instruments and provisions				
Capital instruments	**196.3**	**196.3**	1,119.8	747.3
Minority interest[1]	**3.5**	**3.5**	–	3.4
Collective provisions	**0.9**	**0.9**	0.7	0.7
Tier 2 (T2) Capital before regulatory adjustments	**200.7**	**200.7**	1,120.5	751.4
Tier 2 (T2) Capital: regulatory adjustments				
Expected loss shortfall (half)[4]	**–**	**–**	(268.7)	–
Revaluation reserves[6]	**2.0**	**–**	2.0	–
Total regulatory adjustments to Tier 2 (T2) Capital	**2.0**	**–**	(266.7)	–
Tier 2 (T2) Capital	**202.7**	**200.7**	853.8	751.4
Total Capital (TC = T1 + T2)	**1,289.9**	**1,289.9**	2,124.4	1,698.5

The 2012 balance sheet comparatives have been restated for intangible fixed assets, property, plant and equipment and amounts owed by the other Co-operative Group undertakings as described in note 3 of the Annual Report and Accounts.

1. Minority interest represents the share of the capital and reserves of Unity Trust Bank that is attributable to third party investors. Under CRD IV the amount of minority interest which can be recognised by the Bank is reduced, and then allocated between the different tiers of capital.
2. Under CRD IV intangible assets change from being a deduction from Tier 1 to a deduction from CET1.
3. Deferred tax assets not arising from temporary differences move from being risk weighted to being a deduction from CET1.
4. Expected loss shortfall changes from being deducted half from Tier 1 and half from Tier 2 to a full deduction from CET1. Under Basel II rules the deduction is net of tax, whereas under CRD IV it is gross.
5. Securitisation positions rated at 1,250% are shown as risk weighted under CRD IV.
6. Some prudential filters which apply under Basel II do not apply under CRD IV.
7. The 2013 CRD IV figures show a transitional position based on final CRR regulations. 2012 figures are as reported in the previous year using PRA guidance applicable at that time.
8. Most CRD IV transitional percentages are subject to national discretion. The PRA have applied percentages that ensure transitional values match final end point wherever possible. The only applicable transitional percentage for the Bank relates to unrealised gains on debt instruments held in the available for sale category and available for sale assets (revaluation reserve). In this case CRR allows no notional discretion with a 100% deduction in the first year.

6.3 CRD IV capital ratios 2013

Table 10 Capital requirement and ratios 2012/2013

	CRD IV fully loaded rules 2013 £m	CRD IV fully loaded rules 2012 £m
RWA as per Basel II	**13,992.2**	17,908.7
Additional AVC	**190.2**	431.5
CVA	**200.2**	397.5
Securitisation risk weighted at 1,250%	**681.8**	17.2
DTA not timing differences risk weighted at 100%	**–**	–
DTA timing differences risk weighted at 250%	**–**	77.5
Significant investment in common stock at 250%	**11.7**	9.9
Total Risk Weighted Assets	**15,076.1**	18,842.3
Common Equity Tier 1 (CET1) ratio	**7.2%**	5.0%
Tier 1 ratio	**7.2%**	5.0%
Total Capital ratio	**8.6%**	9.0%

Additional Asset Valuation Correlation (AVC) is due to the higher correlation factor applied to financial institutions under CRD IV. Credit Valuation Adjustment (CVA) represents additional RWA calculated for derivatives. Securitisations with a risk weight of 1,250% are shown as a Risk Weighted Asset (RWA) rather than as a deduction from capital as allowed under CRD IV. In 2012 there was some RWA for Deferred tax asset due to timing differences that exceeded Core Tier 1 thresholds. The increase in CET1 in 2013 now means that thresholds are not now exceeded. Deferred tax assets due to timing differences and significant investments in common stock are both risk weighted at 250% under CRD IV.

6.4 CRD IV leverage ratio

Table 11 CRD IV leverage ratio

	Dec 2013 £m	Restated Dec 2012 £m
Tier 1 Capital	**1,089.2**	947.1
Total assets as per balance sheet	**43,396.1**	49,772.8
Less derivatives accounting value	**(555.8)**	(809.0)
Plus derivatives (Basel II netting and PFE)	**517.7**	752.6
Less SFT accounting value	**–**	(250.0)
Plus SFT (Basel II netting and collateral)	**–**	250.0
Off-balance sheet unconditionally cancellable (10% conversion factor)	**196.8**	252.2
Off-balance sheet 100% conversion factor	**2,157.8**	2,582.1
Less Regulatory adjustments to Tier 1 Capital	**(127.7)**	(347.4)
Regulatory leverage exposure	**45,584.9**	52,203.3
Leverage ratio	**2.4%**	1.8%

Leverage ratio on a fully-loaded basis has increased from 1.8% in 2012 to 2.4% as at 31 December 2013. The leverage ratio is calculated as CRD IV Tier 1 Capital divided by adjusted balance sheet exposures. The improvement in the ratio reflects a £142m increase in total Tier 1 Capital and a £6.6bn decrease in exposures reflecting the overall deleveraging strategy.

7. Risks and their management

7.1 Overview

The Bank seeks to understand and manage the various risks that arise from operations and defines the principal risks it faces in a number of categories. These are:

- Credit risk
- Liquidity risk
- Market risk
- Operational risk
- Reputation risk
- Strategic and business risk
- People risk
- Regulatory risk
- Conduct risk
- Pension risk

These risks and the management of them are discussed in more detail in the Risk Management section of the Annual Report and Accounts

7.2 Credit risk

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

7.2.1 Management of credit risk

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

The inherent risks arising from general economic conditions have been increased by the period of significant turbulence and uncertainty affecting the global economy and the global financial system, and the Eurozone in particular. The Bank continues to be exposed to these risks and their consequences, including lower consumer confidence, high levels of unemployment, interest rate volatility and increased cost of credit, which may result in increased credit risk which could have a material adverse effect on the Bank's business.

All authority to take credit risk derives from the Board. This authority is delegated to the CEO up to certain limits who then sub-delegates to appropriate committees and individuals. The level of credit risk authority delegated depends on seniority and experience, and varies according to the quality of the counterparty, associated security or collateral held. The Bank's policy for credit risk is required to be approved annually by the ERC and defines appropriate standards and principles for the effective management of credit risk throughout the Bank's divisions.

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

In May 2013, in order to strengthen internal risk controls, the Bank Executive, with the approval of the Board Risk Committee and the Board, moved all corporate lending authority to the three principle Executive Lending Committees, the LCC, SCC and STC (see Executive and management committees section). This has proven especially beneficial during the restructuring of this portfolio into that of CoAM and Business and Commercial Banking (BaCB) as new underwriting procedure for these businesses are being formulated.

The Credit Risk Management Forum (CRMF) considers key management information to support the oversight and challenge of the credit risk embedded in each division and across the credit risk life cycle. This includes appropriate benchmarking information from similar portfolios in the market and is key to calibrating risk appetite.

7.2 Credit risk continued

The CRMF is supported by an additional three forums that exist to support the Credit Risk Director in discharging the second line mandate. These include an Impairment Charge Forum, implemented in June 2013, that exists to ensure that the credit risk impairment and loss recognition policy standard is being implemented effectively and that there is sufficient evidence to support the credit risk impairment stock. In addition, an Impairment Adequacy Forum was implemented in the second half of 2013 as a mechanism for approving and reviewing the refresh of impairment parameters and post model adjustments. The third forum is the Treasury Credit Risk Management Forum which provides day-to-day oversight of the credit risk exposure in the Treasury division.

The retail division of the Core Bank uses both application and behavioural scoring techniques to rank a customer's risk of default with this, in common with other retail banks, being embedded in the business. The Non-core division, which includes corporate lending, includes a number of specialist models to reflect the embedded credit risk of sectors such as private finance initiatives (PFIs) and commercial property. The performance of all rating systems is governed by the IRB Model Working Group with oversight from a new Model Risk Forum that met for the first time during the third quarter of 2013.

7.2.2 Credit risk exposures

The following table represents the Bank's Exposures at Default (EAD) analysed by approach, exposure class and contractual maturity.

Table 12a Analysis of EAD by residual contractual maturity 2013

Exposure class	Repayable on demand/ undated £m	Up to 1 year £m	1–5 years £m	5–10 years £m	10–20 years £m	>20 years £m	Total £m
IRB							
Central government and central bank	–	5,144.1	2,128.4	1,091.7	116.8	29.8	8,510.8
Institutions	–	1,867.2	876.4	95.3	0.2	–	2,839.1
Corporates	–	273.6	615.3	290.2	399.3	554.8	2,133.2
Securitisations	–	19.8	69.2	1,677.8	49.7	–	1,816.5
Retail mortgages	–	151.7	1,054.0	2,458.6	11,415.6	6,326.4	21,406.3
Qualifying revolving	2,450.3	–	–	–	–	–	2,450.3
Other retail exposures	29.4	35.4	415.3	98.0	0.1	–	578.2
Total IRB	2,479.7	7,491.8	5,158.6	5,711.6	11,981.7	6,911.0	39,734.4
Specialised lending	–	761.5	1,642.0	559.6	750.2	782.0	4,495.3
Standardised							
Central government and central bank	–	–	–	–	–	–	–
Regional governments or local authorities	–	61.5	13.3	16.5	40.5	4.0	135.8
Administrative bodies and non-commercial	1.5	7.8	29.4	45.3	11.7	1.8	97.5
Multilateral development banks	–	–	20.0	–	–	–	20.0
Institutions	–	314.5	0.1	–	–	–	314.6
Corporates	0.7	22.4	353.1	445.1	390.6	25.4	1,237.3
Secured by mortgages on residential property	–	0.5	0.6	15.6	2.3	7.1	26.1
Secured by mortgages on commercial real estate	–	0.9	–	–	–	–	0.9
Retail	0.3	84.1	–	–	–	–	84.4
Past due	0.1	2.1	52.0	13.9	6.7	–	74.8
Other items	1,168.0	–	–	–	–	–	1,168.0
Total standardised	1,170.6	493.8	468.5	536.4	451.8	38.3	3,159.4
Total credit risk exposures	3,650.3	8,747.1	7,269.1	6,807.6	13,183.7	7,731.3	47,389.1

The above table reflects the exposure impact of the Calico transaction described in sections 5.3 and 7.2.12.

The period to 31 December 2013 has seen an overall reduction in EAD, notably for the Institutions, Corporate and Specialised lending asset classes, reflective of the Bank's strategy to deleverage Non-core assets as well as for the Retail mortgages asset class reflective of the closed nature of the Optimum portfolio. This reduction is partially offset by increases in EAD for the central government and central bank asset class, reflective of the Bank's desire to increase the levels of liquidity it holds as well as for the Securitisations asset class, reflective of the Calico transaction.

7.2 Credit risk continued

Table 12b Analysis of EAD by residual contractual maturity 2012

Exposure class	Repayable on demand/ undated £m	Up to 1 year £m	1-5 years £m	5-10 years £m	10-20 years £m	>20 years £m	Total £m
IRB							
Central government and central bank	–	4,904.2	1,074.3	1,147.5	178.7	25.3	7,330.0
Institutions	–	2,206.4	2,806.3	289.2	54.1	75.8	5,431.8
Corporates	–	649.4	864.3	236.6	462.4	587.4	2,800.1
Securitisations	–	155.1	151.4	56.5	57.4	2.4	422.8
Retail mortgages	–	145.5	1,084.4	2,687.0	12,626.5	7,995.9	24,539.3
Qualifying revolving	2,219.3	–	–	–	–	–	2,219.3
Other retail exposures	48.0	42.4	500.8	160.1	0.1	–	751.4
Total IRB	2,267.3	8,103.0	6,481.5	4,576.9	13,379.2	8,686.8	43,494.7
Specialised lending	–	904.9	2,044.7	963.1	767.5	935.4	5,615.6
Standardised							
Central government and central bank	–	–	–	–	–	–	–
Regional governments or local authorities	–	47.4	19.8	13.9	36.1	4.0	121.2
Administrative bodies and non-commercial	1.6	4.8	16.9	6.5	30.7	22.6	83.1
Multilateral development banks	–	–	–	–	–	–	–
Institutions	–	225.6	0.1	–	–	–	225.7
Corporates	0.3	125.1	893.3	380.1	640.6	36.6	2,076.0
Secured by mortgages on residential property	1.6	–	0.8	3.0	–	11.1	16.5
Secured by mortgages on commercial real estate	–	0.9	–	–	–	–	0.9
Retail	0.4	–	–	–	–	–	0.4
Past due	–	2.5	88.4	–	58.1	–	149.0
Other items	1,036.0	–	–	–	–	–	1,036.0
Total standardised	1,039.9	406.3	1,019.3	403.5	765.5	74.3	3,708.8
Total credit risk exposures	3,307.2	9,414.2	9,545.5	5,943.5	14,912.2	9,696.5	52,819.1

7.2 Credit risk continued

7.2.3 Impaired and past due exposures

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

Table 13a Analysis of impaired and past due exposures 2013

Exposure class	Exposures at Default £m	Of which: Impaired exposures £m	Of which: Past due exposures not impaired £m	Value adjustments and provisions held against impaired exposures £m	Charge for value adjustments in the period £m
IRB approach					
Central government and central bank	8,510.8	–	–	–	–
Institutions	2,839.1	–	–	–	–
Corporates	2,133.2	165.8	0.2	86.5	23.9
Securitisations	1,816.5	18.5	–	18.5	10.1
Retail mortgages	21,406.3	1,259.0	–	40.0	24.1
Qualifying revolving	2,450.3	109.4	1.5	88.2	–
Other retail exposures	578.2	76.1	3.6	72.0	–
Total IRB	39,734.4	1,628.8	5.3	305.2	58.1
Specialised lending	4,495.3	1,774.8	1.2	572.0	334.2
Standardised approach					
Central government and central bank	–	–	–	–	–
Regional governments or local authorities	135.8	–	–	–	–
Administrative bodies and non-commercial	97.5	1.4	–	0.5	–
Multilateral development banks	20.0	–	–	–	–
Institutions	314.6	–	–	–	–
Corporates	1,237.3	38.4	–	7.2	8.5
Secured by mortgages on residential property	26.1	–	–	–	–
Secured by mortgages on commercial real estate	0.9	–	–	–	–
Retail	84.4	–	–	–	–
Past due	74.8	155.9	–	86.5	42.9
Other items	1,168.0	0.7	–	–	–
Total standardised	3,159.4	196.4	–	94.2	51.4
Total credit risk exposures	47,389.1	3,600.0	6.5	971.4	443.7

The period to 31 December 2013 has seen an overall reduction in impaired exposures, notably for Retail mortgages, reflective of the closed nature of the Optimum portfolio as well as for Institutions, Corporate and Specialised lending asset classes, reflective of the Bank's strategy to deleverage Non-core assets.

Within Pillar 3 disclosures, value adjustments are defined as being individual impairments and provisions are defined as collective impairments in line with British Bankers' Association (BBA) guidance. Provisions are disclosed on a statutory basis and exclude those covered by fair value.

The period to 31 December 2013 has seen an increase in value adjustments and provisions, reflective of the Bank's strategy to deleverage Non-core assets resulting in its impairment assessment changing from the basis of a hold to an exit strategy and updated experience in support of our credit risk impairment policy, notably for the Optimum portfolio, as detailed in the Risk Management section of the Bank's 2013 Statutory Report.

The above table reflects the exposure impact of the Calico transaction described in sections 5.3 and 7.2.12.

7.2 Credit risk continued

Table 13b Analysis of impaired and past due exposures 2012

Exposure class	Exposure at Default £m	Of which: Impaired exposures £m	Of which: Past due exposures not impaired £m	Value adjustments and provisions held against impaired exposures £m	Charge for value adjustments in the period £m
IRB					
Central government and central bank	7,330.0	–	–	–	–
Institutions	5,431.8	–	–	–	–
Corporates	2,800.1	147.5	0.3	56.7	26.6
Securitisations	422.8	6.2	–	6.2	–
Retail mortgages	24,539.3	1,442.1	17.5	14.2	8.5
Qualifying revolving	2,219.3	134.5	2.0	98.3	–
Other retail exposures	751.4	72.4	4.9	74.5	–
Total IRB	43,494.7	1,802.7	24.7	249.9	35.1
Specialised lending	5,615.6	2,040.6	1.3	321.8	305.9
Standardised					
Central government and central bank	–	–	–	–	–
Regional governments or local authorities	121.2	–	–	–	–
Administrative bodies and non-commercial	83.1	1.4	–	0.5	–
Multilateral development banks	–	–	–	–	–
Institutions	225.7	–	–	–	–
Corporates	2,076.0	71.6	–	6.9	7.0
Secured by mortgages on residential property	16.5	–	–	–	–
Secured by mortgages on commercial real estate	0.9	–	–	–	–
Retail	0.4	–	–	–	–
Past due	149.0	250.8	–	70.6	40.1
Other items	1,036.0	–	–	–	–
Total standardised	3,708.8	323.8	–	78.0	47.1
Total credit risk exposures	52,819.1	4,167.1	26.0	649.7	388.1

The comparative table has been updated to include the changes made to impairment definitions in both the December 2012 financial statements and the current period.

7.2 Credit risk continued

7.2.4 Analysis of Corporate exposures impaired and past due

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

Table 14a Analysis of Corporate EAD by sector 2013

Sector	Exposure at Default £m	Of which: impaired exposures £m	Value adjustments and provisions held against impaired exposures[1] £m	Charge for value adjustments in the period[2] £m
Accommodation, food and licenced services	564.6	254.8	76.8	38.7
Care	185.7	35.6	9.7	7.1
Education	91.2	1.1	0.7	–
Financial services	106.6	5.7	4.6	1.2
Football clubs	42.8	15.9	6.0	0.3
Housing associations	1,076.9	4.7	4.7	–
Manufacturing	76.0	22.2	6.1	(1.3)
Motor trade/Garages	83.8	8.9	3.1	1.9
Private finance initiatives	1,172.7	42.6	9.8	(0.3)
Professional services	88.3	6.9	1.7	0.6
Property and Construction				
Commercial investment	2,417.6	1,292.8	475.9	271.2
Residential investment	350.2	169.8	35.4	17.8
Commercial development	276.9	135.6	44.8	35.1
Residential development	75.7	17.3	4.9	4.3
Public sector entities	0.2	0.1	0.1	–
Renewable energy	551.6	15.7	15.7	2.6
Retail/Wholesale trade	350.1	28.1	14.6	7.4
Services	343.4	48.9	22.5	14.0
Transport storage and communication	38.6	10.3	3.9	8.7
Utilities	18.7	1.7	1.2	0.4
Other	29.0	16.2	10.0	(0.2)
Total	**7,940.6**	**2,134.9**	**752.2**	**409.5**
IRB corporates	2,133.2	165.8	86.5	23.9
Specialised lending	4,495.3	1,774.8	572.0	334.2
Standardised corporates	1,237.3	38.4	7.2	8.5
Standardised past due corporates	74.8	155.9	86.5	42.9
Total	**7,940.6**	**2,134.9**	**752.2**	**409.5**

1. Includes £45.9m of collective provisions spread across each exposure class/industry.
2. Discloses individual impairments only and excludes securitisations.

The period to 31 December 2013 has seen an overall reduction in impaired exposures, notably for Property and Construction and Specialised lending asset classes, reflective of the Bank's strategy to deleverage Non-core assets. The period to 31 December 2013 has seen an increase in value adjustments and provisions, reflective of the Bank's strategy to deleverage Non-core assets resulting in its impairment assessment changing from the basis of a hold to an exit strategy as detailed in the Risk Management section of the Bank's 2013 Annual Report and Accounts.

7.2 Credit risk continued

Table 14b Analysis of Corporate EAD by sector 2012

Sector	Exposure at Default £m	Of which: impaired exposures[1] £m	Value adjustments and provisions held against impaired exposures £m	Charge for value adjustments in the period £m
Accommodation, food and licenced services	832.0	333.8	56.9	49.0
Care	279.8	20.1	1.8	1.0
Education	108.8	0.2	0.1	–
Financial services	135.7	5.1	2.9	0.7
Football clubs	47.2	19.6	8.6	4.4
Housing associations	1,099.3	–	–	–
Manufacturing	166.2	24.9	8.7	7.1
Motor trade/Garages	109.2	12.3	3.3	–
Private finance initiatives	1,269.1	10.8	5.1	5.1
Professional services	147.5	6.3	3.3	0.3
Property and Construction				
Commercial investment	3,533.9	1,678.2	279.2	265.3
Residential investment	460.2	190.5	24.5	12.9
Commercial development	280.0	64.6	11.4	5.7
Residential development	87.7	15.5	0.7	(0.2)
Public sector entities	1.0	–	–	–
Renewable energy	601.4	9.2	8.1	(1.2)
Retail/Wholesale trade	517.3	26.6	10.8	9.8
Services	610.9	51.4	18.5	3.5
Transport storage and communication	183.3	33.0	10.3	15.6
Utilities	91.1	0.7	0.7	–
Other	79.1	7.7	1.1	0.6
Total	10,640.7	2,510.5	456.0	379.6

IRB Corporates	2,800.1	147.5	56.7	26.6
Specialised lending	5,615.6	2,040.6	321.8	305.9
Standardised Corporates	2,076.0	71.6	6.9	7.0
Standardised past due Corporates	149.0	250.8	70.6	40.1
Total	10,640.7	2,510.5	456.0	379.6

1. During the year ended 31 December 2013, there has been one change to the definition of impaired loans. Corporate watch list cases are now included within impaired balances and the comparative table has been updated to reflect this. This has increased 2012 impaired exposures by £490.4m.

7.2 Credit risk continued

7.2.5 Derivative credit exposure

The table shows the Bank's counterparty credit risk which arises from the use of over the counter (OTC) derivatives. The exposures included in the table exclude any add-on for potential future credit exposure (PFE), whilst the netting benefit quoted is available for regulatory capital purposes only.

Table 15 Net exposures to counterparty credit risk for derivative contracts

	2013			2012		
	Banking book £m	Trading book £m	Total £m	Banking book £m	Trading book £m	Total £m
Interest rate contracts	**234.3**	**–**	**234.3**	275.6	197.3	472.9
Foreign exchange contracts	**216.6**	**–**	**216.6**	222.3	–	222.3
Credit derivative contracts	**–**	**–**	**–**	–	–	–
Equity contracts	**48.6**	**–**	**48.6**	63.0	–	63.0
Embedded derivatives	**56.3**	**–**	**56.3**	60.6	–	60.6
Gross positive fair value of contracts	**555.8**	**–**	**555.8**	621.5	197.3	818.8
Netting benefits	**(200.8)**	**–**	**(200.8)**	(293.8)	–	(293.8)
Netted current credit exposure	**355.0**	**–**	**355.0**	327.7	197.3	525.0
Collateral held	**(104.9)**	**–**	**(104.9)**	–	–	–
Net derivative credit exposure	**250.1**	**–**	**250.1**	327.7	197.3	525.0

The counterparty credit risk mark to market method is used to measure exposure value for counterparty credit risk. The Bank has utilised credit derivatives for credit risk mitigation purposes within the year.

In the use of Treasury credit ratings from External Credit Assessment Institutions (ECAI's), (Moody's and Fitch), and expert judgement the Bank assigns an appropriate Internal Rating Grade (IRG) 1–10, and associated Probability of Default (PD), based upon a limit matrix, which determines the Total Potential Limit (TPL) capacity for any single counterparty or counterparty group. Derivative limits are established, as for other traded products with reference to the limit matrix. The maximum term permitted for Treasury products differs dependent upon the IRG shown on the limit matrix table and whether there is any credit risk mitigation in the form of collateral.

All counterparties are proactively monitored through real time external rating alerts, and media intelligence gathering. Management actions are taken promptly in response to adverse market conditions or ratings actions and counterparties are reviewed on a rolling programme basis in accordance with credit risk policy taking a 'risk based approach'.

Credit policies, control standards and methodologies are formed to avoid correlation or wrong way risk. For repo products, the issuer of the collateral and the counterparty should be neither the same nor connected. The same rule applies for derivatives under collateral policies.

During the year we have reviewed our approach to recognising credit risk mitigation with regard to derivative contracts. This has enabled us to recognise the value of collateral held against positive derivative positions. Trading book activity ceased during the 2013 year. All OTC derivatives are held within the banking book. The decrease in the banking book derivatives exposure is primarily driven by a reduction in the notional values from amortisation and the maturity of deals.

The notional value of credit derivatives outstanding at 31 December 2013 was £175m (2012: £nil) representing credit protection purchased against the Bank's exposure to its transactional counterparties. The fair values of these contracts were negative at the year end, consequently no associated exposure is reported in the table above.

7.2 Credit risk continued

7.2.6 Impairment

Allowance for impairments relating to loans and advances to customers

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

The provisions within the Corporate portfolio are spread over the Corporate exposure classes for foundation IRB and standardised approach. The provisions for retail exposures relate to retail exposures secured by real estate collateral exposure class and the unsecured exposures within the 'qualifying revolving' and 'other retail' exposure classes. With the exception of a small portfolio of personal career development loans, all retail exposures are treated under the retail IRB approach. The classification of the majority of the Corporate portfolio as Non-core and the Non-core asset strategy change from a hold for value to a managed exit has resulted in a significant increase in individual impairment compared to 2012.

Table 16a Allowance for impairment 2013

2013	Individual Retail £m	Individual Corporate £m	Collective Retail £m	Collective Corporate £m	Total £m
At the beginning of the year	**10.6**	**433.6**	**176.4**	**22.4**	**643.0**
Charge against profits	**24.1**	**419.6**	**39.2**	**24.6**	**507.5**
Amounts written off	**(5.8)**	**(140.2)**	**(40.7)**	**(1.1)**	**(187.8)**
Unwind of discount allowance	**–**	**(7.1)**	**(3.6)**	**–**	**(10.7)**
Interest charged on impaired loans	**–**	**0.4**	**–**	**–**	**0.4**
At the end of the year	**28.9**	**706.3**	**171.3**	**45.9**	**952.4**

Table 16b Allowance for impairment 2012

2012	Individual Retail £m	Individual Corporate £m	Collective Retail £m	Collective Corporate £m	Total £m
At the beginning of the year	9.0	105.1	165.7	12.2	292.0
Charge against profits	8.5	379.6	43.5	11.6	443.2
Amounts written off	(6.9)	(47.5)	(29.4)	(1.4)	(85.2)
Unwind of discount allowance	–	(3.7)	(3.4)	–	(7.1)
Interest charged on impaired loans	–	0.1	–	–	0.1
At the end of the year	10.6	433.6	176.4	22.4	643.0

7.2 Credit risk continued

Allowance for impairment relating to debt securities

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

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

Table 17 Allowance for impairment relating to debt securities

	2013 £m	2012 £m
Opening balance	**39.0**	45.2
Charge against profits	**–**	(5.4)
Any other adjustments	**(19.0)**	(0.8)
Closing balance	**20.0**	39.0

Comparison of expected losses to accounting impairment losses

The following table provides a comparison of the expected losses on non defaulted assets as at 31 December 2012 with the actual charge to the income statement for losses on loans and advances that materialised for the whole portfolio over the subsequent year ending on 31 December 2013. Expected losses for exposures on the IRB approach are derived from underlying IRB models and are a function of PD, Loss Given Default (LGD) and Exposures at Default (EAD) estimates. Expected losses for specialised lending are determined using pre-defined expected loss rates for each of the five PRA supervisory categories. Expected loss is not calculated for exposures on the standardised approach.

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

Table 18a Comparison of expected losses to impairment losses 2013

Exposure class	Impairment losses for 2013[1] £m	Expected losses on non defaulted assets as at 31 December 2012 £m
IRB		
Central government and central bank	**–**	–
Institutions	**–**	2.2
Corporates	**58.3**	9.5
Securitisations	**–**	–
Retail mortgages	**24.7**	104.8
Qualifying revolving	**44.3**	29.6
Other retail exposures	**(5.7)**	26.1
Total IRB	**121.6**	172.2
Specialised lending	**334.5**	53.0
Total	**456.1**	225.2
Impairment losses on standardised portfolios	**51.4**	
Net charge to the income statements (loans and advances to customers and banks)	**507.5**	

1. Includes collective impairments.

7.2 Credit risk continued

Table 18b Comparison of expected losses to impairment losses 2012

Exposure class	Impairment losses for 2012[1] £m	Expected losses on non defaulted assets as at 31 December 2011 £m
IRB		
Central government and central bank	–	–
Institutions	–	14.6
Corporates	42.4	12.0
Securitisations	–	–
Retail mortgages	22.3	128.6
Qualifying revolving	29.7	31.9
Other retail exposures	–	28.1
Total IRB	94.4	215.2
Specialised lending	300.2	102.8
Total	394.6	318.0

Impairment losses on standardised portfolios	48.6
Net charge to the income statements (loans and advances to customers and banks)	443.2

1. Includes collective impairments.

7.2 Credit risk continued

7.2.7 Credit risk control

The Credit Risk Management Forum (CRMF) reviews credit risk management information (MI) in considerable depth, for example by key risk segments. In addition, the credit risk second line receive and review credit risk MI on a regular basis split by key characteristic. The CRMF MI is produced on a monthly basis with different MI produced for each business area. The regular MI covers a broader scope than that provided to the ERC. Reports include:

- Performance against agreed risk appetite limits and tolerances;
- Sector and obligor concentrations and risk segmentation;
- Monitoring of exposures at risk and in arrears and impairment levels;
- Monitoring of loans under forbearance; and
- Monitoring of IRB model performance.

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

Retail credit policy

Credit approval and individual limit setting

The Bank's policy on retail secured and unsecured credit is to establish credit criteria that determine the balance between volume growth (generating higher income) and higher arrears and losses, so as to ensure the return is commensurate with the Bank's risk appetite and strategic objectives. Retail credit risk related decisions are based on a combination of defined lending policies and the use of bespoke scorecards derived from historical data. Regular updates are provided to senior management on the performance of the portfolios.

Unsecured lending

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

Mortgage lending (credit approval)

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

Individual and portfolio limit setting

Portfolio limits were agreed in 2012 for specific lending sectors based on an overall assessment of our appetite for exposure to that sector.

Retail pricing and profitability

The IRB models, or the underlying credit risk models upon which the IRB models are based, are used as inputs to pricing/profitability models across the retail lending portfolios (both secured and unsecured).

7.2 Credit risk continued

Corporate credit policy

The Bank's policy on new Corporate lending is to consider relatively low risk and senior (not subordinated) exposures from UK customers provided they meet the criteria contained in the corresponding sector strategy, while avoiding excess single name or sector concentrations. During 2013 very little new to Bank lending was undertaken. Individual cases which show signs of unsatisfactory performance are managed through a specialist Corporate Business Support team who are engaged with the customers to restore them to good health or wherever this is not possible management actions are taken to effect recovery. The CRMF and ERC (and by exception Board Risk Committee (BRC)) receive regular reports on the performance of the portfolio.

Corporate lending and credit approval

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

First line relationship managers submit recommendations for any new money to be lent which are risk assessed by the centrally based credit underwriting team who are independent from income generation. The lending discretions for new money are made by the Large Credit Committee (LCC) (mainly Non-core customers due to their size), the Strategic Asset Review (SAR) groups (Non-core only) or the Small Credit Committee (SCC) (Core business). The CRO, the CFO and the CEO are members of the LCC. The CoAM strategy is executed through higher risk (default and watch list) and performing SAR groups comprising of first and second line business and credit risk representatives where the majority of decisions are taken to set run-off or exit strategies but occasionally the customers who require additional lending may protect value in the work out of a customer asset. Beyond certain levels of exposure and/or new money, the SAR groups make recommendations to the LCC for the fund decision.

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

Wholesale credit policy

Treasury credit risks are managed in accordance with limits and asset quality measures which are set out in the credit risk policy which governs the types of wholesale related exposure that the Bank can take. To complement this, Credit Committees, dependent on IRG and associated PD, approve limits to individual counterparties within the parameters established by the credit risk policy. Ongoing asset quality monitoring is undertaken by the Treasury credit risk team.

Reports relating to the profile of the Treasury credit portfolio are sent to the ERC on a monthly basis. The CRMF receives regular reports on the performance of the portfolio, changes to the counterparty watch list and problem counterparty information. A sub-committee of the CRMF, the Treasury Credit Risk Management Forum also assesses Treasury credit risks. Limits on exposures to counterparties, known as Total Potential Limits (TPL), are established within the operating internal rating grades 1–9 (IRG 10 representing the default state), each having an associated PD using a counterparty limit matrix. All Treasury counterparties are subject to review, which includes comprehensive analysis of the counterparties financial performance, rating status (both external and internal) in order to ensure that the approved credit limits remain at appropriate level given the credit risk. Where appropriate more frequent reviews will be undertaken for those counterparties perceived to be higher risk or in light of significant material changes or events that impact their rating.

7.2.8 Models used

Retail models

Residential mortgages

Probability of Default (PD) models

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

Loss Given Default (LGD) models

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

7.2 Credit risk continued

Qualifying revolving and other retail exposures

Probability of Default (PD) models

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

Loss Given Default (LGD) models

These models estimate the average loss percentage of snapshot balances over a 36 month recovery period for the three population segments: default, non default and charge off. The 36 month LGD is then discounted (using standard discounting principles) and adjusted for recoveries between 36 – 48 months, cost of collections and downturn stress. This LGD measure is then used to set the downturn LGD value based on the worst (highest) LGD observed during the development window, which in turn is used to determine capital requirements.

Exposure at Default (EAD)

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

Corporate models

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

- Where the Bank considers that the borrower is unlikely to repay its credit obligations without recourse by the Bank to actions such as realising security (if held);
- The borrower is past due more than 90 days on any material credit obligation; and/or
- The borrower has committed an act of default; ie bankruptcy, filing for administration, liquidation etc.

An additional watch list marker, which is broken down into three stages, is applied to help identify where a situation has not reached the point of default but is one that the SCC or the SAR groups have decided merits closer management.

Probability of Default (PD) models

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

Loss Given Default (LGD) models

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

Slotting models

Supervisory slotting criteria are used to analyse and monitor the specialised lending exposures to PFIs and commercial real estate. The PFI and property investment and development 'slotting models' are based on regulatory approaches and their output is mapped to five supervisory categories from strong to default (slotting model categories 1–5 respectively) with prescribed risk and expected loss weights. Whilst the prescribed PRA slotting approach is used to calculate capital, internally developed property PD models are used for internal risk assessment with the same key risk drivers informing both the slotting grades and the PD assessment.

Overrides

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

7.2 Credit risk continued

Standardised approach

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

Exposure at Default (EAD)

EAD across the whole Corporate portfolio is calculated by applying regulatory prescribed credit conversion factors (CCFs).

Wholesale model

An IRB model is used to determine PD for Treasury counterparties. Under foundation IRB, regulatory parameters are used for LGD. The PD model is used for all Treasury counterparties, which are largely institutions but also include central governments, central banks, supra-nationals, multilateral development banks and qualifying money market funds. The model consists of two key elements; a statistically driven quantitative rating and a qualitative overlay. The quantitative assessment is based upon bond default statistics. Credit ratings are derived from a variety of information sources including ECAI's (Moody's and Fitch) based on fundamental credit analysis to assign an appropriate Internal Rating Grade (IRG) 1–9. More conservative, qualitative overlays to counterparties' IRG (downward overrides) may be applied with the supporting credit rationale clearly stated in the appropriate credit review.

Treasury counterparty limit matrix

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

7.2.9 IRB approach

Foundation

Foundation IRB takes EAD values and exposure weighted average risk weight for each exposure class by PD band. Credit ratings are derived from a variety of information sources including ECAI's (Moody's and Fitch) based on fundamental credit analysis to assign an appropriate IRG 1–9. More conservative, qualitative overlays to counterparties' IRG (downward overrides) may be applied with the supporting credit rationale clearly stated in the appropriate credit review.

7.2 Credit risk continued

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

Table 19a Foundation IRB EAD by PD band 2013

Internal grades	PD range %	Exposure value £m	Average PD %	Average LGD %	RW %	RWA £m	Mapped external rating
Institutions							
1/2	0.000 to 0.040	822.4	0.03	44.9	1.8	14.7	AAA to AA
3	0.040 to 0.060	812.8	0.05	45.0	13.0	105.5	AA-
4	0.060 to 0.080	415.2	0.08	45.0	25.9	107.7	A+
5	0.080 to 0.200	307.7	0.12	45.0	20.6	63.4	A
6	0.200 to 0.300	478.9	0.28	45.0	43.4	207.9	A- to BBB+
7	0.300 to 1.000	2.1	0.66	45.0	106.3	2.2	BBB to BBB-
8	1.000 to 5.000	–	–	–	–	–	BB+ to BB-
9	5.000 to 99.999	–	–	–	–	–	B+ to C
10	100.000	–	–	–	–	–	Default
Total institutions		2,839.1	0.10	45.0	17.7	501.4	
Central governments and central banks							
1/2	0.000 to 0.040	8,507.7	–	45.0	–	–	AAA to AA
3	0.040 to 0.060	3.1	0.05	45.0	13.0	0.4	AA-
4	0.060 to 0.080	–	–	–	–	–	A+
5	0.080 to 0.200	–	–	–	–	–	A
6	0.200 to 0.300	–	–	–	–	–	A- to BBB+
7	0.300 to 1.000	–	–	–	–	–	BBB to BBB-
8	1.000 to 5.000	–	–	–	–	–	BB+ to BB-
9	5.000 to 99.999	–	–	–	–	–	B+ to C
10	100.000	–	–	–	–	–	Default
Total central governments and banks		8,510.8	–	45.0	–	0.4	
Corporates							
1	0.000 to 0.030	45.0	0.03	45.0	9.7	4.4	A
2	0.030 to 0.060	11.1	0.05	45.0	28.6	3.2	A-
3	0.060 to 0.160	738.1	0.14	37.5	40.7	300.6	BBB+
4	0.160 to 0.260	523.2	0.22	41.0	53.5	280.1	BBB
5	0.260 to 0.400	200.4	0.33	36.5	59.0	118.2	BBB-
6	0.400 to 0.650	240.7	0.51	43.7	73.3	176.5	BBB-
7	0.650 to 1.100	83.8	0.85	39.0	74.9	62.7	BB+
8	1.100 to 1.900	59.5	1.50	38.5	82.5	49.1	BB
9	1.900 to 3.300	63.3	3.00	38.7	112.7	71.3	BB-
10	3.300 to 10.000	62.6	6.00	41.6	132.6	82.9	B
11	10.000 to 15.000	3.5	13.00	43.5	181.6	6.3	B-
12	15.000 to 20.000	3.5	18.00	36.1	168.6	5.9	CCC+
13	20.000 to 99.999	0.9	22.00	39.8	193.3	1.8	CCC
14	100.000	97.6	100.00	40.6	–	–	Default
Total Corporates		2,133.2	5.17	39.6	54.5	1,163.0	

7.2 Credit risk continued

Table 19b Foundation IRB EAD by PD band 2012

Internal grades	PD range %	Exposure value £m	Average PD %	Average LGD %	RW %	RWA £m	Mapped external rating
Institutions							
1/2	0.000 to 0.040	2,542.4	0.03	22.5	8.9	227.1	AAA to AA
3	0.040 to 0.060	975.3	0.05	45.0	16.3	159.0	AA-
4	0.060 to 0.080	281.0	0.08	45.0	19.8	55.7	A+
5	0.080 to 0.200	921.5	0.12	45.0	19.8	182.0	A
6	0.200 to 0.300	627.6	0.28	45.0	52.4	329.0	A- to BBB+
7	0.300 to 1.000	83.9	0.66	45.0	66.7	55.9	BBB to BBB-
8	1.000 to 5.000	0.1	2.04	45.0	101.8	0.1	BB+ to BB-
9	5.000 to 99.999	–	–	–	–	–	B+ to C
10	100.000	–	–	–	–	–	Default
Total institutions		5,431.8	0.09	34.5	18.6	1,008.8	
Central governments and central banks							
1/2	0.000 to 0.040	7,327.2	–	45.0	–	–	AAA to AA
3	0.040 to 0.060	2.8	0.10	45.0	19.0	0.4	AA-
4	0.060 to 0.080	–	–	–	–	–	A+
5	0.080 to 0.200	–	–	–	–	–	A
6	0.200 to 0.300	–	–	–	–	–	A- to BBB+
7	0.300 to 1.000	–	–	–	–	–	BBB to BBB-
8	1.000 to 5.000	–	–	–	–	–	BB+ to BB-
9	5.000 to 99.999	–	–	–	–	–	B+ to C
10	100.000	–	–	–	–	–	Default
Total central governments and banks		7,330.0	–	45.0	–	0.4	
Corporates							
1	0.000 to 0.030	–	–	–	–	–	A
2	0.030 to 0.060	145.9	0.10	45.0	24.5	35.7	A-
3	0.060 to 0.160	744.4	0.10	37.9	41.1	306.1	BBB+
4	0.160 to 0.260	586.7	0.20	38.5	50.7	297.5	BBB
5	0.260 to 0.400	153.5	0.30	41.6	57.4	88.1	BBB-
6	0.400 to 0.650	580.1	0.50	43.4	66.3	384.7	BBB-
7	0.650 to 1.100	251.4	0.90	39.5	79.1	198.9	BB+
8	1.100 to 1.900	85.5	1.50	39.6	84.6	72.3	BB
9	1.900 to 3.300	84.4	3.00	41.1	113.0	95.4	BB-
10	3.300 to 10.000	62.6	6.00	40.7	126.8	79.3	B
11	10.000 to 15.000	26.1	13.00	43.0	176.8	46.1	B-
12	15.000 to 20.000	2.9	18.00	41.0	172.4	4.9	CCC+
13	20.000 to 99.999	14.0	22.00	44.8	212.0	29.7	CCC
14	100.000	62.6	100.00	43.7	–	–	Default
Total Corporates		2,800.1	3.03	40.3	58.5	1,638.7	

Corporate exposures have reduced since last year as the Bank has begun implementing its deleveraging strategy.

7.2 Credit risk continued

IRB approach: EAD analysed by expected loss (EL) grades

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

Table 20a Retail IRB EAD by EL grade 2013

2013	EL grade 1 £m	EL grade 2 £m	EL grade 3 £m	EL grade 4 £m	EL grade 5 £m	EL grade 6 £m	Default £m	Total £m
IRB Exposures class								
Residential mortgages	**14,171.7**	**1,342.2**	**2,384.1**	**926.5**	**1,134.5**	**737.9**	**709.4**	**21,406.3**
Qualifying revolving	**360.3**	**724.1**	**314.1**	**185.2**	**463.3**	**282.7**	**120.6**	**2,450.3**
Other retail	**–**	**–**	**–**	**100.6**	**225.6**	**174.9**	**77.1**	**578.2**
Total retail IRB	**14,532.0**	**2,066.3**	**2,698.2**	**1,212.3**	**1,823.4**	**1,195.5**	**907.1**	**24,434.8**

Table 20b Retail IRB EAD by EL grade 2012

2012	EL grade 1 £m	EL grade 2 £m	EL grade 3 £m	EL grade 4 £m	EL grade 5 £m	EL grade 6 £m	Default £m	Total £m
IRB exposures class								
Residential mortgages	14,857.0	1,342.4	2,646.1	1,432.7	2,387.6	1,053.5	820.0	24,539.3
Qualifying revolving	160.3	562.1	360.8	205.4	399.3	357.4	174.0	2,219.3
Other retail	72.7	–	–	123.3	193.0	273.1	89.3	751.4
Total retail IRB	15,090.0	1,904.5	3,006.9	1,761.4	2,979.9	1,684.0	1,083.3	27,510.0

The above table reflects the exposure impact of the Calico transaction described in sections 5.3 and 7.2.12.

Definition in gradings for EL grade

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

7.2 Credit risk continued

The table below analyses retail IRB RWA's by exposure class and PD grade.

Table 21a Retail IRB RWA by PD grade 2013

Internal grades	PD range %	Exposure value £m	Average PD %	Average LGD %	RW %	RWA £m
Residential mortgages						
1	0.000 to 0.040	3,721.5	0.04	7.5	0.8	30.2
2	0.041 to 0.070	4,822.0	0.07	12.9	1.9	90.5
3	0.071 to 0.310	2,553.9	0.17	13.5	3.8	96.8
4	0.311 to 1.000	4,004.6	0.56	15.6	15.3	613.4
5	1.001 to 3.000	3,911.7	1.70	19.6	33.4	1,307.1
6	3.001 to 15.320	984.8	6.41	20.4	70.6	695.4
7	15.321 to 99.999	748.7	40.11	19.3	101.6	760.7
8	100.000	659.1	100.00	20.9	141.5	932.7
Total residential mortgages		21,406.3	5.24	14.6	21.1	4,526.8
Qualifying revolving						
1	0.000 to 0.040	360.2	0.04	74.4	2.2	7.9
2	0.041 to 0.070	–	–	–	–	–
3	0.071 to 0.120	890.4	0.09	81.3	4.7	41.7
4	0.121 to 0.310	148.7	0.22	80.0	9.3	13.8
5	0.311 to 0.500	342.5	0.48	77.6	17.0	58.1
6	0.501 to 1.000	64.5	0.65	82.9	24.5	15.8
7	1.001 to 5.000	343.9	2.27	79.5	59.0	202.9
8	5.001 to 10.000	145.3	6.19	81.7	120.0	174.4
9	10.001 to 20.000	20.3	13.48	78.8	178.7	36.2
10	20.001 to 50.000	10.6	33.83	80.2	245.6	26.1
11	50.001 to 99.999	3.3	63.70	79.8	211.5	6.9
12	100.000	120.6	100.00	89.5	104.5	126.0
Total qualifying revolving		2,450.3	6.09	79.9	29.0	709.8
Other retail						
1	0.000 to 0.040	–	–	–	–	–
2	0.041 to 0.070	–	–	–	–	–
3	0.071 to 0.120	–	–	–	–	–
4	0.121 to 0.310	10.9	0.27	81.6	42.7	4.6
5	0.311 to 0.500	89.1	0.41	81.4	55.0	49.0
6	0.501 to 1.000	0.1	0.58	74.4	61.0	0.1
7	1.001 to 5.000	282.3	2.68	78.1	111.8	315.7
8	5.001 to 10.000	102.1	9.18	77.5	134.4	137.3
9	10.001 to 20.000	3.9	15.89	80.2	171.1	6.6
10	20.001 to 50.000	7.5	34.22	80.1	219.4	16.5
11	50.001 to 99.999	5.7	62.89	78.2	187.4	10.7
12	100.000	76.6	100.00	89.5	104.7	80.2
Total other retail		578.2	17.42	80.1	107.4	620.7

This table reflects the exposure impact of the Calico transaction described in sections 5.3 and 7.2.12.

7.2 Credit risk continued

Table 21b Retail IRB RWA by PD Grade 2012

Internal grades	PD range %	Exposure value £m	Average PD %	Average LGD %	RW %	RWA £m
Residential mortgages						
1	0.000 to 0.040	3,878.7	0.04	7.7	0.9	33.5
2	0.041 to 0.070	5,399.2	0.06	12.9	1.9	105.1
3	0.071 to 0.310	3,033.7	0.17	13.3	4.1	124.2
4	0.311 to 1.000	4,577.1	0.55	15.7	10.1	460.7
5	1.001 to 3.000	4,609.4	1.71	18.9	31.0	1,430.8
6	3.001 to 15.320	1,255.8	6.36	21.5	74.1	930.1
7	15.321 to 99.999	965.9	40.50	16.8	96.9	936.0
8	100.000	819.5	100.00	21.7	134.5	1,102.2
Total residential mortgages		24,539.3	5.72	14.7	20.9	5,122.6
Qualifying revolving						
1	0.000 to 0.040	160.3	0.04	74.4	2.2	3.5
2	0.041 to 0.070	–	–	–	–	–
3	0.071 to 0.120	714.7	0.09	82.3	4.7	33.8
4	0.121 to 0.310	210.2	0.23	80.2	9.7	20.4
5	0.311 to 0.500	315.2	0.42	79.5	16.4	51.8
6	0.501 to 1.000	77.9	0.67	82.4	24.6	19.1
7	1.001 to 5.000	347.0	2.28	79.9	58.3	202.4
8	5.001 to 10.000	160.2	6.18	81.5	119.9	192.0
9	10.001 to 20.000	24.4	14.18	80.6	190.5	46.4
10	20.001 to 50.000	25.7	24.73	80.3	231.9	59.7
11	50.001 to 99.999	9.7	64.97	81.1	209.5	20.3
12	100.000	174.0	100.00	90.5	67.6	117.7
Total qualifying revolving		2,219.3	9.51	81.3	34.6	767.1
Other retail						
1	0.000 to 0.040	72.7	0.03	81.6	8.6	6.2
2	0.041 to 0.070	–	–	–	–	–
3	0.071 to 0.120	–	–	–	–	–
4	0.121 to 0.310	19.4	0.27	81.6	42.8	8.3
5	0.311 to 0.500	103.9	0.41	81.3	54.9	57.0
6	0.501 to 1.000	0.2	0.58	74.4	61.4	0.1
7	1.001 to 5.000	300.3	2.59	78.3	107.7	323.5
8	5.001 to 10.000	132.4	9.20	77.1	133.8	177.1
9	10.001 to 20.000	18.1	16.46	79.5	172.1	31.1
10	20.001 to 50.000	1.4	25.35	80.6	206.6	2.9
11	50.001 to 99.999	13.7	67.59	79.4	173.6	23.7
12	100.000	89.3	100.00	90.0	81.6	72.9
Total other retail		751.4	16.28	80.4	93.5	702.8

7.2 Credit risk continued

7.2.10 Standardised approach

Analysis of exposures calculated in accordance with the standardised approach

For those Exposures at Default (EAD) subject to the standardised approach a significant portion are unrated. There are some rated exposures to institutions within the Basel defined, immaterial portfolio. For standardised exposures that are rated, the nominated ECAI or export credit agency for these is Moody's. The Bank complies with the credit quality assessments scale in allocating external credit ratings to the credit quality steps as defined by the PRA.

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

Table 22a EAD calculated under the standardised approach 2013

	Credit Quality Step							
2013	1 £m	2 £m	3 £m	4 £m	5 £m	6 £m	Unrated £m	Total £m
Central governments and central banks	–	–	–	–	–	–	–	–
Regional governments or local authorities	–	–	–	–	–	–	135.8	135.8
Administrative bodies and non commercial	–	–	–	–	–	–	97.5	97.5
Multilateral development banks	20.0	–	–	–	–	–	–	20.0
Institutions	140.2	95.0	–	–	–	–	79.4	314.6
Corporates	–	–	–	–	–	–	1,237.3	1,237.3
Retail	–	–	–	–	–	–	84.4	84.4
Secured by mortgages on residential property	–	–	–	–	–	–	26.1	26.1
Secured by mortgages on commercial real estate	–	–	–	–	–	–	0.9	0.9
Past due	–	–	–	–	–	–	74.8	74.8
Other items	1.0	–	–	–	–	–	1,167.0	1,168.0
Total standardised approach	161.2	95.0	–	–	–	–	2,903.2	3,159.4

Table 22b EAD calculated under the standardised approach 2012

	Credit Quality Step							
2012	1 £m	2 £m	3 £m	4 £m	5 £m	6 £m	Unrated £m	Total £m
Central governments and central banks	–	–	–	–	–	–	–	–
Regional governments or local authorities	–	–	–	–	–	–	121.2	121.2
Administrative bodies and non commercial	–	–	–	–	–	–	83.1	83.1
Multilateral development banks	–	–	–	–	–	–	–	–
Institutions	120.3	105.2	–	–	–	–	0.2	225.7
Corporates	–	–	–	–	–	–	2,076.0	2,076.0
Retail	–	–	–	–	–	–	0.4	0.4
Secured by mortgages on residential property	–	–	–	–	–	–	16.5	16.5
Secured by mortgages on commercial real estate	–	–	–	–	–	–	0.9	0.9
Past due	–	–	–	–	–	–	149.0	149.0
Other items	–	–	–	–	–	–	1,036.0	1,036.0
Total standardised approach	120.3	105.2	–	–	–	–	3,483.3	3,708.8

Corporate standardised exposures have decreased since last year as the Bank has begun implementing its deleveraging strategy.

7.2 Credit risk continued

7.2.11 Slotting approach

The Corporate sector includes a specialised lending portfolio, consisting of lending to Private Finance Initiatives (PFIs) and property investment and development. For the specialised lending portfolio, the slotting approach is used. The table analyses exposure (EAD) (including undrawn commitments after CCF) by slotting category. The collateral held is excluded from the analysis.

Table 23 Specialised lending by slotting category

	2013 £m	2012 £m
Slotting category		
Strong	**126.1**	95.1
Good	**2,510.8**	3,161.1
Satisfactory	**252.8**	463.6
Weak	**103.0**	214.6
Default	**1,502.6**	1,681.2
Total	**4,495.3**	5,615.6

Slotting models are used to analyse and monitor specialised lending exposures to property which are assigned to PRA supervisory categories with predefined risk weights. The exposures have reduced since last year as the Bank has begun implementing its deleveraging strategy.

7.2.12 Securitisations

Investments in securitisations

The Bank has total Asset Backed Securitisation (ABS) exposure of £1.8bn, an increase from £0.4bn from 2012. This increase is primarily due to the Calico transaction which is referred to further below and within section 5.3. Sales during the year were £0.2bn, consisting primarily of Residential Mortgage Backed Securities (RMBS). A profit of £40m has been recognised in the year against the asset sales. The assets are generally debt instruments that are held until they mature, although they may be sold or used as collateral for short term borrowing (repos) in response to needs for liquidity or changes in interest rates.

The Bank has no direct exposure to US sub-prime assets. During the year a small number of deals previously reported as Corporate exposures have been reclassified as Securitisation exposures. The portfolio consists of a range of individual transactions where maximum exposures are limited according to their respective rating levels and the size of the transaction. The Treasury Credit Risk team acts as a second line of defence in monitoring changes in the credit risk of our ABS exposure, with external market analysis being supplemented by discussions with the portfolio manager. The Treasury and Markets Risk team perform a similar second line of defence role with regard to market risk of the ABS portfolio. ABS are assessed using the ratings based approach, under foundation IRB, where risk weight percentages are applied to each deal depending on the external rating, seniority and granularity of the instrument. Notwithstanding the risk banding allocation, all transactions where no value adjustment is held continue to meet their payment obligations. There were no securitised revolving exposures held during the reporting period.

Originated securitisations

Securitisation is the process by which a group of assets, usually loans, are aggregated into a pool, and sold to bankruptcy remote special purpose entities (SPE's). The pool of mortgage loans is used to back the issuance of new securities, allowing the credit rating of the securities to be separated from the credit rating of the original company. The Bank has established securitisation structures as part of its funding activities, using residential mortgage loans as the underlying asset pool. Securitisations provide a diverse source of funding for the Bank. However, the majority of the risks and rewards in respect of the underlying mortgage loan pools are retained by the Bank. SPE's are included as subsidiaries in the consolidated financial statements with the Bank continuing to recognise securitised assets as loans and advances to customers on the balance sheet, and income from the securitised assets being recognised as income.

The Bank has experience of issuing securitisations under various programmes. Securitisation is used to increase the diversification of funding sources and manage maturity mismatch risk.

The Bank has only acted as mortgage originator, servicing and administration agent and liquidity facility provider (in Leek Finance Number Eighteen plc and Leek Finance Number Nineteen plc only) in respect of its own securitisations. The Bank does not provide bridging loans nor does it act as underwriter or dealer in its securitisations. All transactions are approved at Board level and benefit from relevant accounting and legal advice to ensure compliance with regulatory/statutory requirements.

Other than in connection with the Calico transaction (see last two paragraphs of this section) announced by the Bank on 18 January 2013, the Bank will continue to be ineligible to receive any regulatory capital relief in respect of any current or future RMBS securitisation transactions for the period determined by the PRA.

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

This table discloses 'first loss pieces' which represent subordinated loans advanced by the Bank (in respect of Leek Seventeen, Eighteen and Nineteen), or variable funding notes subscribed to by the Bank (in respect of Silk Road One, Two and Three).

7.2 Credit risk continued

Table 24 Originated securitisation exposures

	Retained notes initial %	Initial funded amount £m	**2013 Value £m**	2012 Value £m
First loss piece				
Leek Finance Number Seventeen plc		23	**28**	28
Leek Finance Number Eighteen plc		23	**27**	27
Leek Finance Number Nineteen plc		18	**18**	18
Silk Road Finance Number One plc	45%	116	**116**	116
Silk Road Finance Number Two plc		22	**22**	22
Silk Road Finance Number Three plc		19	**19**	19
Liquidity facilities				
Leek Finance Number Eighteen plc		–	**15**	17
Leek Finance Number Nineteen plc		–	**15**	17
Total		221	**260**	264

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

Table 25 Securitised notes sold to third party investors

	Total notes issued £m	Date of issuance	**2013 Notes outstanding[1] £m**	2012 Notes outstanding[1] £m
SPE Company				
Leek Finance Number Seventeen plc	1,168	April 2006	**431**	456
Leek Finance Number Eighteen plc	1,048	October 2006	**515**	540
Leek Finance Number Nineteen plc	833	April 2007	**497**	529
Silk Road Finance Number One plc	1,375	February 2010	**591**	755
Silk Road Finance Number Two plc	728	July 2011	**433**	562
Silk Road Finance Number Three plc	650	August 2012	**490**	591
Calico Finance Number One Limited	117	January 2013	**117**	–
Total	5,919		**3,074**	3,433

1. Where relevant, the 2013 and 2012 notes outstanding figures are based on multiplying outstanding foreign currency note balances outstanding by the foreign exchange rates at issue.

Leek Finance Number Twenty plc (Leek 20), Leek Finance Number Twenty One plc (Leek 21) and Leek Finance Number Twenty Two plc (Leek 22) notes issued in July 2008, October 2008 and January 2009 respectively were fully retained by the Bank. At 31 December 2013, an aggregate amount of £2.3bn of AAA Leek 20, Leek 21 and Leek 22 notes are outstanding, a proportion of which are deployed in Bi-Lateral funding arrangements. Furthermore, the Bank retained £1.5bn of AAA notes issued by Cambric Finance Number One plc (Cambric) in December 2012 (£1.1bn outstanding at 31 December 2013). For corporate planning purposes it is assumed that RMBS markets may be open to the Bank during 2014 and beyond to diversify funding sources further in public markets and/or generate additional collateral for Bi-Lateral funding purposes. Detailed disclosures around each remaining active securitisation are published each quarter on the Bank's website at the following address: http://www.co-operativebank.co.uk/investorrelations

The Bank had previously claimed regulatory capital relief in relation to Leek Finance Number Eighteen (Leek 18) and Leek Finance Number Nineteen (Leek 19) in accordance with the terms of BIPRU 9. Following the restructure of these transactions, in June 2011, the Bank was regarded as providing non-contractual support to each of Leek 18 and Leek 19 respectively. Regulatory capital relief for Leek 18 and Leek 19 was therefore discontinued from June 2011.

In January 2013 the Bank transferred a portion of the risk in its portfolio of Platform originated (predominantly Optimum) mortgages to third party investors via the issuance of £117m of funded notes issued by Calico. The Bank received funded credit protection from third party investors on a residential mortgage portfolio of approximately £1.8bn. The structure conforms to all relevant provisions of the PRA Handbook for significant risk transfer (GENPRU/ BIPRU 9).
A capital improvement is generated from a reduction in the total calculated Risk Weighted Assets as a result of the mezzanine securitisation tranche risk transfer. Other than in respect of Calico, no outstanding securitisation affords the Bank regulatory capital relief.

7.2 Credit risk continued

Securitisation exposures

Capital requirements for all of the Bank's exposures to securitisations, both as investor and as originator, are calculated using the external ratings based method. The following table shows the EAD and capital requirement broken down by external ratings grade. Exposures rated below BB- are treated as a deduction from capital but are reported as a requirement in this table. Capital requirement is shown gross of any provision offsets.

An increase in capital requirements for the first loss fund and retained synthetic notes in the Calico securitisation are partially offset by the exposures to investments in securitisations having been managed down during the year, as further described above.

Table 26a Securitisation exposure by rating grade 2013

		Senior and granular		Non senior and granular		Non senior and non granular		Resecuritisation	
	Credit quality step	Exposure £m	Capital requirement £m	Exposure £m	Capital requirement £m	Exposure £m	Capital requirement £m	Exposure £m	Capital requirement £m
AAA or A1/P1	1	1,252.6	7.1	17.9	0.2	–	–	–	–
AA	2	7.0	–	161.0	2.0	–	–	–	–
A+	3	–	–	–	–	–	–	–	–
A or A2/P2	4	–	–	146.0	2.5	–	–	–	–
A-	5	–	–	–	–	–	–	–	–
BBB+	6	–	–	–	–	–	–	–	–
BBB	7	–	–	71.6	4.6	–	–	–	–
BBB-	8	–	–	22.4	1.9	41.1	2.5	–	–
BB+	9	–	–	–	–	–	–	–	–
BB	10	–	–	–	–	24.5	8.8	–	–
BB-	11	–	–	–	–	–	–	–	–
Rated below BB- or A3/P3	12	–	–	35.4	35.4	27.3	27.3	9.7	9.7
Total		1,259.6	7.1	454.3	46.6	92.9	38.6	9.7	9.7

Table 26b Securitisation exposure by rating grade 2012

		Senior and granular		Non senior and granular		Non senior and non granular		Resecuritisation	
	Credit quality step	Exposure £m	Capital requirement £m	Exposure £m	Capital requirement £m	Exposure £m	Capital requirement £m	Exposure £m	Capital requirement £m
AAA or A1/P1	1	221.8	1.4	–	–	–	–	–	–
AA	2	32.2	0.2	54.2	0.7	1.6	–	–	–
A+	3	3.3	–	6.6	0.1	–	–	–	–
A or A2/P2	4	2.8	–	25.8	0.4	1.9	0.1	–	–
A-	5	10.8	0.2	5.0	0.1	–	–	–	–
BBB+	6	–	–	5.1	0.2	–	–	–	–
BBB	7	–	–	20.2	1.4	7.9	0.5	–	–
BBB-	8	–	–	13.1	1.1	–	–	–	–
BB+	9	–	–	–	–	–	–	–	–
BB	10	–	–	–	–	–	–	–	–
BB-	11	–	–	3.0	1.7	–	–	–	–
Rated below BB- or A3/P3	12	–	–	1.4	1.4	–	–	6.1	6.1
Total		270.9	1.8	134.4	7.1	11.4	0.6	6.1	6.1

7.2 Credit risk continued

7.2.13 Approach to validation

Model governance standards apply to ratings models to ensure that principal risks faced by the Bank are appropriately managed under the Risk Management Framework. All model developments and material adjustments are subject to assessment against this framework, which incorporates all relevant requirements from BIPRU. Model governance standards are set in the Model Risk Control Standards and governed by the Model Risk Forum (MRF). The coordination of all model risk resides with the MRF that reports directly to Executive Risk Committee (ERC).

The Model Risk Control Standards require that:

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

Model development, re-calibration and monitoring requirements in line with these control standards are governed through the Model Working Group reporting up to the MRF. The MRF is represented by appropriately qualified and experienced professionals and plays a key role in the ongoing oversight of the IRB systems/models. To ensure broader business awareness, a monthly update on model performance is tabled and reviewed at Credit Risk Management Forum (CRMF). In addition, subject to materiality, models are further reviewed at ERC. Internal audit provide additional oversight and assurance to senior management, acting as the third line of defence. The Board Audit Committee (BAC) approves the annual audit plan and copies of audit reports are circulated to them and/or the Board Risk Committee (BRC) as appropriate. This approach ensures material models are subject to comprehensive review with awareness by the Senior Executive.

Externally developed models are subject to the same governance standards as internal models and must be approved for use following the validation and independent review process. External models are also subject to the same standards for ongoing monitoring and annual validation requirements.

7.2.14 Credit risk mitigation

Retail and Corporate

The Bank uses collateral and guarantees to mitigate credit risk. Collateral is regularly revalued and guarantees reviewed to ensure continuing effectiveness. The majority of collateral held is residential real estate collateral for retail mortgages and either residential or commercial real estate collateral held against corporate lending.

Property collateral for corporate lending is categorised as security for property development or investment customers (ie 'property' lending) or owner occupied premises to secure mainstream loan and overdraft facilities. For general lending, in addition to taking charges over property assets owned by the company, other security is taken in modest proportion to the total portfolio. This includes debentures or floating charges (supported by tangible security, where appropriate, including property, life policies and stocks and shares) and cash cover. Where exposures are agreed on a secured basis, security cover is recognised only where:

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

Third party unsupported guarantees are generally excluded. Any shortfall of security for an exposure is regarded as unsecured and assessment includes this element of residual risk.

Treasury

Policies are in place to manage collateral and valuation with daily monitoring undertaken within Treasury operations. Repos and secured lending positions are revalued with margin calls on collateralised swaps predominantly made daily save for several arrangements which permit calls on a weekly basis. Eligible financial collateral for Basel reporting predominantly takes the form of gilts held under reverse repo agreements and cash held under both sold repo agreements and collateralised swap arrangements with debt securities less commonly held in the latter two instances. The guarantees relied upon are either parental guarantees held against subsidiary exposures within bank groups or sovereign/sub sovereign guarantees in relation to specific debt security holdings. The following table analyses balance sheet exposure values covered by eligible financial collateral by IRB exposure class.

Credit derivatives are a method of transferring credit risk from one counterparty (the protection buyer) to another (the protection seller). In return for a risk premium, the protection seller agrees to make a payment (or series of payments) to the protection buyer in the event of the occurrence of a stipulated event.

In respect of a credit default swap, various credit events (including non-payment, restructuring, moratorium, bankruptcy) affecting the obligor, can trigger settlement. Settlement usually takes place by the protection buyer delivering a credit obligation of the obligor (eg a bond or loan) to the protection seller, in return for a cash payment at par.

7.2 Credit risk continued

Table 27 IRB exposures covered by collateral

	2013		2012 restated	
	Exposure value covered by collateral after haircut £m	**Exposure value covered by guarantee after haircut £m**	Exposure value covered by collateral after haircut £m	Exposure value covered by guarantee after haircut £m
Central governments and central banks	**–**	**3.1**	–	2.8
Institutions	**2,075.2**	**–**	835.2	30.6
Corporates	**31.9**	**–**	3.0	–
Totals	**2,107.1**	**3.1**	838.2	33.4

Where guarantees held are issued by banking group parent entities in support of activity conducted with their subsidiaries rather than by third party guarantors, the related exposure values are excluded from the above table.

The significant increase in the Bank's collateralised exposures observed between year end 2012 and 2013 primarily results from the conclusion of several term funding repo transactions during 2013, these being cash collateralised at the aggregated level of £1,968.7m as at 31 December 2013.

7.3 Liquidity and funding risk

Liquidity and funding risk is the risk that the Bank cannot pay amounts that it owes when they fall due, or can only do so at excessive cost. The risk can arise either because:

- The Bank has insufficient funds to pay the amounts it owes; or
- Even though the Bank has sufficient funds, those funds have been invested and so are not readily available.

Further details on liquidity and funding risk are included in the Risk Management section of the Annual Report and Accounts.

The Board's risk appetite for liquidity risk is defined in terms of:

- Survival periods which measure the ability of liquid assets to support the Bank's activity over time under a number of stress scenarios;
- Adherence to strategic liquidity risk measures; and
- Compliance with all regulatory liquidity risk limits.

The stress tests encompass survival across various timescales and a range of adverse liquidity events, both firm specific and market wide, which endeavour to cover all aspects of the liquidity risk to which the Bank is exposed.

The strategic measures approved by the Board include:

- Customer loan/deposit ratio, 95% (2012: 92%) – the ratio of gross loans and advances to customer to total customer deposits;
- Encumbrance ratio, 27% (2012: 27%) – the ratio of encumbered assets divided by total assets;
- Regulatory framework – Net Stable Funding ratio and Internal Liquidity Guidance; and
- Internal liquidity stress tests – the survival period of the Bank under a range of stressed scenarios.

Liquidity risk arising from the structure of the balance sheet and stresses occurring from cash withdrawals from customers are managed in line with policies developed by the Liquidity Management Forum (LMF), Asset and Liability Committee (ALCO) and the Board. The Bank's liquidity management policies are reviewed and approved annually by the BRC (on behalf of the Board) and compliance is reviewed by LMF, ALCO and the Board. The Bank's policy is to have sufficient funds available at all times to meet demands from depositors, to fund agreed advances, to meet other commitments as and when they fall due, and to ensure the Board risk appetite is met.

The Bank monitors its liquidity position on a daily basis via liquidity risk metrics. LMF oversees the operational liquidity management. LMF convenes at least once a month but can convene as frequently as required. A range of indicators, details of cash flows and media coverage are monitored to attempt to detect early signs of liquidity risk either in the market or specific to the Bank. The LMF, ALCO and the Board discuss the actual liquidity position and projected position incorporating business plans. More frequent meetings are held if necessary, ie when the markets have a heightened period of stress or liquidity shortage.

The liquidity position is reported at least monthly to ALCO and the Board. The Bank also monitors the adequacy of its controls to provide assurance that liquidity risk is being appropriately managed, and regularly assesses its funding position. This is supported with detailed contingency funding plans and recovery options which are tested and reviewed on a regular basis. The Bank's liquidity management framework is designed in line with Financial Conduct Authority and PRA BIPRU regulations and industry guidelines.

The Bank calculated its total liquidity resources as at 31 December 2013 as £11,193.4m (2012: £8,657.7m). The table below analyses the Bank's liquidity portfolio by product and liquidity value. Primary liquidity is liquid assets that are eligible under BIPRU 12.7 and secondary liquidity is all other liquid assets (excluding non-buffer assets see Table 29), including self-issued retained securitisations.

7.3 Liquidity and funding risk continued

Table 28 Bank's Liquidity portfolio

	31 December 2013 £m	31 December 2012 £m
Operational balances with central banks	**5,076.3**	5,121.0
Gilts	**789.5**	664.8
Central government and multilateral development bank bonds	**1,112.2**	1,455.1
Total primary liquidity	**6,978.0**	7,240.9
Total secondary liquidity	**4,215.4**	1,416.8
Total liquidity	**11,193.4**	8,657.7
Average balance	**9,357.2**	8,967.7

The Bank uses any combination of these asset pools to manage liquidity, with primary liquidity used predominantly for short term cash flow movements, while secondary liquidity is used for creating longer term or contingent liquidity. Regular realisation through repo transactions and outright sales provide assurance that these asset pools remain sufficiently liquid. The overall quantum of primary liquidity remained broadly stable in 2013 supported by a large reduction in non-buffer assets (see Table 29) over the year. The secondary liquidity portfolio has been boosted by an increase in own assets eligible for discounting at central banks.

There has been a substantial reduction in non-buffer assets during the year. This reflects the change in funding profile as a result of the Bank's rating's downgrades. The sale of non-buffer assets has been used to maintain sufficient levels of primary liquidity.

Table 29 Non-buffer assets

	31 December 2013 £m	31 December 2012 £m
Short term deposits	**–**	38.4
Other public sector securities	**2.8**	117.5
Floating rate notes	**2.5**	703.0
Fixed rate notes	**–**	999.5
Other securities and commodities	**–**	68.8
Total non-buffer assets	**5.3**	1,927.2

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

Table 30a Long term wholesale funding sources

	31 December 2013 £m	31 December 2012 £m
Preference shares, perpetual subordinated bonds and subordinated debt	**196.3**	1,335.3
Secured funding	**4,339.5**	4,262.0
Repos	**2,119.3**	2,483.3
Market borrowing	**56.6**	703.7
Medium term notes	**884.0**	961.6
Total wholesale funding	**7,595.7**	9,745.9

7.3 Liquidity and funding risk continued

The following table sets out the Bank's contractual wholesale funding by maturity.

Table 30b Contractual wholesale funding by maturity

	31 December 2013 £m	31 December 2012 £m
Repayable in less than 1 month	**2,010.3**	1,815.0
Repayable between 1 and 3 months	**67.8**	365.6
Repayable between 3 and 12 months	**157.2**	613.6
Repayable between 1 and 5 years	**1,800.8**	5,093.3
Repayable in more than 5 years	**3,559.6**	1,858.4
Total external funding	**7,595.7**	9,745.9

The credit rating downgrades by the rating agencies in 2013 have led to sub-investment grade ratings on the Bank's senior debt leading to a significant reduction in the demand for these types of instrument.

The credit rating downgrades also resulted in the downgrade of the Bank's covered bond by Fitch and Moody's. Moody's also placed all the notes within the Bank's securitisation programmes on review for downgrade during the year. In January 2014, in order to mitigate the effect of the downgrades and comply with certain contractual obligations, the Bank has implemented back-up servicing arrangements and other changes to comply with the current rating agency criteria. These implementations required the consent of note-holders, which was obtained through separate consent solicitations, launched in December 2013, for each transaction.

Liquidity gap

Details of contractual maturities for assets and liabilities underpin the management of liquidity risk. However, in order to reflect more accurately the expected behaviour of the Bank's assets and liabilities, measurement and modelling of the behavioural aspect of each is constructed.

Gross cash flows include interest and other revenue cash flows. The following table is an analysis of:

- Gross undiscounted contractual cash flows of financial assets and liabilities held at the balance sheet date; and
- Behavioural adjustments that reflect the actual behaviour of customers based on historic cash flow profiles over a period of ten years.

7.3 Liquidity and funding risk continued

Table 31a Contractual cash flows 2013

31 December 2013 Contractual cash flows £m	Carrying value	Gross nominal flow	Less than 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
Assets							
Cash and balances at central banks	5,418.8	5,418.8	5,418.8	–	–	–	–
Loans and advances to banks	1,594.4	1,594.4	1,594.4	–	–	–	–
Loans and advances to customers[1]	30,429.8	44,368.1	1,474.8	452.9	2,810.1	11,852.5	27,777.8
Investment securities							
Loans and receivables	23.6	28.4	7.0	0.1	0.1	2.9	18.3
Available for sale	2,732.4	3,137.3	67.9	137.0	101.9	1,092.4	1,738.1
Fair value through income or expense	1,743.4	1,890.1	6.6	13.7	198.4	1,637.0	34.4
Held for trading	–	–	–	–	–	–	–
Derivative financial instruments	555.8	265.8	2.0	7.7	26.7	23.7	205.7
Amounts owed by other Co-operative Group undertakings	–	–	–	–	–	–	–
Other assets	897.9	–	–	–	–	–	–
Total recognised assets	43,396.1	56,702.9	8,571.5	611.4	3,137.2	14,608.5	29,774.3
Liabilities							
Deposits by banks	2,757.5	2,991.9	1,833.0	41.2	153.3	964.4	–
Customer accounts	32,463.3	33,349.4	21,144.6	1,796.5	2,213.3	8,195.0	–
Customer accounts – capital bonds	538.1	536.4	10.2	94.7	146.4	285.1	–
Debt securities in issue	4,195.3	5,391.0	75.4	34.1	628.1	3,964.0	689.4
Derivative financial instruments	538.6	1,031.2	13.7	34.5	106.6	354.4	522.0
Other borrowed funds	196.3	433.6	–	5.7	17.0	91.0	319.9
Other liabilities	929.7	–	–	–	–	–	–
Total recognised liabilities	41,618.8	43,733.5	23,076.9	2,006.7	3,264.7	13,853.9	1,531.3
Unrecognised loan commitments	4,003.6	4,003.6	3,578.5	–	–	425.1	–
Total liabilities	45,622.4	47,737.1	26,655.4	2,006.7	3,264.7	14,279.0	1,531.3
Behavioural adjustments							
Loans and advances to customers		–	112.0	194.0	1,146.0	7,829.0	(9,281.0)
Customer accounts		–	20,901.0	(977.0)	(6,283.0)	(13,641.0)	–
Net cashflow – behavioural		8,965.8	2,929.1	(2,178.3)	(5,264.5)	(5,482.5)	18,962.0

1. This includes fair value adjustment for hedged risk of £107.6m.

7.3 Liquidity and funding risk continued

Table 31b Contractual cash flows 2012

31 December 2012 Contractual cash flows £m	Carrying value	Gross nominal flow	Less than 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
Assets							
Cash and balances at central banks	5,433.0	5,433.0	5,433.0	–	–	–	–
Loans and advances to banks	1,904.1	1,904.1	1,654.1	–	250.0	–	–
Loans and advances to customers	33,693.7	47,488.2	1,611.5	407.3	1,709.8	11,341.5	32,418.1
Investment securities							
Loans and receivables	295.0	369.9	0.3	0.3	1.7	16.9	350.7
Available for sale	3,789.4	4,161.1	99.9	187.6	209.4	1,975.2	1,689.0
Fair value through income or expense	1,845.2	1,957.4	3.7	12.6	60.2	1,875.1	5.8
Held for trading	960.2	991.7	1.4	5.0	77.0	881.4	26.9
Derivative financial instruments	818.8	856.0	5.4	19.0	94.1	277.1	460.4
Amounts owed by other Co-operative Group undertakings	56.8	56.8	56.8	–	–	–	–
Other assets	976.6	–	–	–	–	–	–
Total recognised assets	49,772.8	63,218.2	8,866.1	631.8	2,402.2	16,367.2	34,950.9
Liabilities							
Deposits by banks	3,612.0	3,888.1	2,415.6	412.3	551.0	509.2	–
Customer accounts	35,884.4	36,167.4	24,146.9	1,860.6	6,393.0	3,766.9	–
Customer accounts – capital bonds	888.1	886.8	25.5	64.1	255.8	541.4	–
Debt securities in issue	4,713.7	5,860.6	67.0	127.4	214.4	4,737.4	714.4
Derivative financial instruments	967.6	1,650.6	20.0	48.2	180.4	588.2	813.8
Other borrowed funds	1,258.6	2,292.9	7.2	4.5	86.6	748.6	1,446.0
Amounts owed to other Co-operative Group undertakings	190.0	190.0	190.0	–	–	–	–
Other liabilities	408.2	–	–	–	–	–	–
Total recognised liabilities	47,922.6	50,936.4	26,872.2	2,517.1	7,681.2	10,891.7	2,974.2
Unrecognised loan commitments	4,770.3	4,770.3	4,751.2	19.1	–	–	–
Total liabilities	52,692.9	55,706.7	31,623.4	2,536.2	7,681.2	10,891.7	2,974.2
Behavioural adjustments							
Loans and advances to customers		–	122.4	174.5	697.3	7,491.5	(8,485.7)
Customer accounts		–	21,219.3	(570.8)	(2,410.2)	(18,238.3)	–
Net cashflow – behavioural		7,511.5	(1,415.6)	(2,300.7)	(6,991.9)	(5,271.3)	23,491.0

7.4 Market risk

Market risk is the risk of losses arising due to changes in market prices, the Bank's biggest exposure to market risk is from changes in interest rates. The Bank also has a small exposure to market risk from changes in foreign currency exchange rates.

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

The main source of market risk within the Bank is driven by mismatches between the repricing profiles of asset and liability customer products within the Retail and Corporate businesses and certain characteristics embedded within these products and basis risk. Treasury also creates market risk through its various portfolio management activities along with currency risk.

Interest rate risk

Interest rate risk policy statements, approved by the ERC on behalf of the Board, specify the scope of the Bank's wholesale market activity, market risk limits and delegated authorities. The policy is managed by the BMRF and ALCO. Their prime task is to assess the interest rate risk inherent in the maturity and repricing characteristics of the Bank's assets and liabilities. The Bank seeks to minimise the volatility of future earnings from interest rate changes and all interest rate risk exposure is removed from the Core and Non-core divisions and consolidated at the centre where it is managed from the Core balance sheet within agreed limits. Treasury is responsible for interest rate risk management for the Bank. The principal analytical techniques involve assessing the impact of different interest rate scenarios and changes in balances over various time periods.

The Board receives reports on the management of balance sheet risk and BMRF and ALCO review the balance sheet risk positions and the utilisation of wholesale market risk limits.

Treasury interest rate risk

The Treasury department executes short term funding and hedging transactions with the wholesale markets on behalf of the Bank and its customers. The two prime measures of risk are the Value at Risk (VaR) and PV01 models illustrated below, as supplemented by additional controls such as maturity and stop loss limits. The VaR model incorporates underlying risk factors based on interest rate and foreign exchange volatilities and correlations. Potential movements in market prices are calculated by reference to daily market data from the last two years, equally weighted. Exposures against limits are reviewed daily by management. Actual outcomes are monitored periodically to test the validity of the assumptions and factors used in the VaR calculation.

The Bank uses VaR and PV01 measures to quantify the level of market risk within the Treasury liquid asset portfolios. PV01 assesses the change in value of the net present value of Treasury assets under a 1 basis point shift in rates. VaR estimates the potential loss that could occur as a result of future movements in market rates over a specified time horizon and to a given level of statistical confidence. In its day-to-day monitoring, the Bank uses a 95% confidence level over a one day holding period using one year of historical data. For foreign exchange transactions, the positions are restated to give a sterling equivalent of each long or short position for each currency. The sum of the greater of the total long positions or total short positions may not exceed £20m intraday or £10m at the close of each day.

Analysed by currency the year end position for the wholesale banking book and trading is represented in the table below:

Table 32 Interest rate risk

	2013		2012	
	1 basis point increase in interest rates £	**1 basis point decrease in interest rates £**	1 basis point increase in interest rates £	1 basis point decrease in interest rates £
Wholesale Banking Book	**(14,335)**	**14,679**	(20,509)	20,580
By currency:				
GBP	**(13,791)**	**14,135**	(16,108)	16,175
US Dollars	**154**	**(154)**	(2,512)	2,515
Euros	**(779)**	**779**	(1,828)	1,829
Others	**81**	**(81)**	(61)	61
Treasury Trading Book	**–**	**–**	(18,507)	18,759
Total Treasury	**(14,335)**	**14,679**	(39,016)	39,339

All Trading Book activity ceased in the first half of 2013 and as such there were no trading positions at the end of 2013.

7.4 Market risk continued

Currency risk

The Bank's treasury foreign exchange activities primarily involve:

- Providing a service in meeting the foreign exchange requirements of customers;
- Maintaining liquidity in euros and US dollars by raising funds and investing these to generate a return; and
- Performing limited intraday trading and overnight positioning in major currencies to generate incremental income.

At 31 December 2013, the Bank's net currency position was the equivalent of £2.4m (2012: £2.7m) and represented a potential loss of £0.1m given a 3% depreciation in sterling (2012: loss of £0.1m). The Bank manages its currency positions against both an overall limit and individual currency limits.

Further detail on currency risk can be found in the Risk Management section of the Annual Report and Accounts.

Non-treasury interest rate risk

The Bank (excluding wholesale treasury risk) uses a PV01, gap report and earnings approach for managing interest rate risk, focussing in detail on the sensitivity of assumed changes in interest rates on net interest income for one year. BMRF monitors the non-trading interest rate risk, which is split between certain wholesale portfolios, banking and investment books, and the rest of the Bank's balance sheet. The following describes the Bank non-trading portfolios excluding these certain wholesale portfolios. (These positions are managed by Treasury.) All interest rate risk is centralised into Treasury using appropriate transfer pricing rates.

Gap reports are based on defined time periods. ALCO sets guidance limits around the gap, principally that the sum of positions maturing in greater than 12 months and non-sensitive balances (includes non-maturity deposits) are no more than a set limit.

Non-maturity deposits, which are non-interest bearing, are separated into a stable 'core' element, based on a long run average, and the residual balance, which can fluctuate. In the gap report, the residual balance (along with interest bearing non-maturity deposits) is deemed to reprice or mature within one month. The 'core' non-maturity deposits are within the non-sensitive balance on the gap report, along with non-dated capital and other non-sensitive balances. ALCO sets guidance around the treatment of non-sensitive balances to reinvest in fixed rate assets in periods up to five years to smooth the income based upon the prevailing interest rate environment.

Risk limits are formally calculated at each month end. Interest rate risk and effectiveness of hedging is monitored daily using gap positions, incorporating new business requirements. Draw down risk, in particular for fixed rate mortgages, is managed through weekly balance sheet meetings. The asset and liability management team undertake hedges for interest rate risk using derivative instruments and investment securities which are executed via the Treasury markets team to external wholesale markets, and loans and deposits which are executed internally with the Treasury markets team.

Basis risk is the risk that different assets and liabilities reprice with reference to different indices and at different times. This exposes the Bank to income volatility if indices do not move in a ratio of one to one. The overall exposure to basis risk has remained a net base rate asset throughout 2013 as customers continue to favour variable rate mortgages (where the introductory rate is linked to Bank of England base rate) and a large proportion of the liquidity of the Bank is placed in the Bank of England reserve account. Basis risk is monitored by BMRF and ALCO monthly and action is taken as required, which includes pricing, new products or external hedging.

The table illustrates the greater than 12 month net gap position at the end of the period on the Bank's balances, excluding wholesale treasury and customer currency balances which are managed within the treasury risk framework. The gap is driven by product pricing and product mix. The gap is calculated by placing all assets and liabilities at the earliest of their repricing or maturity date and then summing by time band. The aim is to have assets evenly spread so that the Bank is not exposed to sudden rate movements. The net position shows the amount that the Bank is either over or under invested at a point in time. A £100m positive gap position would equate to the Bank's income increasing by £1m per annum if rates increased by 1%. The maximum sensitivity for the period shown below equates to approximately a £8.0m (31 December 2012: £10.9m) decrease in income if rates increased by 1%.

Table 33 IRR non trading book

	2013 £m	2012 £m
As at 31 December	**(802)**	(928)
Average during the year	**(376)**	(612)
Maximum during the year	**(802)**	(1,090)
Minimum during the year	**(45)**	(248)

7.5 Operational risk

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

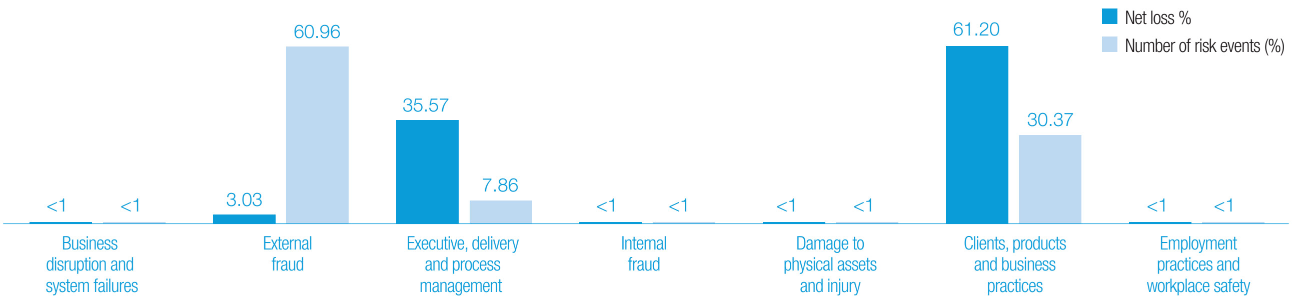
Operational risk framework

The Bank's approach to the management of operational risk is designed to assist the Bank to safely operate within a Board approved risk appetite, particularly with regards to protecting the volatility of earnings, reducing capital requirements, maintaining the Bank's reputation as a trusted provider of financial services and meeting regulatory expectations. Various elements of the framework were concluded to be ineffective in early 2013 and continues to be strengthened in line with good practice and regulatory guidance.

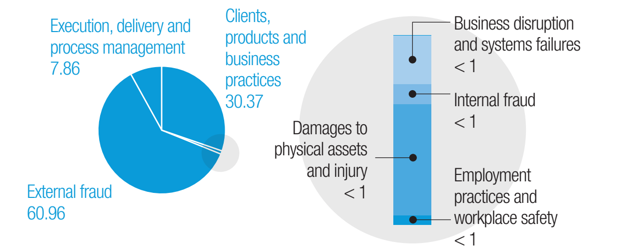
Operational risks are identified, managed and mitigated through on-going risk management practices including material risk assessments, risk event reporting, operational loss data analysis, a detailed risk control self-assessment process (which is being refreshed), monitoring of key risk metrics, and scenario analysis. Significant operational risks are reported to the ORF, the ERC and the BRC. These meet regularly to monitor the development and effectiveness of the Risk Management Framework and the management of significant risks within the Bank.

Risk events and net losses

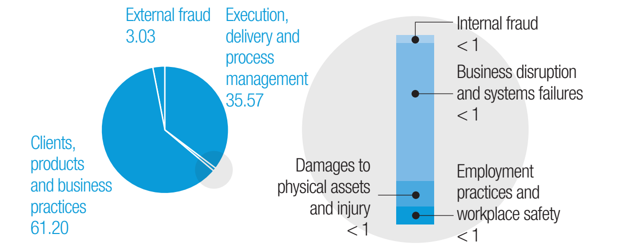
Risk events: number and net losses (%)



Number of risk events (%)



Net losses (%)



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

The most severe losses fell into the Clients, Products and Business Practices category, dominated by provisions made in relation to potential customer redress in respect of Payment Protection Insurance (£103m), potential interest rate swap mis-selling (£33m), potential customer redress in relation to mortgage fees and charges (£31m), failings in the introduction of third party sales of card and identification protection products (£26m), potential customer redress on secured arrears (£22m) and potential conduct issues incurred but not reported (£15m).

In 2013, External Fraud accounted for over 60% of the loss events; however, its associated financial impact was 3% of the total financial loss. These events are driven by financial crime, such as credit and debit card fraud, with mortgage fraud accounting for the bulk of the losses.

Execution, Delivery and Process Management accounted for 7.86% of total loss events, but 35% of total financial impact with a value of £151.4m, representing the next dominant loss event type. The most significant events within this category relate to potential customer redress following identification of breaches of the Consumer Credit Act (£110m), potential customer redress relating to the processing of first payments on certain mortgages (£29m) and potential customer redress and other costs in relation to mortgage documentation (£13m). The mortgage capital repayment issues related to customers whose first mortgage repayments were allocated as interest only payment on the mortgage systems.

A revised risk event management process was implemented in 2013 and this is still being fully embedded. Oversight is provided by the ORF and the ERC. An operational risk event is any situation which has or could have resulted in a financial loss, loss of an asset or data, a breach in regulatory/legal requirements, customer detriment or business disruption. This could be due to inadequate or failed processes, people, systems or external events. A standard threshold is used for the reporting of events. As part of the process a review and analysis of risk events is performed to ensure that any required improvements to processes and/or controls and any learnings are implemented in order to help prevent reoccurrence.

Stronger challenge and oversight of Regulatory and Conduct risks by the second and third lines of defence have identified significant historic control failures and the need for material provisions being raised in 2013. Significant enhancements to the Regulatory and Conduct Risk Control Frameworks were implemented during 2013.

7.6 Reputational risk

Reputational risk is the risk that the Bank's image in the eyes of its customers, its employees and other businesses it works with could be damaged as a result of poor decision making, performance, the impact of operational failures or other external issues.

As part of the assessment and control of reputational risk, the business performance and risk profile across all risk themes are closely monitored and reviewed. The business proactively monitors and manages media, public and customer opinion and works closely with external rating agencies to ensure fair and balanced representation. This approach helps maintain investor customer and market confidence.

This is discussed further in the Risk Management section of the Annual Report and Accounts.

7.7 Strategic and business risk

Strategic and business risk is the risk that the Bank's plans cannot be carried out because of changes, either internal to the company or external (eg recession), in the markets in which it operates.

The difficult situation currently faced by the Bank is unprecedented for this business and heightens the strategic and business risk it currently faces. To improve its financial and operational performance and capital position the Bank has adopted a new five year business plan. The Bank's strategy was developed in a relatively short time-frame, is in the early stages of implementation and its performance and effectiveness is not yet proven. There is a risk that this strategy may still not sufficiently address the Bank's problems or deliver the expected benefits.

The Bank does not have a track record in successfully executing large scale changes and the successful execution of the Bank's strategy requires the simultaneous execution of a number of complex and overlapping changes in a manner that seeks not to negatively impact on the Bank's brand, reputation and customer satisfaction or its relationship with, and ability to retain, its employees.

This is discussed further in the Risk Management section of the Annual Report and Accounts.

7.8 People risk

People risk is the risk associated with the recruitment, employment and management of individuals within the Bank.

There are seven sub-categories of people risk, as follows:

- Inadequate people capability – the risk that the Bank will fail to attract, select, performance manage, engage and retain appropriate or sufficient resources;
- Inappropriate behaviour – the risk that employees will act outside of policies, discretions and accepted codes of behaviour without authorisation;
- Breach of employment legislation – the risk that the Bank will fail to comply with relevant employment codes and legislation;
- Breach of trade union agreements – the risk that the Bank will fail to comply with relevant agreements and/or will face industrial action, resulting in operational losses and damage reputation;
- Ineffective organisational design – the risk that the organisational design does not support the business strategy and/or that individuals are not directly engaged by the Bank, are on short term contracts or are not fully aware of the scope or accountability of their role;
- Inadequate colleague engagement – the risk that colleagues are not adequately engaged in the course of their work and particularly throughout periods of change, resulting in fraudulent or unauthorised activities or poor customer service; and
- Failure to deliver a compliant and timely payroll function – the risk that the Bank will not meet its obligations in respect of its employees and/or any external requirements in respect of payroll provision.

7.9 Regulatory risk

Regulatory risk is the risk of fines, public censure, limitation on business, or restitution costs arising from failure to understand, interpret, implement and comply with UK and EU regulatory requirements. Demonstrating compliance with all applicable regulatory requirements is essential for the Bank to remain in business.

Management of regulatory risk entails on-going compliance with existing obligations and early identification and effective management of changes in legislative and regulatory requirements that may affect the Bank. Regulatory risk is one of the Principal risks the Bank sets out in its Risk Management Framework. The Principal risks are the key financial and non-financial risk to which the Bank is exposed (the 'Principal risks'). The Principal risk policies and control standards provide the business with guidance on how to achieve strategic objectives whilst managing risk within defined risk appetite tolerances.

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

Further details on regulatory risk can be found in the Risk Management section of the Annual Report and Accounts.

7.10 Conduct risk

Conduct risk is the risk that the Bank's behaviours, offerings or interactions may result in unfair outcomes for customers. To reflect the importance placed on conduct risk by the Bank, during 2013 we have specifically recategorised conduct risk as a Principal Risk within our Risk Management Framework. Its effective management helps build trust with customers and other stakeholders and promotes a fair outcome/focused business through the implementation of an appropriate policy and suite of standards properly communicated to trained staff.

The Bank manages conduct risk in a way that is consistent with its overall risk appetite and aligns with its strategy.

The concept of conduct risk is in part derived from elements of the Financial Conduct Authority rules and guidance that are concerned with the conduct of business regulation. However, it also encompasses the principle of treating customers fairly and is outcome driven.

Conduct risk may arise from any aspect of the way the Bank's business is conducted, a key criteria for the Bank being whether the outcome is fair for its customers. When assessing conduct risk there will often be a closely linked regulatory requirement.

The Bank's aim is to avoid the conduct of its business resulting in unfair outcomes for its customers and therefore the Bank will manage its conduct risk within its stated risk appetite. Further, the Bank aims to minimise the probability of any such outcomes occurring and ultimately to remedy any material consequences where a risk materialises.

At the end of 2013, the Bank has conduct risk provisions of £438m, to cover the costs relating to PPI mis-selling, breaches of the Consumer Credit Act, interest rate swap mis-selling, incorrect processing of first mortgage payments, errors on mortgage fees, alleged failings in the introduction of third party sales of card and identification protection products and potential customer redress in relation to arrears charges. Further detail on these provisions is provided in note 34 of the Annual Report and Accounts.

7.11 Pension risk

Pension risk is the risk that the Bank will be required to pay more than expected into its employees' pension schemes in order that the schemes can pay the pensions to which its employees, former employees and retirees are entitled as they fall due.

The Co-operative Group Pension Scheme (Pace) is used by all employees in The Co-operative Group, including the Bank. Pace is a hybrid scheme, consisting of both a defined benefit and defined contribution scheme.

Following its separation from The Co-operative Group, the Bank is still a participating member of the Pace scheme. As a multi-employer pension scheme, Pace exposes the Bank to risks associated with current and former employees of other Co-operative Group companies. Risks are identified at The Co-operative Group level, with the impact of any potential changes to contribution assessed under the Bank's Risk Management Framework.

The Bank is also exposed to pension risk through the Britannia pension scheme. In 2009, following the transfer of engagements of Britannia Building Society, CFSMS (a subsidiary of The Co-operative Banking Group Ltd) became principal employer of the scheme. This scheme closed on 6 October 2010 with active members at the date of closure being invited to join Pace.

Pension risk is defined under the Risk Management Framework as the risk to capital and funds from exposure to pension liabilities (to the extent liabilities are not met by scheme assets) and risks inherent in the valuation of scheme liabilities and assets. The Bank is assessing its pension risk appetite and the appropriate measures to help manage pension risk. The Bank has analysed pension risk into seven sub-categories as follows:

- Scheme membership – the profile of scheme membership impacts cost and risk;
- Market risk – the valuation of pension liabilities is reliant on the level of government gilt yields and inflation. Market fluctuations in these factors impact the value of liabilities;
- Investment risk – asset values are vulnerable to volatile asset markets;
- Credit risk – concentration of credit risk across counterparty, market sector, geography, asset type may increase risk;
- Longevity – valuation of pension liabilities is reliant on scheme member longevity;
- Legislation and regulation – pension schemes are highly regulated and complex; changes in legislation and regulation may increase cost and risk; and
- Strategy and structure – any changes in corporate strategy or structure may impact on pension risk and cost.

Controls are applied to mitigate these risks and a pension risk report is made to the ERC each month to monitor pension risk and decide if further action is necessary. The report takes account of the risk reporting delivered to pension scheme trustees. The Bank is able to engage directly with the Trustees of the Britannia pension scheme and can influence the Trustees of Pace through its relationship with the sponsor, The Co-operative Group.

The trustee of Pace is primarily responsible for the risk management arrangements for Pace, agreeing suitable contribution rates with the principal employer, investment strategy and taking professional advice as appropriate. The trustee of the Britannia scheme is primarily responsible for the risk management arrangements for the Britannia scheme, agreeing suitable contribution rates with the principal employer, investment strategy and for taking professional advice as appropriate.

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

The Bank is therefore exposed to potential future increases in required contributions and capital set aside for pension risk.

Further information can be found in note 36 of the Annual Report and Accounts.

8. Capital and liquidity management framework

Assessing the adequacy of internal capital

Capital is held by the Bank to protect its depositors, to cover its inherent risks, to provide a cushion for unexpected losses and to support the development of the business. The Bank's objective is to achieve a capital base in excess of regulatory requirements. The Bank is not currently compliant with its Individual Capital Guidance, being the PRA's statement as to the regulatory capital it expects the Bank to hold, although the Bank does meet Pillar 1 Capital requirements. More details are found in the Annual Report and Accounts.

Assessment of capital adequacy is made on a forward looking basis with reference to prevailing and forthcoming prudential rules including those under consultation. As at 31 December 2013 the Bank was subject to rules which implement the EU CRD (which implemented Basel II). From 1 January 2014 the Bank is subject to CRD IV and CRR (which implements Basel III).

ALCO is responsible for ensuring that the capital and solvency position of the Bank is managed in line with policy and that adequate capital is maintained. The CMF is a sub-forum of ALCO and is responsible for oversight of all aspects of Bank capital risk management, monitoring and control including consideration of prudential regulations. CMF has specific responsibility as follows:

- Review, challenge and monitor current and forecast capital adequacy with reference to regulatory requirements, Board risk appetite and Corporate Plan;
- Review and ratify the Bank's ICAAP and capital adequacy stress testing;
- Assess and report on risks and opportunities to plan and on capital management actions;
- Review and monitor Bank capital management control standards; and
- Report to and make recommendations to ALCO as appropriate.

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

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

Stage 2 – models the Bank's five year plan earnings and balance sheet in order to ensure that its Pillar 1 and Pillar 2 capital requirements are met during a severe but plausible stressed environment over the plan period, utilising appropriate management actions. The Bank's most material risk is credit risk, making up 89% of the Basel II RWA before business risk. On this basis, the Bank's principal stress in determining its Pillar 2 capital is that of credit quality deterioration as a result of the Bank's chosen view of stress conditions.

Liquidity management framework

The Bank's liquidity Risk Management Framework comprises:

1. A defined risk appetite, controls and governance in the Bank's liquidity management policies;
2. Articulation of how liquidity risk is identified, measured, monitored and managed in the Individual Liquidity Adequacy Assessment (ILAA) and procedures and governance in place to mitigate the risk;
3. Liquidity risk quantification and mitigation techniques and processes;
4. Management actions linked through to stress testing and liquidity planning models, enabling a method of mitigating the effects of a number of stress scenarios for varying periods of time and to ensure that the Bank operates within its agreed risk appetite parameters in all planning models;
5. Ongoing development and enhancement of the Bank's liquidity risk appetite framework; and
6. A process to attribute the cost, benefit and risks of liquidity to specific business lines via the Bank's funds transfer pricing mechanism.

Assessing the adequacy of liquidity

The Bank's approach to assessing the adequacy of its liquid assets to support potential liquidity events is documented in the ILAA which has been constructed by:

Stage 1 – assessing the PRA standard stresses to establish what the liquidity impact may be on the Bank.

Stage 2 – undertaking an internal assessment looking at the Bank's business model to identify the potential liquidity events which may impact the Bank and to assess how these are identified, measured, monitored, managed and mitigated. These scenarios are documented in the ILAA and are reviewed on an annual basis or more regularly if the business model changes.

The most material liquidity risk is withdrawal of customer deposits as the Bank is strongly customer funded. Mitigants to address this include good customer service, transparent products, business strategy of the Bank and coverage of deposits from the Financial Services Compensation Scheme.

9. Glossary

The following glossary defines terminology used within the Bank's Pillar 3 disclosures to assist the reader and to facilitate comparison with publications by other financial institutions:

Item	Description
Application score	The credit score calculated on the application data alone. Typically, data provided on an application form and/or credit reference data.
Asset Backed Security (ABS)	Securities that represent an interest in an underlying pool of referenced assets. The referenced pool can comprise any assets which attract a set of associated cash flows but are commonly pools of residential or commercial mortgages but could also include leases, credit card receivables, motor vehicles, student loans.
Asset and Liability Committee (ALCO)	This committee is chaired by the CEO and is primarily responsible for overseeing the management of market, liquidity and funding risks. Its responsibilities include identifying, managing and controlling the Bank balance sheet risks in executing its chosen business strategy, overseeing and monitoring relevant risk control frameworks and recommending to CEO and ERC relevant risk policies and detailed risk appetite limits for approval.
Asset Valuation Correlation (AVC)	The Asset Value Correlation increases the correlation factor used in the RWA calculation to allow for the potential for losses from intra-bank lending.
Bank Market Risk Forum (BMRF)	This committee reviews, challenges and monitors the market risk profile for the Bank, in line with policy and within the risk appetite.
Basel II	A statement of best practice issued by the Basel Committee on Banking Supervision, that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the FSA handbook.
Basel 2.5	Basel 2.5 was an interim strengthening of requirements laid out in Basel II, with changes focussing on trading book and securitisations. Basel 2.5 was implemented within the UK in 2011 via the FSA's policy statement PS11/12. References to Basel II within these disclosures is in accordance with Basel 2.5.
Basel III	A strengthening of the requirements laid out in Basel II, to be phased into the Bank from 2014 ahead of full implementation by 2022. Basel III is implemented within the European Union (including the UK) through CRD IV.
Basis Points (bps)	One hundredth of a per cent (0.01%), so 100 basis points is 1%. Used in quoting movements in interest rates or yields on securities.
Behaviour score (behavioural scorecard)	A credit risk scoring system for retail customers assessing the performance of a customer's account. Typically using data from previous performance of a customer's account and/or credit reference data.
BIPRU	The Prudential Sourcebook for Banks, Building Societies and Investment Firms which set out the PRA's requirements for capital and liquidity.
Board Audit Committee (BAC)	The committee which provides oversight in relation to financial reporting, internal control, regulatory compliance, external and internal audit across the Bank.
Board Risk Committee (BRC)	This committee provides oversight and advice to the Bank Board on current and potential risks and the overall risk framework, including risk appetite, risk tolerance and management strategies.
British Bankers' Association (BBA)	The BBA is the UK's leading association for the banking sector, representing the interests of more than 240 member organisations with a worldwide presence in 180 countries. Their membership include retail banks, wholesale institutions, challenger banks and private banks.
Business and Commercial Banking (BaCB)	The core segment of the Bank which specialises in lending to businesses.
Calico	Calico Finance Number One Limited.
Capital Management Forum (CMF)	This committee reviews, challenges and monitors the capital adequacy of the Bank, in line with capital policy and within risk appetite.
Capital Resources	Capital held, allowable under regulatory rules, less certain regulatory adjustments and deductions that are required to be made. Capital includes retained earnings, share premium and minority interests.
Capital Requirements	Capital required under Pillar 1. Capital requirements are 8% of Risk Weighted Assets.
Capital Requirements Regulation (CRR)	CRR is a European regulation that will apply directly to UK financial institutions. Broadly, it implements the Pillar 3 aspects of Basel III in relation to capital adequacy and new liquidity requirements.
CEO	Chief Executive Officer.
CFO	Chief Finance Officer.

Item	Description
Collateral	A borrower's pledge, usually a property, which acts as security for repayment of the loan (see secured lending).
Collateralised swap	A swap, whose volatility is secured (collateralised) by way of exchanging cash deposits (see swaps).
Collective Impairment	Impairment is measured collectively where a portfolio comprises assets with a homogenous risk and where appropriate statistical techniques are available.
Common Equity Tier 1 Capital (CET1)	A CRD IV regulatory measure of financial (capital) strength. Common Equity Tier 1 Capital is the highest quality of capital and comprises share capital and associated share premium, and general reserves from retained profits. The book values of goodwill and intangible assets as well as other regulatory adjustments, including the full amount of expected loss over provisions, are deducted from Common Equity Tier 1 Capital for the purposes of capital adequacy.
Common Equity Tier 1 (CET1) ratio	Common Equity Tier 1 Capital divided by Risk Weighted Assets.
Co-operative Asset Management (CoAM)	The segment that comprises Non-core assets managed for run down or exit.
Co-operative Financial Services Management Services Limited (CFSMS)	CFSMS provides supplies and services on behalf of fellow subsidiary undertakings within The Co-operative Banking Group.
Core business	Lines of business that are consistent with the Bank's strategy and risk appetite.
Core Tier 1 Capital	A Basel II regulatory measure of financial (capital) strength. Core Tier 1 Capital comprises share capital and associated share premium, and general reserves from retained profits. The book values of goodwill and intangible assets are deducted from Core Tier 1 Capital and other regulatory adjustments may be made for the purposes of capital adequacy.
Core Tier 1 Ratio	Core Tier 1 Capital divided by Risk Weighted Assets.
Counterparty Credit Risk	The risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.
CRD III	The third edition of the Capital Requirements Directive implemented Basel 2.5 within the EU.
CRD IV	This encompasses both the Capital Requirements Directive and Capital Requirements Regulation (CRR) as well as the PRA's Policy Statement PS7/13: Strengthening capital standards. CRD IV implements Basel III within the European Union (including the UK) and is a strengthening of the requirements laid out in Basel II, with phased implementation from 2014, ahead of full implementation by 2022.
Credit Conversion Factor (CCF)	The CCF is an estimate of the proportion of undrawn commitments expected to have been drawn down at the point of default, and is used within the calculation of EAD.
Credit Default Swap (CDS)	An arrangement whereby the credit risk of an asset (the reference asset) is transferred from the buyer to the seller of protection. A credit default swap is a contract where the protection seller receives premium or interest related payments in return for contracting to make payments to the protection buyer upon a defined credit event. Credit events normally include bankruptcy, payment default on a reference asset or assets, or downgrades by a credit rating agency.
Credit quality assessment scale	Published by the FSA in accordance with the Capital Requirements Regulations 2006 which maps the external credit rating provided by eligible ECAIs and ECAs to credit quality steps.
Credit quality steps	A credit quality step in a credit quality assessment scale as set out in BIPRU 3.4 (Risk weights under the standardised approach to credit risk) and BIPRU 9 (Securitisation.)
Credit Risk	The current or prospective risk to earnings and capital arising from a borrower's failure to meet the terms of any contract with the Bank or their failure to perform as agreed.
Credit Risk Management Forum (CRMF)	This committee advises and supports the Credit Risk Director. It designs the credit risk control implementation approach and risk control framework. It reviews the Bank's credit risk policy and credit measurement methodologies, defines and recommends the credit risk appetite and limits and reviews and challenges the Bank's credit risk processes and procedures.
Credit Risk Mitigation	Reduction of credit risk by application of credit risk mitigants. The Bank utilises collateral and guarantees as credit risk mitigation.
Credit Valuation Adjustments (CVAs)	Adjustments to the fair values of derivative assets to reflect the creditworthiness of the counterparty.
CRO	Chief Risk Officer.
Default	Circumstances in which probability of default is taken as 100% for the purposes of the calculation of regulatory capital and compliance with Basel II. This is defined as where the customer reaches a predefined arrears status or where the Bank may consider the borrower is unlikely to repay its credit obligation in full without the lender taking action.
Derivative	A financial instrument that has a value, based on the expected future price movements of the instrument to which it is linked, such as a share or a currency.
Draw down risk	The risk to a lender that a customer will withdraw additional funds up to their maximum facility limit.

Item	Description
Encumbrance	Encumbrance is an impediment to use of assets, for example a claim against a property by another party. Encumbrance usually impacts the transferability of the asset and can restrict its free use until the encumbrance is removed.
Enhanced Disclosure Task Force (EDTF)	The Enhanced Disclosure Task Force (EDTF) is a private sector group established by the Financial Stability Board (FSB) and composed of members representing both the users and preparers of financial reports. It released a report in October 2012 that included 32 recommendations for improving bank risk disclosures in the areas of usability, risk governance and risk management, capital adequacy, liquidity and funding, market risk, credit risk and other risks.
Executive Committee (ExCo)	This committee manages the business in line with the Board risk appetite statement. It also maintains oversight of risk management processes and management information.
Executive Risk Committee (ERC)	ERC provides a mechanism to ensure that the Bank's risk management is reviewed, challenged, approved and embedded within the Bank.
Expected Loss (EL)	A Basel II Pillar 1 calculation – the amount estimated under the IRB approach to be lost on current exposures due to potential defaults on existing and committed lending over a one year time horizon. Expected loss equals EAD multiplied by Probability of Default and Loss Given Default. Expected loss percentage equals expected loss divided by EAD.
Exposure	The maximum loss the Bank might suffer if: (a) a customer (or counterparty) or a group of connected customers fails to meet its obligations; or (b) it realises assets or off-balance sheet positions.
Exposure at Default (EAD)	A Basel II Pillar 1 parameter – the amount estimated to be outstanding at the time of default. EAD calculated under the standardised approach is always reported post credit conversion factors and provisions. Under the IRB approach the EAD includes undrawn commitments after credit conversion factors.
Export Credit Agencies (ECA)	Export Credit Agencies are private or quasi-governmental institutions that act as intermediaries between national governments and exporters to issue export financing. The financing can take the form of credits (financial support) or credit insurance and guarantees (pure cover) or both, depending on the mandate the ECA has been given by its government. ECAs can also offer credit or cover on their own account.
External Credit Assessment Institution (ECAI)	An External Credit Assessment Institution is a credit rating agency eg Moody's, Standard and Poor's, and Fitch. A credit rating agency (CRA) is a company that assigns credit ratings for issuers of certain types of debt obligations as well as the debt instruments themselves.
Financial Services Authority (FSA)	An independent body that regulated the financial services industry in the UK. The FSA was replaced as the UK's financial regulator on 1 April 2013 by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).
Forbearance	The Bank, for reasons relating to the actual or apparent financial stress of a borrower, grants a concession whether temporarily or permanently to that borrower. A concession may involve restructuring the contractual terms of a debt (such as an extension of the maturity date or any weakening of the security structure or adjustment/non enforcement of covenants) or payment in some form other than cash, such as an equity interest in the borrower.
Foundation IRB	Foundation internal ratings based approach (see IRB), uses standard LGD and EAD parameters but PD is estimated by the Bank.
General Prudential sourcebook (GENPRU)	Part of the Prudential Regulation Authority (PRA) handbook setting out prudential requirements. Available to view at http://fshandbook.info/FS/html/PRA
Impaired Loans	Loans where the Bank does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.
Impairment Allowance	A loss allowance held on the balance sheet as a result of the raising of a charge against profit from the incurred loss inherent in the lending book. An impairment loss allowance may be either individual or collective.
Individual Capital Guidance (ICG)	The PRA's statement as to the regulatory capital it expects the Bank to hold.
Individually Impaired	Impairment is measured individually for assets that are individually significant with risk.
Individual Liquidity Adequacy Assessment (ILAA)	The Bank's assessment of its liquidity risks, controls and quantification of liquid assets required to survive severe financial shocks through the use of stress tests prescribed by the PRA (see liquidity risk).
Individual Liquidity Guidance (ILG)	A PRA guidance on the required amount and composition of the liquid assets buffer that should be held by a firm. This guidance arises once the firm's Individual Liquidity Adequacy Assessment (ILAA) has been conducted.
Internal Capital Adequacy Assessment Process (ICAAP)	The Bank's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events.
Interest Rate Risk (IRR)	The variability in value borne by an interest bearing asset, such as a loan or a bond, due to variability of interest rates. In general, as rates rise, the price of a fixed rate bond will fall, and vice versa.

Item	Description
Internal Rating Grade (IRG)	For Corporate exposures the Bank has adopted an internal rating based approach in accordance with Basel II guidelines. Exposures are sanctioned based on an assessment of the risks and are allocated a Risk Grade or Rating extracted from a suite of Basel compliant models. These models have been implemented with outputs calibrated to reflect the Corporate portfolio or PRA slotting standards as appropriate. For Treasury exposures individual counterparties may be allocated credit ratings obtained from External Credit Assessment Institutions. These ratings combined with expert judgement drive the formulation of internal rating grades ranging from 0 to 10 and associated Probability of Default (PDs). These internal rating grades form the basis of the Treasury Counterparty Limit Matrix.
IRB Internal ratings based approach (IRB)	A Basel II approach for measuring exposure to credit risks. IRB approaches are more sophisticated and risk sensitive than the Standardised Approach and may be Foundation or Advanced. IRB approaches may only be used with PRA permission.
Large Credit Committee (LCC)	The LCC supports the CEO and has the responsibilities of sanctioning large counterparty transactions and managing large exposure positions.
Leverage Ratio	A CRD IV measure, calculated as the ratio of Tier 1 Capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives. The leverage ratio is a supplementary measure to the risk-based capital requirements and is intended to constrain the build-up of excess leverage in the banking sector.
Liability Management Exercise (LME)	The process by which the Bank successfully raised c.£1.2bn of capital in 2013. This was effected by the transfer of preference shares and extinguishment of multiple subordinated liabilities, followed by the recognition of a single tranche of subordinated debt.
Liquidity Coverage Ratio	Liquidity ratio that will be introduced under CRD IV, measuring highly liquid assets against stressed net cash outflows over a 30 day period.
Liquidity and funding risk	The risk that the Bank's resources will prove inadequate to meet its liabilities as they contractually fall due or as a result of any contingent or discretionary cash outflows that may occur in times of stress. It arises from mismatch of timings of cash flows generated from the Bank's assets and liabilities (including derivatives).
Liquidity Management Forum (LMF)	This forum enables more detailed discussion on all aspects of Bank liquidity risk management, monitoring and control including operational issues in respect of covered bond and residential mortgage backed security funding activities. It also recommends actions to ensure the Bank's liquidity position remains in line with agreed levels.
Loan To Value (LTV)	A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Bank calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI)).
London Interbank Offered Rate (LIBOR)	The interest rate participating banks offer to other banks for loans on the London market.
Long Run Average Probability of Default (LRA PD)	A LRA PD is reflective of the long run average default rates expected over a full economic cycle. Also referred to as long run PD.
Loss Given Default (LGD)	A Basel II Pillar 1 parameter – an estimate of the actual loss that would occur in the event of default expressed as a percentage of the EAD.
Loss provisions	Provisions held against assets on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. The allowance represents management's best estimate of losses incurred in the loan portfolio at the balance sheet date.
Market Risk	Risk that the values of assets and liabilities, earnings and/or capital may change as a result of changes in market prices of financial instruments. The majority of the Bank's market risk arises from changes in interest rates.
Master Grading Scale	Brings together the respective expected default frequency (EDF) from Moody's KMV RiskCalc and Moody's KMV CreditEdge models to produce a Basel II compliant Corporate Banking PD.
Minimum Capital Requirement	The minimum amount of regulatory capital that the Bank must hold to meet the Pillar 1 capital requirements for credit, market and operational risk.
Model Risk Forum (MRF)	This forum provides oversight and challenge of model governance across the Bank in support of the Enterprise Risk Director.
Model Validation	The process of assessing how well a credit risk model performs.
Mortgage Backed Security (MBS)	Securities that represent interests in a group of mortgages. Investors in these securities have the right to cash received from future interest and/or principal mortgage payments.
Multilateral Development Banks (MDBs)	Supranational institutions which provide financial support and professional advice for economic and social development activities in developing countries. The term MDBs typically refers to the World Bank Group and Regional Development Banks.
Net Stable Funding Ratio	Liquidity ratio that will be introduced under CRD IV, measuring the proportion of long term assets which are funded by long term or stable funding.
Net Present Value (NPV)	The present value of the expected future cash in and out flows on an asset or liability.

Item	Description
Non-core business	Lines of business not congruent with the Bank's current strategy, are managed for value and are targeted for run down and exit, and contain the majority of impairment risk. Included in Non-core is corporate Non-core business, Optimum (closed book of residential mortgages originated through intermediaries and previously purchased mortgage portfolios) and Illius (the residential property company).
Operational Risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This encompasses the effectiveness of risk management techniques and controls to minimise these losses.
Operational Risk Forum (ORF)	This committee is chaired by the Operational Risk Director. It monitors significant operational risks and controls as well as the management actions taken to mitigate them to an acceptable level and/or transfer them.
Over-the-Counter (OTC) Derivatives	Derivatives contracts that are traded (and privately negotiated) directly between two parties, without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange traded products, they can be tailored to fit specific needs.
Basel II IRB Permission Application Pack (PAP)	A financial institution planning to use the IRB approach for calculation of its credit risk capital requirement needs to apply for permission from the PRA. The information submitted should at least include: 1. Cover letter requesting the approval; 2. Description of/approach to the control environment; IT infrastructure; validation; data standards; reconciliations/performance monitoring; IRB rating systems (including models); outputs; 3. Documentation of above; 4. Implementation plan (including roll-out); 5. Self-assessment.
Past Due Items	When a counterparty has failed to make a payment when contractually due.
Perpetual Subordinated Bonds (PSBs)	Bonds with no maturity date that do not require the issuer to redeem.
Pillar 1	Pillar 1 Capital is a prescribed measure of capital required by a bank representing the minimum capital requirements. The Pillar 1 capital ratio is calculated using regulatory capital and RWA. The total capital ratio must be no lower than 8%.
Pillar 2	Pillar 2 is the Basel II terminology for the internal capital adequacy assessment process, which reviews the capital calculation derived within the Pillar 1 work and calculates the additional capital required through various economic cycles, in addition to other risks not covered under Pillar 1.
Pillar 3	Under Basel II, Pillar 3 covers market discipline. Market discipline takes the form of standard disclosure requirements that are intended to provide information about a bank's exposure to risks and risk assessment processes. The aim is to provide a means of disclosure comparable between banks.
Point in time (PiT)	Point in time refers to Basel II modelling approach which assesses the risk of an account at a single point in time.
Potential Future Exposure (PFE)	An add-on to derivative exposure for potential future exposure.
Private Finance Initiatives (PFI's)	Private Finance Initiatives.
Probability of Default (PD)	Probability of Default, a Basel II Pillar 1 parameter under IRB approach, estimate of the probability that a borrower will default in next 12 months.
Probability of Possession Given Default (PPD)	Probability of Possession Given Default is the probability that a proportion of mortgages (secured accounts) will to go to repossession.
Prudential Regulation Authority (PRA)	The FSA was replaced as the UK's financial regulator on 1 April 2013 by two new regulatory bodies: the PRA and the FCA. The PRA a subsidiary of the Bank of England, is responsible for promoting the stable and prudent operation of the financial system through regulation of all deposit-taking institutions, insurers and investment banks.
Prudent Valuation Adjustment (PVA)	A deduction under CRD IV from Common Equity Tier 1 Capital where the prudent value financial assets measured at fair value is materially lower than the fair value recognised in the Annual Report.
PV01	Daily calculation of the effect on the net present value (NPV) of Treasury portfolios to both parallel and specific point of yield curve stress testing (ie non-linear yield curve shifts). Analysis includes daily parallel shifts in yield curve rates of +/– 100 bps with the resultant change in NPVs representing the potential change in portfolio values.
Qualifying revolving	Qualifying Revolving Retail Exposure eg overdraft or credit cards.
Ratings Based Method	The calculation method used by the Bank for exposures to securitisations as defined under the IRB approach. The approach uses risk weightings based on ECAI ratings, the granularity of the underlying pool and the seniority of the position.
Rating systems	System for implementing scorecards and ranking customers/accounts by risk. May also include decision systems which use the ratings as a key input.
Regulatory Capital	The capital that the Bank holds in accordance with the PRA handbook.
Regulatory Risk Forum (RRF)	The RRF supports the Regulatory Risk Director in carrying out his/her responsibilities.

9. Glossary continued

Item	Description
Repurchase Agreement (Repo)/Reverse Repurchase Agreement (Reverse Repo)	A repurchase agreement that allows a borrower to use a financial security as collateral for a cash loan at a fixed rate of interest. In a repo, the borrower agrees to sell a security to the lender subject to a commitment to repurchase the asset at a specified price on a given date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo.
Residential Mortgage Backed Securities (RMBS)	Securities that represent an interest in an underlying pool of residential mortgages.
Residual Maturity	The remaining period for an exposure from the reporting date to its maturity.
Retail SME	Loans extended to small businesses and managed as retail exposures are eligible for retail treatment under Basel II, provided the total exposure of the Bank to a small business borrower (on a consolidated basis where applicable) is less than €1m. Small business loans extended through or guaranteed by an individual are subject to the same exposure threshold.
Retail	The segment that comprises customer focused products and services for individuals, sole traders and small partnerships. This includes mortgages, credit cards, consumer loans, current accounts and savings products.
Retail Advanced IRB Approach	Internal Ratings Based approach for Retail customers stipulated within Basel II allowing a more sophisticated and risk sensitive approach to calculate credit risk. More advanced than Foundation IRB approach as PD, LGD and EAD parameters are derived by the Bank.
Risk grade	Credit risk score or output from a rating system or Basel II Pillar 1 model.
Risk Weighted Asset (RWA)	A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with Basel II.
Scorecard	A set of questions (called characteristics) that provide the most predictive information on future account performance. The account receives points (or weighting) for each question depending on the answer. These points are then added together to create a score.
Secured lending	Lending in which the borrower pledges retail or commercial property as collateral for the loan, which then becomes a secured debt owed to the Bank. In the event that the borrower defaults, the Bank may take possession of the asset used as collateral and may sell it to regain some or the entire amount originally lent to the borrower.
Securities Financing Transaction (SFT)	Loaning of a stock, derivative, or other security to a third party.
Securitisation	A process by which a portfolio of retail mortgages is used to back the issuance of new securities by an SPE. The Bank has established securitisation structures as part of its funding and capital management activities (see Special purpose entities (SPEs)).
Securitisation Position	An exposure to a securitisation
Slotting approach	An approach applied to specialised lending exposures to calculate Pillar 1 capital requirement and EL. For each of five risk categories that may be assigned to a specialised lending customer, a set percentage based on the slotting category is applied to the account exposure value to derive capital requirement and expected loss.
Small Credit Committee (SCC)	The SCC is a sub-committee of the LCC and its core purpose is to independently sanction new and increased lending over set limits of authority.
Special Purpose Entities (SPE)	Entities that are created to accomplish a narrow and well defined objective. For the Bank this includes: various securitisation transactions in which mortgages were sold to SPEs. The equity of these SPEs is not owned by the Bank; Covered Bond Limited Liability Partnerships created in order to act as guarantors for issues of covered bonds.
Specialised lending	A specific Basel portfolio type which are commercial exposures that possess the following characteristics: 1. the exposure is to an entity which was created specifically to finance and/or operate physical assets; 2. the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate; and 3. the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.
Standardised approach	Under Basel II, the basic method of calculating Pillar 1 capital requirements based on supervisory defined factors which are applied to exposure values.
Strategic Asset Review Forum (SAR)	A forum established at the discretion of the LCC and SCC for CoAM and non performing facilities. Its function is to set strategies on a case by case basis and sanction within its authority.
Strategic Transactions Committee (STC)	Chaired by the CEO, the STC reviews, challenges and approves (where permitted within the authority delegated by the Board) strategic transactions designed to achieve the deleveraging of the balance sheet in line with the strategy outlined by the Board for the Non-core assets within the CoAM business.

Item	Description
Stress testing	Assessing the risk of a portfolio using a what-if approach to represent various economic changes, for example, a rise in unemployment.
Subordinated debt/liabilities	Liabilities which, in the event of insolvency or liquidation of the Bank, are subordinated to the claims of depositors and other creditors of the Bank.
Swaps	An agreement between the Bank and a counterparty in which one stream of future payments is exchanged for another stream, based on a specified principal amount. For example, interest rate swaps often involve exchanging a fixed receipt for a floating receipt, which is linked to an interest rate (most often LIBOR). The Bank's use of swaps helps to manage periodic market risk on its financial instruments.
The Bank	The Co-operative Bank plc and its subsidiaries.
The Banking Group	See 'The Co-operative Banking Group'.
The Board	The Board of Directors. They manage the Bank's business performance in line with its purpose, givens, visions and values.
The Co-operative Banking Group	The Co-operative Banking Group Limited and its subsidiaries, which included the Bank until legal separation on 20 December 2013.
The Co-operative Group	The former ultimate parent company of the Bank, pre legal separation.
Tier 1 Capital	A regulatory measure of financial (capital) strength. Tier 1 is divided into Core Tier 1 and other Tier 1 Capital. Core Tier 1 Capital comprises share capital and associated share premium, and general reserves from retained profits. The book values of goodwill and intangible assets are deducted from Core Tier 1 Capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as perpetual subordinated bonds are included in other Tier 1 Capital.
Tier 1 Capital Ratio	Tier 1 Capital divided by Risk Weighted Assets.
Tier 2 Capital	Tier 2 Capital comprises the Bank's property valuation reserve, qualifying subordinated notes and collective impairment allowance (for exposures treated on a Basel II standardised basis). Certain regulatory deductions may be made for the purposes of assessing capital adequacy.
Total Potential Limit (TPL)	For Treasury exposures – the maximum aggregate exposure (Total Potential Limit) extended to any single counterparty. For Retail/Corporate customers – the total exposure up to and including any shadow limits which a customer could utilise.
Trading book	In relation to the Bank's business or exposures, means its proprietary positions in financial instruments: 1. which are held for resale and/or are taken on by the firm with the intention of benefiting in the short term from actual and/or expected differences between their buying and selling prices or from other price or interest rate variations; and 2. taken in order to hedge other elements of the trading book.
Value adjustments	Individual impairment balance.
Value at risk (VaR)	VaR measures the daily maximum potential gain or loss due to past market volatility. The VaR methodology employed is historical simulation using a time series of 1 year to latest day. Confidence level of 95% with a one day holding period.
Write down	After an advance has been identified as impaired and is subject to an impairment allowance, the stage may be reached whereby it is concluded that there is no realistic prospect of further recovery. Write downs will occur when, and to the extent that, the whole or part of a debt is considered irrecoverable. This action can occur at any time in the debts life.
Wrong way risk	This type of risk occurs when exposure to a counterparty is adversely correlated with the credit quality of that counterparty.

The Co-operative Bank plc
Registered office: 1 Balloon Street
Manchester M60 4EP
Registered number: 990937
www.co-operativebank.co.uk