THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION.

THIS DOCUMENT COMPRISES AN EXPLANATORY STATEMENT IN COMPLIANCE WITH SECTION 897 OF THE COMPANIES ACT 2006 (the **Explanatory Statement**). It is being sent to persons who are believed to be Scheme Creditors at the date of this Explanatory Statement. If you have assigned, sold, or otherwise transferred, or assign, sell or otherwise transfer, your interests as a Scheme Creditor before the Record Date you must forward this Explanatory Statement and the accompanying documents at once to the person or persons to whom you have assigned, sold or otherwise transferred, or assign, sell or otherwise transfer, your interests as a Scheme Creditor.

If you are in any doubt as to the contents of this Explanatory Statement or the documents that accompany it or what action you should take, you are recommended to seek your own independent financial, legal and tax advice immediately from your financial, legal and/or tax adviser who, if you are taking advice in the United Kingdom, is authorised pursuant to the Financial Services and Markets Act 2000 (**FSMA**) or by an appropriate regulatory body, or from another appropriately authorised independent adviser if you are in a territory outside the United Kingdom.

This Explanatory Statement is accompanied by an Account Holder Letter. It is important that you read the Account Holder Letter carefully for information about the Scheme and that you complete and return it in accordance with the instructions contained in it.

Further copies of this Explanatory Statement can be obtained by contacting the Information Agent at via email to co-op@lucid-is.com or telephone on + 44 20 7704 0880.

Application has been made to the Financial Conduct Authority under Part VI of the Financial Services and Markets Act 2000 (the **UK Listing Authority)** for the Bank T2 Notes referred to in this Explanatory Statement to be admitted to the Official List of the UK Listing Authority and to the London Stock Exchange plc. (the **London Stock Exchange**) for the Bank T2 Notes to be admitted to trading on the London Stock Exchange's regulated market. The London Stock Exchange's regulated market is a regulated market for the purposes of the Markets in Financial Instruments Directive (Directive 2004/39/EC).

A document comprising a prospectus relating to the Company has been prepared in accordance with Article 5.4 of Directive 2003/71/EC as amended (which includes the amendments made by Directive 2010/73/EU to the extent that such amendments have been implemented in a relevant Member State of the European Economic Area) (the **Prospectus Directive**), and a copy of that prospectus together with a related supplementary prospectus (referred to in this Explanatory Statement as the Bank T2 Notes Prospectus) is appended to this Explanatory Statement at Appendix 9 (*Bank T2 Notes Prospectus*).

EXPLANATORY STATEMENT IN RELATION TO A SCHEME OF ARRANGEMENT

under Part 26 of the Companies Act 2006

between

THE CO-OPERATIVE BANK P.L.C.

and the

Scheme Creditors

(as defined in this Explanatory Statement)

DATE: 18 November 2013 (as amended on 4 December 2013)

VOLUME 1 OF 2

The Record Date for the Scheme will be 4.30 p.m. (London time) on 13 December 2013. The Scheme Meeting for the Scheme Creditors to consider and vote on the Scheme will be held at 10 a.m. (London time) on 16 December 2013. The notice convening the Scheme Meeting is set out in Appendix 4 (*Notice of Scheme Meeting*) of this Explanatory Statement. Instructions about actions to be taken by Scheme Creditors preceding the Scheme Meeting are set out in Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*) and summarised on pages 21 to 27 (*Summary of actions to be taken by Scheme Creditors and any person with an interest in the Dated Notes*) of this Explanatory Statement. **Whether or not you intend to attend the Scheme Meeting, you are requested to ensure that your Account Holder completes, executes and returns the Account Holder Letter which accompanies this Explanatory Statement in accordance with the instructions printed thereon as soon as possible.**

Further important information is set out under the sections entitled *Important Notice* and *Important Securities Law Notice* on pages 5 to 12 (inclusive) of this Explanatory Statement.

INDEX

VOLUME 1

Preliminary Sections

1. Important Notice....5

2. Letter from the Chairman of the Company....13

3. Expected timetable of Principal Events....16

4. Are you a Scheme Creditor or a person with an interest in the Dated Notes?....18

5. Summary of actions to be taken by Scheme Creditors and any person with an interest in the Dated Notes....21

PART A

6. Background to and Reasons for the Recapitalisation Plan....28

PART B

7. Overview of the Scheme....36

PART C

8. Overview of the Liability Management Exercise....64

PART D

9. Risk Factors....77

PART E

10. Information on the Company and Additional information relating to the Scheme....84

PART F

11. Taxation....93

PART G

12. The Scheme....97

Appendices

1. Definitions and Interpretation 163

2. Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes 178

3. Form of Account Holder Letter 198

4. Notice of Scheme Meeting 227

5. Notice of Director Nomination Resolution 230

6. Illustrative Additional New Ordinary Shares Allocation Model 232

7. Resolution Analysis 234

8. Financial Statements 242

   (A) Audited Financial Statements of the Company for the Financial Year Ending 31 December 2012 242

   (B) Audited Financial Statements of the Company for the Financial Year Ending 31 December 2011 391

   (C) Audited Financial Statements of the Company for the Financial Year Ending 31 December 2010 528

   (D) Audited Interim Financial Statements of the Company for the Period Ending 30 June 2013 665

VOLUME 2

9. Bank T2 Notes Prospectus 670

   (A) prospectus dated 4 November 2013 671

   (B) supplementary prospectus dated 4 December 2013 1372

IMPORTANT NOTICE

Unless the context otherwise requires, all capitalised terms used in this Explanatory Statement shall have the meanings set out in Appendix 1 (*Definitions and Interpretation*) of this Explanatory Statement. The appendices to this Explanatory Statement form an integral part of it and, unless expressly stated otherwise, references to this Explanatory Statement shall be construed as references to the Explanatory Statement including the appendices to it.

Information

This Explanatory Statement has been prepared in connection with a scheme of arrangement under Part 26 of the Companies Act 2006, namely a scheme between the Company and the Scheme Creditors and has been prepared solely for the purpose of providing information to Scheme Creditors in relation to the Scheme.

Nothing in this Explanatory Statement or any other document issued with or appended to it should be relied on for any purpose other than for Scheme Creditors to make a decision on the Scheme and Scheme Creditors may not reproduce or distribute this Explanatory Statement, in whole or in part, and may not disclose any of the contents of this Explanatory Statement or use any information herein for any purpose other than considering and/or making a decision in respect of the Scheme. In particular and without limitation, nothing in this Explanatory Statement should be relied on in connection with the purchase or acquisition of any Dated Notes or any other financial instruments or assets of the Company or any other member of the Group.

Nothing in this Important Notice and the Important Securities Law Notice sections of this Explanatory Statement shall be construed as amending, varying or waiving the notice set out in section 21 (Important Legal Information) on pages 471 to 476 of the Bank T2 Notes Prospectus and, in respect of the information set out in the Bank T2 Notes Prospectus, Scheme Creditors should read that section of the Bank T2 Notes Prospectus carefully. With respect to the Bank T2 Notes, Scheme Creditors should read the Bank T2 Notes Prospectus in full before making a decision in respect of the Scheme.

Without prejudice to the responsibility of the Company for the information contained in the Bank T2 Notes Prospectus (as expressly set out therein), nothing contained in this Explanatory Statement shall constitute a warranty, undertaking or guarantee of any kind, express or implied, and nothing contained in this Explanatory Statement shall constitute any admission of any fact or liability on the part of the Company, or any other member of the Group with respect to any asset to which it or they may be entitled or any claim against it or them. Without prejudice to the generality of the foregoing, nothing in this Explanatory Statement or the distribution thereof evidences to any person, or constitutes any admission by the Company or any other member of the Group, that a liability is owed to any person in respect of any claim (including without limitation any Scheme Claim) or that any person is or may be a Scheme Creditor. The failure to distribute this Explanatory Statement to any Scheme Creditor shall not constitute an admission by the Company that such person is not a Scheme Creditor.

No person has been authorised by the Company, the Dealer Managers or Lucid Issuer Services Limited as Information Agent to give any information or make any representations concerning the Scheme (including concerning the Company or any other member of the Group or the Scheme Consideration or the Additional New Ordinary Shares) which is inconsistent with this Explanatory Statement and, if made, such representations may not be relied upon as having been so authorised.

The information contained in this Explanatory Statement (with the exception of the Bank T2 Notes Prospectus appended hereto) has been prepared based upon information available to the Company prior to the date of this Explanatory Statement. The information contained in the Bank T2 Notes Prospectus has been prepared based upon the information available to the Company prior to the date the Bank T2 Notes Prospectus was published. The delivery of this Explanatory Statement does not imply that, unless expressly stated otherwise, (i) the information herein (other than in the Bank T2 Notes Prospectus appended hereto) is

correct as at any time subsequent to the date hereof; and (ii) the information contained in the Bank T2 Notes Prospectus, is correct as at any time subsequent to the date the Bank T2 Notes Prospectus was published. Save as otherwise agreed, or as required by law, the Company has no obligation whatsoever to update or revise any of the information, forward-looking statements or the conclusions contained herein or to reflect new events or circumstances or to correct any inaccuracies which may become apparent subsequent to the date hereof. To the best of the Company's knowledge, information and belief, the information relating to the Company contained in this Explanatory Statement other than the Bank T2 Notes Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information. In addition, the Company accepts responsibility for the information contained in the Bank T2 Notes Prospectus as set out in the "Important Notices" on pages 2 to 4 of the Bank T2 Notes Prospectus. The Company has taken all reasonable steps to ensure that this Explanatory Statement contains the information reasonably necessary to enable Scheme Creditors to make an informed decision about the effect of the Scheme on them.

None of the Scheme Creditors nor their advisers have authorised the content of this Explanatory Statement or any part of it, nor do they accept any responsibility for the accuracy, completeness or reasonableness of the statements contained within it.

In making a decision in respect of the Scheme, each Scheme Creditor must rely on its own examination, analysis and enquiry of the Company and the terms of the Scheme including the merits and risks involved. None of the Company's advisers have verified that the information contained in this Explanatory Statement is in accordance with facts and does not omit anything likely to affect the import of such information and each of those persons expressly disclaims responsibility for such information. Each Scheme Creditor, by its participation in the Liability Management Exercise and receipt of any Scheme Consideration and/or Additional New Ordinary Shares and/or participation in the Sub-purchasing Offer pursuant to the Scheme acknowledges that:

(i) it has not relied on HSBC Bank plc and UBS Limited (the **Dealer Managers**), Lucid Issuer Services Limited as Information Agent or any person affiliated with the Dealer Managers or the Information Agent in connection with any investigation of the accuracy of any information contained in this Explanatory Statement or their investment decision (including any decision in connection with the Scheme); and

(ii) it has relied only on the information contained in this Explanatory Statement.

This Explanatory Statement has not been reviewed, verified or approved by any rating agency or any regulatory authority (other than the Bank T2 Notes Prospectus appended hereto which has been approved by the UK Listing Authority). Without prejudice to the representations and warranties given by the Company or any other member of the Group or any directors or officers of any member of the Group elsewhere, to the fullest extent permitted by law, neither the Company nor any other member of the Group nor any directors or officers of the Company or any other member of the Group will have any tortious, contractual or any other liability to any person in connection with the use of this Explanatory Statement and the Company and all other members of the Group do not accept any liability whatsoever to any person, regardless of the form of action, for any lost profits or lost opportunity, or for any indirect, special, consequential, incidental or punitive damages arising from any use of this Explanatory Statement, its contents or preparation or otherwise in connection with it, even if the Company or other member of the Group (as applicable) has been advised of the possibility of such damages.

Electronic Form

If this Explanatory Statement has been sent to you in an electronic form, you are reminded that documents transmitted via this medium may be altered or changed during the process of transmission and consequently none of the Company, the Dealer Managers, the Information Agent, the Registrars or any person who controls, or is a director, officer, employee, agent or any affiliate of any such person accepts any liability or responsibility whatsoever in respect of any difference between the Explanatory Statement distributed to you

in electronic format and the hard copy version available to you on request from the Information Agent and/or the Registrars.

You are reminded that the Explanatory Statement has been delivered to you on the basis that you are a person into whose possession it may be lawfully delivered in accordance with the laws of the jurisdiction in which you are located and you may not nor are you authorised to deliver the Explanatory Statement or any part of it to any other person. If you are not the named addressee to which the Explanatory Statement has been delivered, please notify the sender immediately and destroy the Explanatory Statement.

Restrictions

The distribution of this Explanatory Statement and the offer or sale of Bank T2 Notes, New Ordinary Shares and/or Additional New Ordinary Shares may be restricted by law in certain jurisdictions. None of the Company or the Dealer Managers represent that this Explanatory Statement may be lawfully distributed in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating such distribution.

The distribution of this Explanatory Statement to or in certain jurisdictions may be restricted by law or regulation in certain jurisdictions and persons into whose possession this Explanatory Statement comes are requested to inform themselves about, and to observe, any such restrictions. Failure to comply with any such restrictions could result in a violation of the laws of such jurisdictions.

Lock-Up Arrangements may be sought from any person in the United Kingdom who is (a) a holder of any of the Existing Securities or (b) any other person also falling within Article 43(2) or within Article 49(2)(a) to (d) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the **Financial Promotion Order**) or falling within the definition of investment professionals (as defined in Article 19(5) of the Order). The Company may exercise its discretion not to enter into a Lock-Up Arrangement with any person in the United Kingdom other than as described in the previous sentence and no other person in the United Kingdom should rely on this Explanatory Statement for the purposes of entering into a Lock-Up Arrangement.

Summary Only

The summary of the principal provisions of the Scheme contained in this Explanatory Statement is qualified in its entirety by reference to the Scheme itself, the full text of which is set out in Part G (*The Scheme*) of this Explanatory Statement. Each Scheme Creditor is advised to read and consider carefully the text of the Scheme. This Explanatory Statement has been prepared solely to assist Scheme Creditors in respect of voting on the Scheme.

IN THE EVENT OF A CONFLICT BETWEEN THE INFORMATION AND TERMS DESCRIBED IN THIS EXPLANATORY STATEMENT AND THE SCHEME, THE TERMS OF THE SCHEME SHALL PREVAIL.

Prospectus

This Explanatory Statement is not a prospectus within the meaning of Article 5.4 of the Prospectus Directive, or a prospectus equivalent document. In connection with the Bank T2 Notes a document comprising a prospectus for the purposes of the Prospectus Directive has been prepared. A copy of the Bank T2 Notes Prospectus is appended to the Explanatory Statement and has been made available to the public in accordance with the Prospectus Rules.

Forward-looking statements

Nothing in this Explanatory Statement shall be deemed to be a forecast, projection or estimate of the future financial performance of the Company and/or any member of the Group except where otherwise specifically stated.

This Explanatory Statement contains statements, estimates, opinions and projections with respect to the Company and certain of its subsidiaries, and certain plans and objectives of the Company and certain of its subsidiaries. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. Forward-looking statements often use words such as "anticipate", "target", "expect", "estimate", "intend", "plan", "goal", "believe", "will", "may", "should", "would", "could" or other words of similar import. These statements are based on numerous assumptions and assessments made by the Company and/or any other member of the Group as appropriate in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors which they believe appropriate. Although the Company and/or any other member of the Group, as appropriate, believe that the expectations reflected in such statements are reasonable, no assurance can be given that such expectations will prove to be correct. Forward-looking statements involve significant risks and uncertainties, should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not such results will be achieved. Such forward-looking statements only speak as at 18 November 2013. A number of factors could cause actual results to necessarily differ materially from the results discussed in the forward looking statements, including, but not limited to, future collections being lower than expected, deterioration in general economic conditions, changes in the regulatory environment, fluctuations in interest and exchange rates, the outcome of litigation, government actions and the other factors set out or referred to in Part D (*Risk Factors*) of this Explanatory Statement. It is up to the recipient of this Explanatory Statement to make its own assessment of the validity of such forward-looking statements and assumptions and no liability is accepted by the Company or any other member of the Group in respect of the achievement of such forward-looking statements and assumptions. Should one or more of these risks or uncertainties materialise, or should underlying assumptions prove incorrect, actual results may vary materially from those described in this Explanatory Statement.

Risk factors

SCHEME CREDITORS' ATTENTION IS DRAWN TO CERTAIN RISKS ASSOCIATED WITH THE LIABILITY MANAGEMENT EXERCISE (TO THE EXTENT RELATING TO THE SCHEME) THAT ARE SET OUT OR REFERRED TO IN PART D (*RISK FACTORS*) OF THIS EXPLANATORY STATEMENT.

Legal, tax and financial advice

Scheme Creditors should not construe the contents of this Explanatory Statement as legal, tax or financial advice.

This Explanatory Statement has been prepared without taking into account the objectives, financial situation or needs of any particular recipient of it, and consequently, the information contained in this Explanatory Statement may not be sufficient or appropriate for the purpose for which a recipient might use it. Any such recipients should conduct their own due diligence and consider the appropriateness of the information in this Explanatory Statement having regard to their own objectives, financial situations and needs. Scheme Creditors are recommended to consult their own professional advisers as to legal, tax, financial or other matters relevant to the action Scheme Creditors should take in relation to the Scheme, or the implications/consequences of those actions.

This Explanatory Statement is issued by the Company to the Scheme Creditors in the United Kingdom in reliance on Article 43 of the Financial Promotion Order. This Explanatory Statement is only addressed to Scheme Creditors and no other person (whether in the United Kingdom or otherwise) should rely on it.

Other jurisdictions

The implications of the Scheme for Scheme Creditors who are residents or citizens of jurisdictions other than the United Kingdom may be affected by the laws of the relevant jurisdictions. Such overseas Scheme Creditors should inform themselves about and observe any applicable legal requirements. Any person outside the United Kingdom who is resident in, or who has a registered address in, or is a citizen of, an overseas jurisdiction should consult independent professional advisers and satisfy themselves as to the full observance of the laws of the relevant jurisdiction in connection with the Scheme, including obtaining any requisite governmental or other consents, observing any other requisite formalities and paying any issue, transfer or other taxes due in such jurisdiction.

SCHEME CREDITORS SHOULD CONSULT THEIR OWN PROFESSIONAL ADVISERS WITH RESPECT TO THE MATTERS DESCRIBED IN THIS DOCUMENT, INCLUDING THE LEGAL, FINANCIAL AND TAX CONSEQUENCES OF THE SCHEME IN THEIR PARTICULAR CIRCUMSTANCES.

IMPORTANT SECURITIES LAW NOTICE

NONE OF THE SECURITIES REFERRED TO IN THIS EXPLANATORY STATEMENT SHALL BE SOLD, ISSUED OR TRANSFERRED IN ANY JURISDICTION IN CONTRAVENTION OF APPLICABLE LAW.

If the Scheme is implemented in accordance with its terms, the Scheme Consideration (being the New Ordinary Shares and the Bank T2 Notes) and the Additional New Ordinary Shares will be issued by the Company in accordance with the terms of the Scheme.

Information for United States and other overseas Scheme Creditors

Neither this Explanatory Statement nor any part hereof constitutes an offer to distribute, issue or sell, or a solicitation of an offer to subscribe for or purchase the Scheme Consideration and/or Additional New Ordinary Shares or any other securities in any jurisdiction in which such distribution, issue, sale or solicitation is not permitted and neither this Explanatory Statement nor any part hereof may be used for or in connection with an offer to, or the solicitation by, any person in any jurisdiction or in any circumstances in which such offer or solicitation is not authorised or to any person to whom it is unlawful to make such offer or solicitation. Accordingly, neither the Scheme Consideration, Additional New Ordinary Shares nor any other securities may be offered or sold, directly or indirectly, and neither this Explanatory Statement nor any part hereof nor any prospectus, offering circular, form of application, advertisement, other offering materials nor other information may be issued, distributed or published in any country or jurisdiction except in circumstances that will result in compliance with all applicable laws, orders, rules and regulations.

The Scheme Consideration and Additional New Ordinary Shares to be issued pursuant to the Scheme, will not be registered under the U.S. Securities Act of 1933, as amended (the **Securities Act**), or under any relevant securities laws of any state or other jurisdiction of the United States or under the applicable securities laws of Australia, New Zealand, South Africa, Canada, Japan or Switzerland and other relevant jurisdictions. No public offering of securities will be made in Australia, New Zealand, South Africa, Canada, Japan or Switzerland.

The Scheme Consideration and Additional New Ordinary Shares will be issued in reliance upon the exemption from the registration requirements of the Securities Act provided by section 3(a)(10) thereof. For the purpose of qualifying for the exemption from the registration requirements of the Securities Act provided by section 3(a)(10) thereof with respect to such securities that may be issued pursuant to the Scheme, the Court has been advised that its sanctioning of the Scheme will be relied upon as an approval of the Scheme following a hearing on its fairness to security holders at which hearing all such security holders are entitled to attend in person, by proxy or through counsel to support or oppose the sanctioning of the Scheme and with respect to which notification has been given to all such security holders. Such transaction will not be approved or disapproved by the U.S. Securities and Exchange Commission (**SEC**), nor will the SEC or any U.S. state securities commission pass upon the merits or fairness of the transaction nor upon the adequacy or accuracy of the information contained in this Explanatory Statement. Accordingly, the Scheme Consideration and Additional New Ordinary Shares issued in connection with the Liability Management Exercise have not been recommended by any U.S. federal or state securities commission or regulatory authority. Any representation to the contrary is a criminal offence in the United States. The information disclosed in this Explanatory Statement is not the same as that which would have been disclosed if this Explanatory Statement had been prepared for the purpose of complying with the registration requirements of the Securities Act or in accordance with the laws and regulations of any state or other jurisdiction of the United States.

Holders of Dated Notes in the United States should note that the Scheme will relate to the securities of an English public limited company that is a "foreign private issuer" as defined under Rule 3b-4 of the U.S. Securities Exchange Act of 1934, as amended (the **Exchange Act**), and will be governed by English law.

Neither the proxy solicitation nor the tender offer rules under the Exchange Act will apply to the Scheme. Moreover, the Scheme will be subject to the disclosure requirements and practices applicable in the United Kingdom to schemes of arrangement, which differ from the requirements of the U.S. proxy solicitation rules and tender offer rules.

The Scheme Consideration and Additional New Ordinary Shares may generally be resold without restriction under the Securities Act by former holders of Dated Notes who are not affiliates of the Company or the Group and have not been affiliates of the Company or the Group within 90 days prior to the issuance of such Scheme Consideration and Additional New Ordinary Shares under the Scheme. Thereafter, a former holder of Dated Notes may resell without restriction under the Securities Act the respective Scheme Consideration and Additional New Ordinary Shares issued under the Scheme, unless such person is an affiliate of the Company or the Group at the time of such resale, or was an affiliate of the Company or the Group within 90 days prior to such resale.

Application has been made to the UK Listing Authority for the Bank T2 Notes to be admitted to the Official List of the UK Listing Authority and to the London Stock Exchange for the Bank T2 Notes to be admitted to trading on the London Stock Exchange's regulated market. The London Stock Exchange's regulated market is a regulated market for the purposes of the Markets in Financial Instruments Directive (Directive 2004/39/EC).

Scheme Consideration and Additional New Ordinary Shares will not be distributed pursuant to the Scheme to or to the order, or for the account or benefit, of any person where such distribution would be prohibited by any applicable law or regulation, or so prohibited except after compliance with conditions or requirements that are unduly onerous. To the extent that such a prohibition applies, the Scheme Consideration and Additional New Ordinary Shares that would otherwise have been distributed to any relevant person pursuant to the Scheme will be delivered to a holding period trustee and, subject to the terms of the Scheme and certain limited exceptions, sold and the net cash proceeds of such sale (after deduction of all applicable expenses and currency conversion costs) paid to that person in Sterling in full satisfaction of his rights in respect of such securities under the Scheme. For further information see clauses 18 to 31 of the Scheme and paragraphs 3.5 to 3.18 of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Section 178 FSMA

Under section 178 of FSMA, if a person intends to acquire or increase its "control" of a UK authorised person (which includes the Company), it must first notify the appropriate regulator (in the case of the Company, this is the PRA). The PRA must then (after consulting with the FCA) decide whether to approve the acquisition or increase of control within 60 working days' of receipt of this notice (assuming it has been provided with a complete application). The PRA will not approve any new controller or any increase of control without being satisfied that the controller is financially sound and suitable to be a controller of, or acquire increased control of, the UK authorised person. Acquiring control for the purposes of FSMA includes where a person first holds 10% or more of the shares or voting power in a UK authorised person or its parent undertaking. A person will be treated as increasing his or her control over a UK authorised person, and therefore require further approval from the PRA, if the level of his or her shareholding or entitlement to voting power increases from a holding below certain thresholds to a holding above them. The thresholds are 10 per cent., 20 per cent., 30 per cent. or 50 per cent. of shares or voting power. When determining a person's level of control, that person's holding of shares or entitlement to voting power will be aggregated with the holdings or entitlements of any person with whom he or she is "acting in concert". Acquisition or increase of control without PRA approval is a criminal offence.

Takeover Regulation

The City Code on Takeovers and Mergers (the **City Code**) is issued and administered by The Panel on Takeovers and Mergers (the **Takeover Panel**). The Company is subject to the City Code and therefore its shareholders are entitled to the protections afforded by the City Code. Under rule 9 of the City Code when

(a) a person acquires an interest in shares which (taken together with shares he and persons acting in concert with him are interested) carry 30 per cent. or more of the voting rights of a company subject to the City Code, or (b) any person who, together with persons acting in concert with him, is interested in shares which in the aggregate carry not less than 30 per cent. of the voting rights of a company, but does not hold shares carrying more than 50 per cent. of the voting rights of the company subject to the City Code, and such person, or any persons acting in concert with him, acquires an interest in any other shares which increases the percentage of the shares carrying voting rights in which he is interested, then, in either case, that person, together with the person acting in concert with him, is normally required to extend offers in cash, at the highest price paid by him (or any persons acting in concert with him) for shares in the company within the preceding 12 months, to the holders of any class of equity share capital whether voting or non-voting and also to the holders of any other class of transferable securities carrying voting rights. Investors should be aware that any person who acquires 30 per cent. or more of the voting rights attached to the issued share capital of the Company may, pursuant to note 8 to rule 9.1 of the City Code, be required by the Takeover Panel to make an offer for the shares in the Company not owned or controlled by them at that time.

LETTER FROM THE CHAIRMAN OF THE COMPANY

18 November 2013

Dear Noteholders,

On 17 June 2013, following the conclusion of the Company's review of its capital position and discussions with the Prudential Regulation Authority (the **PRA**), the Company and Co-operative Group announced that the Company required additional aggregate Common Equity Tier 1 Capital of £1.5 billion (the **June Announcement**). In the June Announcement, the Company and Co-operative Group also announced the initial details of the Recapitalisation Plan, which was intended to address this capital requirement. At least £1 billion is expected to be contributed pursuant to the Liability Management Exercise by the end of 2013 and, conditional on completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is expected to be contributed by CBGL during 2014.

The publication on 4 November 2013 of the various documents launching the Liability Management Exercise in relation to the Company's Existing Securities and describing the Recapitalisation Plan in the form that has developed since June represents a significant milestone in the Company's plan to address this shortfall.

I said in June that the announcement of the Recapitalisation Plan was an important turning point for the Company and the Company's board continues to believe that the completion of that plan will provide the foundations to support the long-term success of the Company in offering a real alternative to customers. If the initial details of the Recapitalisation Plan had not been announced in June, the Company believes it is likely that it would have been resolved almost immediately by the Bank of England or HM Treasury. The Recapitalisation Plan which was announced on 4 November 2013 is different from the initial plan announced in June but we believe it is much better for all stakeholders than the plan previously announced. The Liability Management Exercise that was launched on 4 November 2013 is the cornerstone of the Recapitalisation Plan. The support of Noteholders is critically important to the success of the Liability Management Exercise and the viability of the Company. It is only with the support of Noteholders that the Company will be able to move forward.

The Company believes that there are only two realistic outcomes for the Company following the launch of the Liability Management Exercise, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Company being subject to a resolution procedure under the Banking Act 2009 (the **Banking Act**). The Company believes that its recapitalisation through the Liability Management Exercise would be substantially more beneficial to Noteholders than resolution of the Company.

Part A (*Background to and Reasons for the Recapitalisation Plan*) and Appendix 7 (*Resolution Analysis*) of this Explanatory Statement set out a description of the hypothetical position that Noteholders would be likely to face if the Company were to be resolved. The purpose of the resolution analysis is to assist Noteholders in determining whether or not to vote in favour of the Scheme.

In summary, the Company believes that, if the Company were to be resolved and go into an insolvency proceeding as a result of that resolution, Noteholders would not receive any recovery in respect of their Existing Securities in any such insolvency proceeding and would not be entitled to any compensation under the resolution regime arising from their holding of Existing Securities. Further, the Company considers that there are fundamental uncertainties as to whether the Company could be successfully resolved such that the Company itself remained a going concern without the active participation of Co-operative Group and a substantial amount of additional capital.

Over the last few months, we have worked hard to bring the Company to the stage of announcing the Recapitalisation Plan. In developing the details of the Recapitalisation Plan we know we cannot please everyone but we have sought to balance the interests of a large number of stakeholders and we believe that the Recapitalisation Plan provides an outcome which is in the long-term interests for all stakeholders given the current circumstances of the Company.

The Company has listened carefully to the often competing demands of its various stakeholder groups as it has put together the revised Recapitalisation Plan. As a result, the Recapitalisation Plan which was announced on 4 November 2013 is different from the initial plan announced in June, but we believe that the revised Recapitalisation Plan is much better for all stakeholders.

Following discussions we have held with certain Noteholders and their representatives, these Noteholders (who as at 4 November 2013 represented approximately 48% of the nominal value of the Dated Notes) agreed on 4 November 2013 to lock-up their holdings and vote in favour of the Scheme (the **LT2 Group**) by entering into Lock-up Agreements. This is a significant vote of confidence by these Noteholders in the revised Recapitalisation Plan.

The LT2 Group has acknowledged that the Company is unique for its ethics, mission and heritage, which are essential components of the Company's differentiated approach and it is important to them that the Company maintains its unique characteristics and ethos.

On completion of the Recapitalisation Plan, 70 per cent. of the equity of the Company will be owned by former holders of Dated Notes, but it is not anticipated that any single holder will own 10% or more of the equity. Noteholders will also be entitled to receive the Bank T2 Notes as part of the Recapitalisation Plan. Co-operative Group, which will hold the remaining 30 per cent. of the equity of the Company, will be the Company's largest single shareholder by far, which will enable it to maintain significant influence over how the Company operates. Further, to ensure that the Company continues to have a clear ethical focus, co-operative values and ethics were, on 15 November 2013, for the first time, with the agreement of Co-operative Group and the LT2 Group whom we have held discussions with, embedded in the constitution of the Company and the Company will set up a values and ethics committee, with an independent director as its chair. The Company's values and ethics committee will be entrusted with ensuring that the Company conducts itself in a manner informed by the established values of the co-operative movement.

In the initial details of the Recapitalisation Plan published in June it was indicated that holders of the Company's more junior ranking subordinated securities were likely to be offered a substantially greater proportion of ordinary shares in the Company as opposed to debt instruments as part of the proposed recapitalisation. Many of the holders of these junior ranking securities are retail investors and a strong preference has been expressed by, or on behalf of, many of those investors to receive income producing debt instruments rather than ordinary shares. Accordingly, the Recapitalisation Plan provides for the issue to such holders of income producing debt instruments rather than ordinary shares.

The Recapitalisation Plan also provides for a contribution of £462 million from Co-operative Group, which has been consented to by bank creditors of Co-operative Group on terms which Co-operative Group believes not to be materially detrimental to the development of its other businesses.

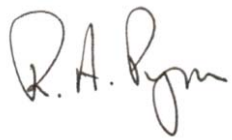
As a result, I would urge you to read the rest of the documentation that has been published and which is applicable to the Dated Notes you hold and consider the actions to be taken by Noteholders set out in this Explanatory Statement. I would particularly draw your attention to the description of the risks relating to the Scheme, the Company and its business and the rights related to the features of the Bank T2 Notes, the New Ordinary Shares and the Additional New Ordinary Shares set out in Part D (*Risk Factors*) of this Explanatory Statement (including the sections of the Bank T2 Notes Prospectus referred to therein).

In conclusion therefore, I present to you our Recapitalisation Plan, which has the benefit of the strong backing of both Co-operative Group and the LT2 Group, including strong support for the preservation of the

unique co-operative principles and ethics of the Company, whilst also being able to cater for the demands of the Company's retail investors. So, whilst the journey has been most unusual, what we are still trying to achieve is a more sustainable bank better placed to serve its customers in the future. I remain convinced that this is a worthwhile enterprise and that, with your support, we can rebuild our bank.

Your decision as to whether to vote in favour of the Scheme and elect to participate in the Additional New Ordinary Shares Offer (as described in Part B (*Overview of the Scheme*) of this Explanatory Statement) will depend on your individual circumstances. If you are in any doubt as to the action you should take, you are recommended to seek your own personal financial advice from an independent financial adviser authorised under the Financial Services and Markets Act 2000 (as amended) if you are in the UK or, if you are outside the UK, from an appropriately authorised independent financial adviser, without delay.

Yours faithfully



Richard Pym

Chairman

EXPECTED TIMETABLE OF PRINCIPAL EVENTS[1, 2]

Noteholders should observe any deadlines set by any institution or settlement system through which they hold interests in the Dated Notes to ensure that any voting instructions given by them are taken into account at the Scheme Meeting. The Company strongly urges each Noteholder to contact its relevant Account Holder or Intermediary as soon as possible to ensure they are aware of this Explanatory Statement and the process and timetable set out in it.

Event	**Expected Time and date**
Latest time for blocking Dated Notes in the Clearing Systems for the purposes of delivery of Account Holder Letters containing voting instructions for the purposes of the Scheme Meeting (the **Custody Instruction Deadline**)	5 p.m. (local time in the place of the relevant Clearing System) on 12 December 2013
Record Date[3]	4.30 p.m. on 13 December 2013
Voting Instruction Deadline – latest time and date for receipt of Account Holder Letters by the Information Agent in order for Noteholders' voting instructions to be taken into account for the purposes of the Scheme Meeting, Noteholders to elect to subscribe for Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer, Noteholders' confirmations as to their eligibility to receive Scheme Consideration and Additional New Ordinary Shares to be taken into account for the purposes of distribution of the Scheme Consideration and Additional New Ordinary Shares on the Scheme Settlement Date, Noteholders to elect to participate in the Sub-purchasing Offer and (although not a part of the Scheme, but included here for information purposes) Noteholders to vote for or against the appointment of any Nominated Directors (if applicable).[4]	4.30 p.m. on 13 December 2013
Scheme Meeting[5]	10 a.m on 16 December 2013

1 Unless otherwise stated, all references to time in this Explanatory Statement are to London time.

2 The dates in this timetable and mentioned throughout this Explanatory Statement assume that the Scheme Meeting is not adjourned. It is also possible that the drawing up of the order of the Court sanctioning the Scheme may be delayed if any person appeals the order.

3 All Scheme Claims are determined as at the Record Date. The Company will be entitled to exercise discretion as to whether it recognises any assignment or transfer of Scheme Claims after the Record Date.

4 Please see the section entitled Summary of actions to be taken by Scheme Creditors and any person with an interest in the Dated Notes of this Explanatory Statement at page 21 to 27 and Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*). Account Holders are encouraged to obtain whatever information or instructions they may require from Noteholders in sufficient time to enable them to return their valid Account Holder Letters to the Information Agent as soon as possible, having considered this Explanatory Statement carefully. Voting instructions, elections to subscribe for Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer, elections to participate in the Sub-purchasing Offer and director nominations will not be taken into account in respect of Account Holder Letters received after the Voting Instruction Deadline, being 4.30 p.m. on 13 December 2013. Each Noteholder must ensure that an Account Holder Letter valid for the purposes of confirming eligibility to receive Scheme Consideration and, if applicable, Additional New Ordinary Shares is delivered to and received by the Information Agent before the Voting Instruction Deadline in order for it (or, if applicable, its Designated Recipient) to be entitled to receive the Scheme Consideration and, if applicable, Additional New Ordinary Shares to which it is entitled in accordance with the terms of the Scheme (if it is an Eligible Noteholder) on the Scheme Settlement Date. Account Holders requiring any assistance in completing Account Holder Letters should contact the Information Agent using the contact details in the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*). All relevant documentation can be accessed on the Scheme Website at http://www.co-operative.coop/Bondholders.

5 The Scheme Meeting will commence at the time stated. Noteholders that wish to attend the Scheme Meeting should produce a duplicate copy of the valid Account Holder Letter delivered on its behalf, evidence of corporate authority (in the case of a corporation) (for example, a valid power of attorney and/or board minutes) and evidence of personal identity (for example, a passport or other picture identification) at the registration desk by no later than one hour before the scheduled time of the Scheme Meeting.

Scheme Sanction Hearing[6]	18 December 2013
Anticipated Scheme Effective Date	18 December 2013
Anticipated Scheme Settlement Date	20 December 2013

The Scheme Meeting will be held at the offices of Allen & Overy LLP, One Bishops Square, London E1 6AD

[6] The Court will be requested to sanction the Scheme. The date for that hearing has not yet been settled, although it is expected to be on or about 18 December 2013. If this date changes, the dates of all subsequent steps, including the Scheme Effective Date and Scheme Settlement Date, may be affected. In this event, the date of the hearing will be announced at the Scheme Meeting to the extent then known or otherwise notified to the Noteholders. A notice regarding the date and time of the hearing will be circulated once the hearing has been scheduled.

ARE YOU A SCHEME CREDITOR OR A PERSON WITH AN INTEREST IN THE DATED NOTES?

The following persons have interests in the Dated Notes:

- Account Holders: You are an Account Holder if you are recorded directly in the records of a Clearing System as holding an interest at the Record Date in any Dated Notes in an account with that Clearing System.

- Intermediaries: You are an Intermediary if you hold an interest at the Record Date in any Dated Notes on behalf of another person or other persons and you do not hold that interest as an Account Holder.

- Noteholders: You are a Noteholder if you are the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes, whose interest in the relevant Dated Notes is held through and shown on records maintained in book entry form by a Clearing System at the Record Date. For the avoidance of doubt, an Account Holder may also be a Noteholder.

- The Common Depositaries and the Trustees.

Scheme Creditors are entitled to take, or direct the taking of, certain actions in respect of the Scheme.

For the purposes of the Scheme, the following persons are Scheme Creditors:

1. the Trustees;

2. the Common Depositaries, as holders of the Global Notes; and

3. the Noteholders, as contingent creditors.

Each of Bank of New York Mellon, London Branch and Citibank Europe PLC, in its capacity as a Common Depositary, and The Law Debenture Trust Corporation p.l.c., in its capacity as each of the Trustees, has confirmed to the Company that it will not vote in respect of the Dated Notes at the Scheme Meeting.

Account Holders are **not** Scheme Creditors unless and to the extent that they are Noteholders. However, as described in the section of this Explanatory Statement entitled *Summary of actions to be taken by Scheme Creditors and any person with an interest in the Dated Notes* at pages 21 to 27 below and Appendix 2 (Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes), the assistance of Account Holders will be required, in accordance with their custodial duties, to deliver facsimile or e-mail versions of the completed Account Holder Letters in accordance with the instructions provided to them by the Noteholders and to arrange for the Dated Notes to be blocked in accordance with the instructions contained in this Explanatory Statement.

Account Holder Letters are required for the purposes of (i) voting on the Scheme and electing to enter into Lock-up Undertakings, (ii) electing to subscribe for Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer, (iii) electing to participate in the Sub-purchasing Offer in accordance with its terms and (iv) confirming eligibility to receive Scheme Consideration and, if applicable, Additional New Ordinary Shares distributed in accordance with the terms of the Scheme. Account Holder Letters also include elections for the purposes of voting for or against the appointment of any Nominated Directors (if applicable). Noteholders are referred to Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*) for more information.

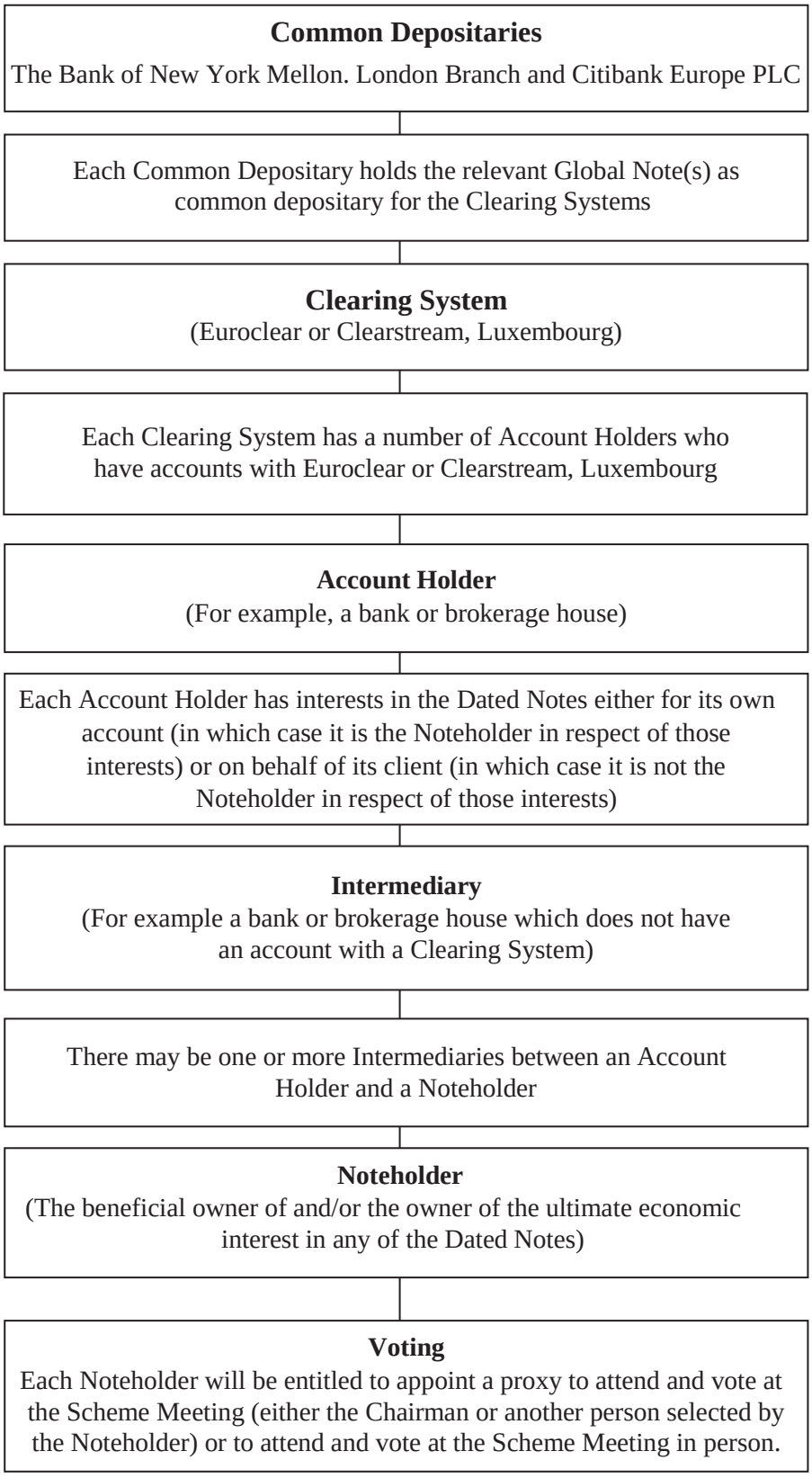
In determining whether a particular person is the ultimate beneficial owner and therefore a Noteholder, entitled to a particular principal amount of Dated Notes as aforesaid, each of the Company and the Information Agent may rely on such evidence and/or information and/or certification as it shall, in its absolute discretion, think fit and, if it does so rely, such evidence and/or information and/or certification shall, in the absence of manifest error, be conclusive and binding on all concerned.

If you are a Noteholder you should read this Explanatory Statement carefully. If you are a Noteholder that is not an Account Holder you should contact your Account Holder (through any Intermediaries, if applicable) to ensure that your Account Holder takes the appropriate action described in the section of this Explanatory Statement entitled *Summary of actions to be taken by Scheme Creditors and any person with an interest in the Dated Notes* at pages 21 to 27 below and Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*).

The number of Noteholders voting and the votes cast by them will be taken into account for both value and numerosity purposes in relation to the Scheme. The value of the Dated Notes for the purposes of voting at the Scheme Meeting is described in Part B (*Overview of the Scheme*).

For further information on the action to be taken by Scheme Creditors and persons with an interest in the Dated Notes, see the section of this Explanatory Statement entitled *Summary of actions to be taken by Scheme Creditors and any person with an interest in the Dated Notes* at pages 21 to 27 below and Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*).

The following diagram illustrates the relationship between certain persons with interests in the Dated Notes, which are held in global form through the Clearing Systems:



SUMMARY OF ACTIONS TO BE TAKEN BY SCHEME CREDITORS AND ANY PERSON WITH AN INTEREST IN THE DATED NOTES

Noteholders are invited to vote at the Scheme Meeting, elect to subscribe for Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer, elect to participate in the Sub-purchasing Offer in accordance with its terms, vote for or against the appointment of any Nominated Directors (if applicable) and confirm their eligibility to receive Scheme Consideration and, if applicable, Additional New Ordinary Shares by directing their Account Holder to complete and deliver to the Information Agent the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*).

Detailed instructions on the actions which Noteholders, Intermediaries and Account Holders should take are set out in this Explanatory Statement and are summarised below.

Scheme Creditors and any persons with an interest in the Dated Notes should read the full instructions set out in Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*).

1. You should read this Explanatory Statement as a whole, in conjunction with the documents that accompany it (including the Account Holder Letter which contains, amongst other things, the voting form relating to the Scheme Meeting and elections relating to the Lock-up Undertakings and eligibility to receive Scheme Consideration and, if applicable, Additional New Ordinary Shares).

2. An Account Holder may complete and submit an Account Holder Letter on behalf of a Noteholder if the Account Holder has the authority to do so.

3. **A valid Account Holder Letter for the purposes of voting, electing to enter into Lock-up Undertakings, electing to subscribe for Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer, electing to participate in the Sub-purchasing Offer in accordance with its terms, voting for or against the appointment of any Nominated Directors (if applicable) and confirming eligibility to receive Scheme Consideration and, if applicable, Additional New Ordinary Shares can be delivered as one Account Holder Letter, provided that the Account Holder Letter is delivered prior to the Voting Instruction Deadline.**

Actions to be taken in relation to the Scheme for the purposes of voting at the Scheme Meeting

4. If you are a ***Noteholder that is not an Account Holder*** and wish to vote at the Scheme Meeting, you should direct your Account Holder to complete the appropriate parts of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) and deliver the completed Account Holder Letter as soon as possible to the Information Agent and, in any event, so as to be received before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013.

5. If you are a ***Noteholder that is an Account Holder*** and wish to vote at the Scheme Meeting in accordance with the terms of the Scheme, you should complete the appropriate parts of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) and deliver the completed Account Holder Letter as soon as possible to the Information Agent and, in any event, so as to be received before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013.

6. Part 2 Section 3 (*Voting*) of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) includes elections pursuant to which the Noteholder is able (i) to attend and vote at the Scheme Meeting in person or by a duly appointed representative if a corporation, (ii) to instruct

the Chairman as its proxy to cast its vote in accordance with the wishes of that Noteholder or (iii) to appoint another person as its proxy to attend and vote at the Scheme Meeting in person on its behalf.

7. Part 2 Section 2 (*Lock-up*) of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) enables a Noteholder to enter into a Lock-up Arrangement by confirming on its behalf its agreement to enter into the Lock-up Undertakings.

8. In connection with the Account Holder Letter, each Noteholder that wishes to vote at the Scheme Meeting will be required to ensure that its Account Holder instructs the relevant Clearing System in which the Dated Notes which are the subject of the Account Holder Letter are held to block those Dated Notes. This can be effected by giving Custody Instructions to that effect to the relevant Clearing System prior to the Custody Instruction Deadline. As the procedure for blocking Dated Notes may take a considerable period of time, Noteholders should ensure that Custody Instructions are given as early as possible so that the relevant Dated Notes may be blocked prior to the latest time for blocking Dated Notes as set out in the *Expected Timetable of Principal Events* at page 16 of this Explanatory Statement. The procedure for doing this is described in Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*).

9. **Failure to deliver a valid Account Holder Letter on behalf of a Noteholder by the Voting Instruction Deadline will mean that the voting instructions contained in that Account Holder Letter will be disregarded for the purposes of voting at the Scheme Meeting and the Noteholder will not be entitled to vote at the Scheme Meeting.**

10. The Scheme requires the approval of a majority in number representing at least 75% in value of the Noteholders present and voting (in person, by a duly authorised representative if a corporation, or by proxy) at the Scheme Meeting to be held at 10 a.m. (London time) on 16 December 2013.

11. It is important that as many votes as possible are cast at the Scheme Meeting so that the Court may be satisfied that there is a fair and reasonable representation of opinion of Noteholders. You are therefore strongly urged to complete and sign or direct your Account Holder to complete and sign the relevant parts of your Account Holder Letter.

12. The amount of the Scheme Claims of each Noteholder which submits a valid Account Holder Letter in respect of the Dated Notes will be calculated as at the Record Date based on information confidentially provided to the Company by the Information Agent. This information will be used by the Chairman to determine whether the Scheme is approved at the Scheme Meeting. Accordingly, Noteholders do not need to take any action in respect of confirming the amount of their Scheme Claims other than providing the details requested in the Account Holder Letter.

13. As the 2016 Notes are denominated in Euro and all the other series of the Dated Notes are denominated in Sterling, the Scheme Claims in respect of the 2016 Notes of each Noteholder which submits a valid Account Holder Letter shall be notionally converted into Sterling at the Scheme FX Rate for the purposes of calculating the value of those Scheme Claims in connection with voting at the Scheme Meeting.

14. Each of the Common Depositaries and the Trustees has confirmed that it will not exercise any voting rights to which it may be entitled as a Scheme Creditor at the Scheme Meeting.

15. Completed Account Holder Letters for the purposes of voting at the Scheme Meeting should be delivered to the Information Agent. Account Holder Letters should not in any circumstances be delivered to any of the Common Depositaries, the Trustees, the Company or Co-operative Group or any other person. None of the Common Depositaries, the Trustees, the Company or Co-operative Group and any of their respective affiliates, officers, directors or employees or any other person will

be under any duty to give notification of any defects, irregularities or delays in any Account Holder Letter, nor will any of such entities or persons incur any liability for failure to give such notification.

16. A Noteholder on whose behalf a valid Account Holder Letter is delivered prior to the Scheme Meeting may still attend and vote for or against the Scheme at the Scheme Meeting.

17. **Completed Account Holder Letters for the purposes of voting should be delivered to the Information Agent so as to be received by the Information Agent as soon as possible and in any event before the Voting Instruction Deadline being 4.30 p.m. (London time) on 13 December 2013.**

Actions to be taken in relation to the Scheme for the purposes of confirming eligibility to receive Scheme Consideration

18. If you are a ***Noteholder that is not an Account Holder*** and wish to receive the Scheme Consideration to which you are entitled on the Scheme Settlement Date (or, to the extent you are not eligible to receive such Scheme Consideration and, if applicable, Additional New Ordinary Shares and have not appointed a Designated Recipient, in order to receive the net proceeds of the sale of such Scheme Consideration in accordance with the terms of the Scheme and the Distribution Agreement), you should direct your Account Holder to complete the appropriate parts of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) and deliver the completed Account Holder Letter as soon as possible to the Information Agent and, in any event, so as to be received before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013.

19. If you are a ***Noteholder that is an Account Holder*** and wish to receive the Scheme Consideration and, if applicable, Additional New Ordinary Shares to which you are entitled on the Scheme Settlement Date (or, to the extent you are not eligible to receive such Scheme Consideration and, if applicable, Additional New Ordinary Shares and have not appointed a Designated Recipient, in order to receive the net proceeds of the sale of such Scheme Consideration in accordance with the terms of the Scheme and the Distribution Agreement), you should complete Part 4 (*Scheme Consideration, Eligibility and Delivery of the Additional New Ordinary Shares*) of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) and deliver the completed Account Holder Letter as soon as possible to the Information Agent and, in any event, so as to be received before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013.

20. Part 4 (*Scheme Consideration, Eligibility and Delivery of the Additional New Ordinary Shares*) of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) enables a Noteholder to designate a Designated Recipient to receive the Scheme Consideration and, if applicable, Additional New Ordinary Shares to which that Noteholder will be entitled in accordance with the terms of the Scheme.

21. Part 4 (*Scheme Consideration, Eligibility and Delivery of the Additional New Ordinary Shares*) of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) includes an eligibility section in which the Account Holder is required to confirm on behalf of itself and the Noteholder (or, if the Noteholder has appointed a Designated Recipient, its Designated Recipient) certain statements relating to eligibility to receive the relevant Scheme Consideration to which that Noteholder is entitled in accordance with the terms of the Scheme.

22. **Failure to deliver a valid Account Holder Letter on behalf of a Noteholder by the Voting Instruction Deadline will mean that the Noteholder (irrespective of whether it would otherwise be eligible to receive Scheme Consideration and, if applicable, Additional New Ordinary Shares) will not be entitled to receive any Scheme Consideration to which it would be entitled in accordance with the terms of the Scheme on the Scheme Settlement Date but will need to**

take certain additional steps described in Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*) following the occurrence of the Scheme Settlement Date, including, without limitation, the delivery of a valid Account Holder Letter to the Information Agent.

23. Completed Account Holder Letters for the purposes of confirming eligibility to receive Scheme Consideration and, if applicable, Additional New Ordinary Shares should be delivered to the Information Agent. Account Holder Letters should not in any circumstances be delivered to any of the Common Depositaries, the Trustees, the Company or Co-operative Group or any other person. None of the Common Depositaries, the Trustees, the Company or Co-operative Group and any of their respective affiliates, officers, directors or employees or any other person will be under any duty to give notification of any defects, irregularities or delays in any Account Holder Letter, nor will any of such entities or persons incur any liability for failure to give such notification.

Actions to be taken in relation to the Scheme for the purposes of electing to subscribe for the Additional New Ordinary Shares

24. If you are a ***Noteholder that is not an Account Holder*** and wish to elect to subscribe for Additional New Ordinary Shares pursuant to the terms of the Additional New Ordinary Shares Offer, you should direct your Account Holder to complete the appropriate parts of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) and deliver the completed Account Holder Letter as soon as possible to the Information Agent and, in any event, so as to be received before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013.

25. If you are a ***Noteholder that is an Account Holder*** and wish to elect to subscribe for Additional New Ordinary Shares pursuant to the terms of the Additional New Ordinary Shares Offer, you should complete the appropriate parts of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) and deliver the completed Account Holder Letter as soon as possible to the Information Agent and, in any event, so as to be received before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013.

26. Part 3 Section 1 (*Election to Subscribe*) of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) enables a Noteholder to elect to subscribe for Additional New Ordinary Shares pursuant to the terms of the Additional New Ordinary Shares Offer. The Additional New Ordinary Shares Offer is described in Part B (*Overview of the Scheme*) of this Explanatory Statement and the procedure for participating in the Additional New Ordinary Shares Offer is described in more detail in Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*).

27. **Any Noteholder wishing to participate in the Additional New Ordinary Shares Offer should note that, in addition to instructing its Account Holder to make the appropriate elections in relation to the Additional New Ordinary Shares Offer in the Account Holder Letter, it must also ensure that its Account Holder confirms on its behalf in the Account Holder Letter that the Noteholder is an Eligible Person or, if it has appointed a Designated Recipient, that the Designated Recipient is an Eligible Person and that the duly completed and valid Account Holder Letter is delivered to and received by the Information Agent before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013. Failure to do so will result in that Noteholder not being entitled to participate in the Additional New Ordinary Shares Offer.**

28. **Failure to deliver a valid Account Holder Letter on behalf of a Noteholder by the Voting Instruction Deadline will mean that any election to subscribe for Additional New Ordinary Shares pursuant to the terms of the Additional New Ordinary Shares Offer in that Account**

Holder Letter will be disregarded for the purposes of the Additional New Ordinary Shares Offer.

29. Completed Account Holder Letters for the purposes of electing to subscribe for Additional New Ordinary Shares should be delivered to the Information Agent. Account Holder Letters should not in any circumstances be delivered to any of the Common Depositaries, the Trustees, the Company or Co-operative Group or any other person. None of the Common Depositaries, the Trustees, the Company or Co-operative Group and any of their respective affiliates, officers, directors or employees or any other person will be under any duty to give notification of any defects, irregularities or delays in any Account Holder Letter, nor will any of such entities or persons incur any liability for failure to give such notification.

30. **Completed Account Holder Letters for the purposes of or electing to subscribe for Additional New Ordinary Shares pursuant to the terms of the Additional New Ordinary Shares Offer should be delivered to the Information Agent so as to be received by the Information Agent as soon as possible and in any event before the Voting Instruction Deadline being 4.30 p.m. (London time) on 13 December 2013.**

Action to be taken in relation to the Scheme for the purposes of electing to participate in the Sub-purchasing Offer.

31. If you are a ***Noteholder that is not an Account Holder*** and wish to elect to participate in the Sub-purchasing Offer, you should direct your Account Holder to complete the appropriate parts of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) and deliver the completed Account Holder Letter as soon as possible to the Information Agent and, in any event, so as to be received by the Information Agent before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013.

32. If you are a ***Noteholder that is an Account Holder*** and wish to elect to participate in the Sub-purchasing Offer in accordance with the terms of the Scheme, you should complete the appropriate parts of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) and deliver the completed Account Holder Letter as soon as possible to the Information Agent and, in any event, so as to be received by the Information Agent before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013.

33. Part 3 Section 2 (*Election to Sub-purchase*) of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) enables a Noteholder to elect to participate in the Sub-purchasing Offer. The Sub-purchasing Offer is described in Part B (*Overview of the Scheme*) of this Explanatory Statement and the procedure for participating in the Sub-purchasing Offer is described in more detail in Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*).

34. **Any Noteholder wishing to participate in the Sub-purchasing Offer should note that, in addition to instructing its Account Holder to make the appropriate elections in relation to the Sub-purchasing Offer in the Account Holder Letter, it must also ensure that its Account Holder confirms on its behalf in the Account Holder Letter that the Noteholder is an Eligible Person or, if it has appointed a Designated Recipient, that the Designated Recipient is an Eligible Person and that the duly completed and valid Account Holder Letter is delivered to and received by the Information Agent before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013. Failure to do so will result in that Noteholder not being entitled to participate in the Sub-purchasing Offer.**

35. **Failure to deliver a valid Account Holder Letter on behalf of a Noteholder by the Voting Instruction Deadline will mean that any election to participate in the Sub-purchasing Offer in that Account Holder Letter will be disregarded for the purposes of the Sub-purchasing Offer.**

36. Completed Account Holder Letters for the purposes of electing to participate in the Sub-purchasing Offer should be delivered to the Information Agent. Account Holder Letters should not in any circumstances be delivered to any of the Common Depositaries, the Trustees, the Company or Co-operative Group or any other person. None of the Common Depositaries, the Trustees, the Company or Co-operative Group and any of their respective affiliates, officers, directors or employees or any other person will be under any duty to give notification of any defects, irregularities or delays in any Account Holder Letter, nor will any of such entities or persons incur any liability for failure to give such notification.

Action to be taken in relation to the Noteholder resolutions to approve the appointment of any Nominated Directors

37. Although not a term of the Scheme, as described in more detail in Part B Paragraph 6 (*Director Nominations*) of this Explanatory Statement, Noteholders will be entitled to participate in a resolution to approve the appointment of the Nominated Directors to the extent they are nominated by the Modified Scheme Purchasers and notified to the Noteholders by the Company in advance of the Scheme Meeting.

38. If you are a ***Noteholder that is not an Account Holder*** and wish to vote for or against the appointment of any Nominated Director (if applicable), you should direct your Account Holder to complete the appropriate parts of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) and deliver the completed Account Holder Letter as soon as possible to the Information Agent and, in any event, so as to be received before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013.

39. If you are a ***Noteholder that is an Account Holder*** and wish to vote for or against the appointment of any Nominated Director (if applicable), you should complete the appropriate parts of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) and deliver the completed Account Holder Letter as soon as possible to the Information Agent and, in any event, so as to be received before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013.

40. Part 5 (*Director Nominations*) of the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*) enables a Noteholder to vote for or against the appointment of any Nominated Director (if applicable). The details of the nomination of directors is described in Part B (*Overview of the Scheme*) of this Explanatory Statement and the procedure for voting for or against the appointment of any Nominated Directors is described in more detail in Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*).

41. **Failure to deliver a valid Account Holder Letter on behalf of a Noteholder by the Voting Instruction Deadline will mean that any vote for or against the appointment of any Nominated Directors will be disregarded for the purposes of determining whether any such appointment has been approved by the requisite majority of Noteholders.**

42. Completed Account Holder Letters for the purposes of voting for or against the appointment of any Nominated Directors should be delivered to the Information Agent. Account Holder Letters should not in any circumstances be delivered to any of the Common Depositaries, the Trustees, the Company or Co-operative Group or any other person. None of the Common Depositaries, the Trustees, the Company or Co-operative Group and any of their respective affiliates, officers, directors or employees or any other person will be under any duty to give notification of any defects,

irregularities or delays in any Account Holder Letter, nor will any of such entities or persons incur any liability for failure to give such notification**.**

Crest

43. If you are a Noteholder that holds your interests in the Dated Notes in Crest and are not a Crest participant, contact your Crest participant and the Information Agent as soon as possible in connection with participation in the Scheme (and any part thereof). Crest participants should contact the Information Agent immediately. In either case, please refer to paragraph 37 of Appendix 2 (*Instructions and guidance for Scheme Creditors and any person with an interest in the Dated Notes*) for more details.

44. If you are in any doubt as to what action you should take in connection with this Explanatory Statement, the proposals contained in it or the documents that accompany it, you are recommended to seek your own independent advice immediately from your legal, financial, tax or other independent adviser authorised under FSMA if you are resident in, have a registered address in, or are a citizen of the United Kingdom, or, if not, from another appropriately authorised independent financial adviser.

PART A

BACKGROUND TO AND REASONS FOR THE RECAPITALISATION PLAN

1. Introduction

On 17 June 2013, following the conclusion of the Company's review of its capital position and discussions with the PRA, the Company and Co-operative Group announced that the Company required additional aggregate Common Equity Tier 1 Capital of £1.5 billion. The Company and Co-operative Group also announced the initial details of the Recapitalisation Plan, which was intended to address this capital requirement. The Recapitalisation Plan consists of the Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Company's Existing Securities surrendered in the Liability Management Exercise. The Liability Management Exercise is expected to generate at least £1 billion of Common Equity Tier 1 Capital in 2013 and, conditional upon successful completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is expected to be contributed by CBGL during 2014, under the 2014 Commitment, of which £170 million is to be contributed by 30 June 2014 (with £70 million of this contribution to be paid by 31 January 2014) and the remaining £163 million by 31 December 2014.

The purpose of this Part A (*Background to and reasons for the Recapitalisation Plan*) is to set out the background to, and the reasons for, the Recapitalisation Plan and the potential consequences of Noteholders failing to support the Liability Management Exercise.

The key objective of the Recapitalisation Plan is to strengthen significantly the Company's Common Equity Tier 1 Capital base and this can only be achieved with the support and participation of Noteholders in the Liability Management Exercise. The Company's board, having explored extensively (both before the June Announcement and since that time) various potential means of strengthening the Company's capital position, remains of the view that the Recapitalisation Plan (notwithstanding the revisions to the Recapitalisation Plan announced on 4 November 2013) and the Liability Management Exercise that forms the cornerstone of the Recapitalisation Plan, is the only viable means of recapitalising the Company in a manner outside of a resolution procedure under the Banking Act 2009 (the **Banking Act**). If the initial details of the Recapitalisation Plan had not been announced in June, the Company believes it is likely that it would have been resolved almost immediately by the Bank of England or HM Treasury. The Recapitalisation Plan which was announced on 4 November 2013 is different from the initial plan announced in June but the Company believes that the revised Recapitalisation Plan is much better for all stakeholders than the plan previously announced.

Further details of the background to and components of the Recapitalisation Plan are set out in paragraphs 2, 3 and 6 of this Part A (*Background to and Reasons for the Recapitalisation Plan*, Part B (*Overview of the Scheme*), Part C (*Overview of the Liability Management Exercise*) and Part D (*Risk Factors*) of this Explanatory Statement (including the sections of the Bank T2 Notes Prospectus referred to therein), the Bank T2 Notes Prospectus and the Offer Memorandum.

The decision originally taken in June by Co-operative Group to support the Recapitalisation Plan was taken in the belief that the Recapitalisation Plan was in the long-term interest of all Co-operative Group's and the Company's respective stakeholders and of the Company itself. As explained in more detail in paragraph 5 below and Appendix 7 (*Resolution Analysis*) of this Explanatory Statement, absent the willingness of sufficient Noteholders to participate in and, where requested, to support the proposals being made in the Scheme and the Liability Management Exercise, the Company's board believes that the Company would be subject to a resolution procedure under the Banking Act. For a description of the resolution procedure under the Banking Act see paragraph 2.6 in section 17 (*Recovery and resolution regime*) at pages 402 and 403 of the Bank T2 Notes Prospectus.

In the event that the Company enters an insolvency procedure following action taken by the Resolution Authorities under the Banking Act, and as further described in Appendix 7 (*Resolution Analysis*) of this Explanatory Statement, the Company's board believes it likely that Noteholders would not receive any recovery in any such insolvency procedure and would not be entitled to any compensation as a result of a bank insolvency procedure of the Company). The Company also believes that there are fundamental uncertainties as to whether it is capable of being resolved as a going concern. The Company's board therefore believes that the Recapitalisation Plan represents the only realistic opportunity for Noteholders to recover any value in return for their investment in the Company.

The details of the Recapitalisation Plan have been discussed with the PRA, which announced on 29 August 2013 (and as reconfirmed to the Company on 21 October 2013) that its assessment remains that the Company has a capital shortfall of £1.5 billion relative to the requirement for 7 per cent. Common Equity Tier 1 Capital after adjustments.

The announcement of the Recapitalisation Plan in the June Announcement marked an important turning point for the Company and the Company's board continues to believe that the completion of the Recapitalisation Plan, as amended, will provide the foundations to support the long-term success of the Company in offering a real alternative to customers. The Company's strategy to achieve this goal is described in further detail in paragraphs 2 "*Key Strengths*" and 3 "*Strategy*" in section 8 (*Description of the Bank*) at pages 147 to 148 and 148 to 151 of the Bank T2 Notes Prospectus. Only following the implementation of the Liability Management Exercise and the other elements of the Recapitalisation Plan, will the Company be in a position to pursue this four to five year turnaround plan and seek to achieve the key targets described in paragraph 3 "*Strategy*" in section 8 (*Description of the Bank*) at pages 148 to 151 of the Bank T2 Notes Prospectus.

However, the support of Noteholders is critically important to the viability of the Company and it is only with their support that the Company will be able to move forward.

Further information on the Recapitalisation Plan (including a summary of the Liability Management Exercise) is set out in the Bank T2 Notes Prospectus. You should read the whole of this Explanatory Statement, including the Bank T2 Notes Prospectus (and its appendices) appended to this Explanatory Statement, and the documents (or parts thereof) incorporated therein by reference before taking any decision in connection with the Scheme.

2. Background to and reasons for the Recapitalisation Plan

The Company's capital shortfall

Common Equity Tier 1 Capital is a form of capital which banks and other financial institutions are required to maintain to help absorb losses in times of financial distress. As a direct result of the recent global financial crisis, the PRA, in line with banking regulators around the world, is requiring UK banks to bolster their capital resources so that the banks, and the UK banking system generally, are better able to withstand future asset write-downs and financial shocks.

In March 2013, a meeting of the then interim Financial Policy Committee (**FPC**), a part of the Bank of England responsible for macro-prudential regulation, voted unanimously that the PRA should take steps to ensure that, by the end of 2013, major UK banks and building societies, including the Company, hold capital resources equivalent to at least 7 per cent. of their risk-weighted assets assessed using the Basel III definition of equity capital but after:

(a) making deductions from currently-stated capital to reflect an assessment of expected future losses and a realistic assessment of future costs of conduct redress; and

(b) adjusting for a more prudent calculation of risk weightings. The FPC noted that, relative to that benchmark, major UK banks and building societies in aggregate had a shortfall in capital of around £25 billion. The PRA's calculation of capital adequacy was based on CRD IV definitions, applying them on a fully loaded basis with certain PRA adjustments (such adjustments to reflect the FPC's assessment of expected losses and future costs of conduct redress, and adjusting for a more prudent calculation of risk weights, amounting to £1.7 billion for the Company at that point in time).

Continuing losses in the first half of 2013 have reduced the Company's capital to a point where, if the Liability Management Exercise is not successfully completed, the Company will not remain a going concern. Following these losses, as at 30 June 2013 the Company's Core Tier 1 Capital ratio stands at 4.9 per cent. (2012: 8.8 per cent.) (i.e. which is the applicable test under Basel II) and at 3.0% on a Common Equity Tier 1 Capital basis (i.e. which is the applicable test under CRD IV). As a result, the Company has a significant capital shortfall against the PRA's target of a Common Equity Tier 1 Capital Ratio based on the Basel III/CRD IV definition of at least 7 per cent., and after any required adjustments. See section 13 (*Capital Adequacy*) at pages 232 to 243 of the Bank T2 Notes Prospectus for further details of the Company's capital position.

The Company remains dependent on the successful completion of the Recapitalisation Plan to return to compliance with its regulatory capital requirements.

For further details of CRD IV and its expected impact on the Company, please see Part D (*Risk Factors*) of this Explanatory Statement (including the sections of the Bank T2 Notes Prospectus referred to therein) and section 17 (*Supervision and Regulation*) at pages 397 to 408 of the Bank T2 Notes Prospectus.

The launch of the Recapitalisation Plan

On 17 June 2013, following the conclusion of the Company's review of its capital position and discussions with the PRA, it was stated in the June Announcement that the Company required additional aggregate Common Equity Tier 1 Capital of £1.5 billion, of which at least £1 billion is expected to be contributed pursuant to the Liability Management Exercise in 2013 and, conditional on completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is to be contributed by CBGL in 2014 pursuant to the 2014 Commitment (of which £170 million must be satisfied at the latest by 30 June 2014 (with £70 million of this contribution to be paid before 31 January 2014), and the remaining £163 million by 31 December 2014).

On 17 June 2013, the PRA made the following statement:

"*The PRA's current assessment is that the Co-operative Bank needs to generate an additional £1.5 billion in Common Equity Tier One capital in order to absorb potential losses over coming years. We will hold the Co-operative Group to the delivery of its plans. In relation to the Co-operative Bank this action will deliver the Financial Policy Committee's recommendation to the PRA in March regarding the capital position of the banking system*."

On 29 August 2013, the PRA reconfirmed its assessment of the Company's capital shortfall of £1.5 billion of Common Equity Tier 1 Capital following the announcement of the Company's interim results for the six month period ended 30 June 2013. The PRA also reconfirmed that this requirement remained unchanged following the announcement by the Company on 21 October 2013 of an expectation of an increase in its overall provisions of approximately £103 million relating to customer redress. The Liability Management Exercise is intended to generate at least £1 billion of the required £1.5 billion of Common Equity Tier 1 Capital by the end of 2013. Successful completion of the Liability Management Exercise is conditional upon the entire principal amount of all Existing Securities being exchanged or sold pursuant to the Liability Management Exercise.

The contributions that a successful Liability Management Exercise would provide by the end of 2013 would increase the Company's Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9 per cent. but above the regulatory minimum requirement" by the end of 2013, including after taking into account the impact of the impairment charges of £496.0 million incurred for the six month period ended 30 June 2013 and potential impairment charges for the remainder of the Company's financial year ending 31 December 2013.

3. The Recapitalisation Plan

The key objective of the Recapitalisation Plan is to strengthen significantly the Company's Common Equity Tier 1 Capital base and to refocus the Company's strategy around its strength in core relationship retail banking providing current accounts, residential mortgages and savings products to retail customers and SMEs. The Liability Management Exercise forms a critical element of the Recapitalisation Plan. The Liability Management Exercise is intended to generate at least £1 billion of the £1.5 billion of Common Equity Tier 1 Capital required by the Company. The Liability Management Exercise will generate Common Equity Tier 1 Capital in two ways:

- first, to the extent that the Company exchanges Dated Notes for New Ordinary Shares and issues Additional New Ordinary Shares pursuant to the Scheme, the amount of such New Ordinary Shares and Additional New Ordinary Shares issued will constitute Common Equity Tier 1 Capital for the Company; and

- second, to the extent that Existing Securities are exchanged or sold for New Securities at a discount to the Company's book value of those Existing Securities (i.e. by imposing a discount on the Existing Securities through the Liability Management Exercise), the amount of that discount will also be recognisable as Common Equity Tier 1 Capital (on the basis that the Company will reduce a liability for less than the book value of that liability in the Company's accounts).

The offers in respect of the Preference Shares and Perpetual Subordinated Bonds are being conducted by way of the Exchange Offers and the Proposals. The offer in respect of the Dated Notes is being conducted by way of the Scheme. The Liability Management Exercise will only be successfully completed if the entire principal amounts of the Existing Securities are exchanged or sold pursuant to the Liability Management Exercise.

The Scheme also provides that 33,333,334 ordinary shares will be made available to Noteholders for subscription for an aggregate consideration equal to £125,000,002.50 on the terms of the Additional New Ordinary Shares Offer, as described in Part B (*Overview of the Scheme*) of this Explanatory Statement.

The Exchange Offers, the Proposals and the Scheme are collectively referred to in this Explanatory Statement as the Liability Management Exercise. In addition, as part of the Liability Management Exercise the Preference Shareholders and 13% Bondholders will have the option to either exchange their Existing Securities for Final Repayment Notes or sell their Existing Securities to Co-operative Group for cash consideration payable in instalments (represented by Instalment Repayment Notes). Each Preference Shareholder and 13% Bondholder will have the opportunity to choose whether it would prefer to receive Final Repayment Notes or Instalment Repayment Notes (if the Liability Management Exercise is successfully completed) each to be issued by Co-operative Group pursuant to the Group Notes Prospectus.

In addition, the Company expects that capital created through interest savings on the Existing Securities surrendered in the Liability Management Exercise net of any coupon payments on the New Securities should contribute an additional amount of Common Equity Tier 1 Capital towards

the Recapitalisation Plan, beyond that created as a result of the Liability Management Exercise. The Company currently estimates that net interest savings should result in allowable Common Equity Tier 1 Capital in the region of £40 million during the course of 2014.

2014 Commitment

Under the Recapitalisation Plan, CBGL has agreed to contribute £333 million of Common Equity Tier 1 Capital during 2014 (the **2014 Commitment**). On 4 November 2013 (being the date of the launch of the Recapitalisation Plan), CBGL entered into a legally binding and irrevocable undertaking to pay (the **Undertaking to Pay**) in favour of the Company in consideration for the issuance of 54,058,442 New Ordinary Shares immediately prior to the completion of the Liability Management Exercise (the **2014 Commitment Agreement**). CBGL's obligations under the 2014 Commitment and the Undertaking to Pay are conditional only upon the successful completion of the Liability Management Exercise.

As announced on 17 June 2013, CBGL is expecting to satisfy the 2014 Commitment from the net proceeds of the sale by CBGL of Royal London (CIS) Limited (formerly known as Co-operative Insurance Society Limited) and Royal London Asset Management (CIS) Limited (formerly known as The Co-operative Asset Management Limited) (**Co-operative Life Insurance and Asset Management**) and the net proceeds of the proposed sale of CIS General Insurance Limited (CIS General Insurance) (together the **Insurance Proceeds**). The sale of Co-operative Life Insurance and Asset Management to The Royal London Mutual Insurance Society Limited (**Royal London**) completed on 31 July 2013. The total consideration for the sale is £219.0 million, of which £39.0 million has already been paid to CBGL in respect of the disposal of Royal London (CIS) Limited. Payment of the remaining £180 million (as deferred consideration) is subject to the approval of the court under a transfer of the life insurance fund of Co-operative Life Insurance Society Ltd (now named RL (CIS) Ltd) into Royal London under Part VII of FSMA. There is no certainty as to timing or outcome of the court process and therefore no certainty as to when the deferred consideration may be received by CBGL or if it will be received at all. In respect of the disposal of CIS General Insurance, the Company has been told that, whilst Co-operative Group is currently in discussions with various interested parties to sell CIS General Insurance, as at 18 November 2013, no legally binding agreement to sell CIS General Insurance has been entered into and any such agreement may, when entered into, be subject to various conditions precedent.

To provide support to CBGL's obligations under the Undertaking to Pay should the Insurance Proceeds not materialise or be insufficient to satisfy the Undertaking to Pay, CBGL has entered into an intra-group loan with Co-operative Group and the Company (the **Intra-group Loan**). The Intra-group Loan allows CBGL to draw down sufficient amounts to satisfy the Undertaking to Pay taking into account CBGL's existing cash resources and is intended to be unconditional before 2014 (see paragraph 20.6 "*Intra-group Loan*" in section 20 (*Additional Information*) at page 461 of the Bank T2 Notes Prospectus). CBGL, under the terms of the Intra-group Loan is obliged to pay any amounts drawn down under that loan to the Company in satisfaction of the Undertaking to Pay.

Co-operative Group has informed the Company that it has appropriate arrangements in place to satisfy the discharge of its obligations under the Intra-group Loan from alternative resources in the event that the Insurance Proceeds are not sufficient to satisfy the amount of the 2014 Commitment or otherwise not received in time to satisfy the PRA's required timing to satisfy the 2014 Commitment. For further details, see the risk factor titled "*The commitment by Banking Group to contribute £333 million of Common Equity Tier 1 Capital during 2014, in addition to being solely conditional upon the successful completion of the Liability Management Exercise, is subject to the ability of Banking Group and/or Co-operative Group to fund the commitment, which is dependent on certain actions, some of which are partially outside the control of Co-operative Group*" in section 2 (*Risk Factors*) at pages 55 to 57 of the Bank T2 Notes Prospectus.

The Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Company's Existing Securities are together referred to in this Explanatory Statement as the Recapitalisation Plan.

Structure of the 2014 Commitment

The 2014 Commitment has been structured as follows:

(a) The 54,058,442 ordinary shares of the Company to be issued to CBGL against the Undertaking to Pay will be issued immediately following the implementation of the Scheme in accordance with its terms (including the issue of Additional New Ordinary Shares in accordance with the Scheme and the Additional New Ordinary Shares Offer). The ordinary shares of the Company issued in consideration for the Undertaking to Pay will be fully paid up for the purposes of the Companies Act and will be freely transferable (subject to the lock-up restrictions imposed under the 2014 Commitment Agreement, which are to be superseded by the lock-up restrictions imposed in the Relationship Agreement between CBGL, Co-operative Group and the Company once this comes into force (as described in paragraph 20.3 "*Relationship Agreement*" in section 20 (*Additional Information*) at pages 455 to 457 of the Bank T2 Notes Prospectus) and fungible with all other ordinary shares of the Company. The ordinary shares of the Company issued against the Undertaking to Pay, which will be issued in the same exchange ratio as the New Ordinary Shares to be issued to Holders of the Dated Notes pursuant to the Scheme, will represent 21.6 per cent. of the ordinary shares of the Company in issue at completion of the Liability Management Exercise.

(b) The Undertaking to Pay does not generate Common Equity Tier 1 Capital of the Company until such time as the cash proceeds of the undertaking are received by the Company.

(c) The 2014 Commitment requires CBGL to deliver the cash proceeds to discharge the relevant proportion of the Undertaking to Pay by such dates as to satisfy the PRA's timing requirements. The PRA has stipulated that the 2014 Commitment must be satisfied in two tranches, with £170 million payable by 30 June 2014 and £163 million payable after 30 June 2014 but not later than 31 December 2014. In the 2014 Commitment Agreement, CBGL has agreed to contribute the 2014 Commitment and satisfy the Undertaking to Pay in a number of tranches, with (i) £20 million payable by no later than 31 December 2013; (ii) £50 million by no later than 31 January 2014; (iii) £100 million by no later than 30 June 2014; and (iv) £163 million by no later than 31 December 2014. In addition, following receipt by CBGL of the Co-operative Life Insurance and Asset Management Deferred Consideration or the net proceeds of the disposal of CIS General Insurance, CBGL is required to apply such proceeds as soon as reasonably practicable following receipt of such proceeds in satisfaction of the Undertaking to Pay (in part or in full as the case may be).

See paragraph 20.4 "*2014 Commitment Agreement*" in section 20 (*Additional Information*) at pages 457 to 460 of the Bank T2 Notes Prospectus for more details of the 2014 Commitment.

(d) The Intra-group Loan allows CBGL to draw down sufficient amounts to satisfy the Undertaking to Pay taking into account CBGL's existing cash resources and is intended to be unconditional before 2014 (and is only subject to a small number of customary conditions precedent – see the paragraph number 20.6 "*Intra-group Loan*" in section 20 (*Additional Information*) at page 461 of the Bank T2 Notes Prospectus for further details). CBGL, under the terms of the Intra-group Loan is obliged to pay any amounts drawn down under that loan to the Company in satisfaction of the Undertaking to Pay.

4. Impact of the successful implementation of the Liability Management Exercise

The Liability Management Exercise, if successful, will generate at least £1 billion of Common Equity Tier 1 Capital for the Company being comprised of the Common Equity Tier 1 Capital generated pursuant to the Exchange Offers, the Proposals and the Scheme, together with £125,000,002.50 in respect of the Additional New Ordinary Shares Offer under the Scheme. The completion of the Liability Management Exercise will, in turn, mean that the Undertaking to Pay will become unconditional and, when taking into account the allowable capital benefits from interest savings on Existing Securities surrendered as a result of the Liability Management Exercise, means the Company will be in a position to satisfy the requirement that the Company raise an additional £1.5 billion of Common Equity Tier 1 Capital by the end of 2014.

Assuming the Liability Management Exercise is completed and therefore at least £1 billion of Common Equity Tier 1 Capital is raised in respect of the Exchange Offers, the Proposals and the Scheme, and £125,000,002.50 is in 2013 raised pursuant to the Additional New Ordinary Shares Offer under the Scheme, the Company expects to report, for the end of 2013, a Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9 per cent. but above the regulatory minimum requirement". Taking into account the benefit of the additional Common Equity Tier 1 Capital to be provided by CBGL to satisfy the 2014 Commitment and a reduction in risk weighted assets, partially offset by expected losses in the Company in 2014, it is currently expected that the Company's Common Equity Tier 1 Capital ratio will remain broadly stable, improving only modestly from this level in the coming years. The Company expects to achieve a leverage ratio above the regulatory minimum by the end of 2014.

5. Consequences of a failure of the Liability Management Exercise

The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities are exchanged or sold pursuant to the Liability Management Exercise. The Liability Management Exercise cannot succeed unless the Scheme is implemented.

As stated in the June Announcement, Co-operative Group and the Company continue to believe that the Recapitalisation Plan (including in its revised form), of which the Liability Management Exercise forms an integral part, is in the long-term interests of their respective stakeholders and of the Company itself.

Absent the support of sufficient Noteholders to participate in and, where requested, approve the proposals being made in the Scheme, the Scheme and therefore the Liability Management Exercise will fail.

The uncertainty around the implementation of the Recapitalisation Plan constitutes a material uncertainty which casts significant doubt on the Company's ability to continue as a going concern. The Company's Interim Financial Information, therefore, included an emphasis of matter statement as to the Company's ability to continue as a going concern (see note 2 to the Interim Financial Information for further details of the going concern position of the Company contained in part A in section 16 (*Financial Information*) at pages 278 to 396 of the Bank T2 Notes Prospectus).

Given the discretionary nature of the powers available to the Resolution Authorities under the Banking Act, the Company is unable to predict with certainty the precise outcome for Noteholders, if the Scheme and the Liability Management Exercise are not successfully implemented during 2013. However, the Company has no other source available to it to raise the required additional capital. As stated in the Company's Interim Financial Information, if the Liability Management Exercise is not successfully completed, the Company will cease to be a going concern and the Company considers that it is likely to fail to satisfy its threshold conditions for authorisation (within the meaning of Section 55B of FSMA). In such circumstances, the relevant Resolution Authority may then exercise

a stabilisation power under the Banking Act. These threshold conditions include a requirement that the PRA is satisfied that the Company, in particular, has appropriate financial and non-financial resources, including that the Company has made appropriate provisions for its liabilities. In addition, the Resolution Authorities may also exercise their powers to resolve the Company even if it remains a going concern.

If the Scheme and the Liability Management Exercise are not successfully implemented on or before 31 December 2013, the Company therefore considers that the PRA would have a basis for determining that the Company is failing, or is likely to fail, to satisfy its threshold conditions; that the power of the Resolution Authorities to exercise stabilisation powers under the Banking Act had arisen; and the Company believes that it is likely that it would be subject to a resolution procedure under the Banking Act. The Company therefore believes that there are only two realistic outcomes for the Company, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Company becoming subject to a resolution procedure under the Banking Act.

For further details of the risks of the Scheme and the Liability Management Exercise, see Part D (*Risk Factors*) of this Explanatory Statement (including the sections of the Bank T2 Notes Prospectus referred to therein). For further information on the consequences of a failure of the Scheme and therefore the Liability Management Exercise, see Appendix 7 (*Resolution Analysis*) of this Explanatory Statement.

6. Details of the Liability Management Exercise

The Liability Management Exercise being conducted by the Company and Co-operative Group involves inviting the Holders of the Existing Securities to exchange or sell their Existing Securities for New Securities to be issued by the Company and, in certain cases, Co-operative Group.

Details of the Liability Management Exercise can be found in Part C (*Overview of the Liability Management Exercise*) and in the Offer Memorandum which is appended to and forms part of the Bank T2 Notes Prospectus, which is appended to this Explanatory Statement at Appendix 9 (*Bank T2 Notes Prospectus*).

PART B

OVERVIEW OF THE SCHEME

This section contains a brief overview of the Scheme. The summary information contained herein does not purport to be complete and should be read in conjunction with, and is qualified in its entirety by references to, the more detailed information presented elsewhere in this Explanatory Statement and to the Scheme.

1. SCHEME OF ARRANGEMENT OVERVIEW

1.1 The proposed restructuring is proposed to be effected by way of a scheme of arrangement of the Company under the laws of England and Wales.

1.2 A scheme of arrangement is a formal procedure under Part 26 of the Companies Act 2006 which enables a company to agree a compromise or arrangement with its creditors or any class of its creditors in respect of its debts or obligations owed to those creditors. A scheme of arrangement requires the following to occur in order to become legally binding:

(a) the approval of a majority in number representing at least 75 per cent. in value of the creditors or class of creditors present in person or by proxy and voting at the meeting convened to approve the scheme of arrangement;

(b) the approval of the Court by the making of an order sanctioning the scheme of arrangement; and

(c) the delivery of the order sanctioning the scheme of arrangement to the Registrar of Companies.

1.3 If the scheme of arrangement is approved by the requisite majorities and sanctioned by the Court and the order sanctioning the scheme of arrangement is delivered to the Registrar of Companies, the scheme of arrangement will become effective in accordance with its terms and bind all the creditors subject to it, both those creditors who voted in favour of it and those creditors who voted against it or did not vote at all.

1.4 A scheme of arrangement cannot be sanctioned by the Court unless the Court is satisfied, among other things, that the relevant provisions of Part 26 of the Companies Act 2006 have been complied with and an intelligent and honest person, a member of the class concerned and acting in respect of his own interest, might reasonably approve the scheme of arrangement.

1.5 The role of the Scheme Creditors in the implementation of the Scheme is set out in detail in Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*) of this Explanatory Statement, to which Scheme Creditors should refer.

1.6 A summary of: (i) the identity of Scheme Creditors; (ii) the process for and voting at the Scheme Meeting; and (iii) when the Scheme will become effective, is set out below.

Identity of Scheme Creditors

1.7 The Scheme is being proposed by the Company in respect of the Scheme Claims of the Scheme Creditors. The Scheme Creditors consist of:

(a) the direct creditors in respect of the Scheme Claims - the Common Depositaries as holders of the Global Notes and the Trustees solely as the beneficiaries of the covenants to repay principal and pay interest on the Dated Notes pursuant to the Trust Deeds; and

(b) the contingent creditors in respect of the Scheme Claims - the Noteholders as the beneficial owners of and/or the persons with the ultimate economic interest in the Dated Notes.

1.8 The Noteholders, as the beneficial owners of and/or the persons with the ultimate economic interest in the Dated Notes, are the persons with the "real" interest in the Scheme Claims and accordingly they will be entitled to vote in respect of the Scheme. To avoid double counting in respect of the Scheme Claims, each of the Trustees and the Common Depositaries has confirmed in writing that it will not exercise any voting rights to which it may be entitled as a Scheme Creditor. This has been done to ensure an orderly voting procedure and is considered by the legal advisers to the Company to represent current market practice in this type of situation. For this reason, in certain instances in this Explanatory Statement the Noteholders are referred to rather than Scheme Creditors as the Noteholders will be the Scheme Creditors that vote at the Scheme Meeting.

Scheme Meeting – process and voting

General

1.9 The Company considers that:

(a) as described in more detail in Part A (*Background to and Reasons for the Recapitalisation Plan*) there are only two realistic outcomes for the Company following the launch of the Liability Management Exercise, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Company being subject to a resolution procedure pursuant to one or more of the stabilisation options available to the Bank of England or HM Treasury under the Banking Act. The Company believes that its recapitalisation through the Liability Management Exercise would be substantially more beneficial to the Noteholders, the Preference Shareholders, the 5.5555% Bondholders and the 13% Bondholders than resolution of the Company; and

(b) if the Company is resolved and goes into an insolvency proceeding as a result of that resolution, the Noteholders would not receive any recovery in respect of the Dated Notes in any such insolvency proceedings and would not be entitled to any compensation under the resolution arising from their holdings of the Dated Notes, as described in Appendix 7 (*Resolution Analysis*). Further, the Company considers that there are fundamental uncertainties as to whether the Company could be successfully resolved such that the Company itself remained a going concern without the active participation of Co-operative Group and a substantial amount of additional capital.

1.10 The Company considers that the rights of all the Scheme Creditors (including, without limitation, the right to participate in the Additional New Ordinary Shares Offer) are sufficiently similar so as to make it possible for them to consult together with a view to a common interest because:

(a) as unsecured creditors of the Company, subordinated to all unsecured unsubordinated creditors of the Company, and ranking *pari passu* as between themselves in the Company's

capital structure, they have materially the same rights against the Company and, as described in paragraph 1.9 above, are unlikely to receive any recovery if the Company is subject to a resolution procedure and enters into an insolvency proceeding; and

(b) if the Scheme becomes effective in accordance with its terms, those rights will be compromised in materially the same way,

irrespective of the fact that some Scheme Creditors may hold different series of the Dated Notes.

1.11 Accordingly, the Company has concluded that it is appropriate for the Scheme Creditors (i.e. all Noteholders) to vote together as one class at the Scheme Meeting.

1.12 The Scheme Meeting for the purpose of considering and, if thought fit, approving the Scheme has been ordered to be convened by the Court.

1.13 A notice of the Scheme Meeting to be held on 16 December 2013 is set out in Appendix 4 (*Notice of Scheme Meeting*). For the avoidance of doubt and as the Scheme is subject to an order of the Court, the procedure for the Scheme Meeting is as set out in Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*) and not the procedures for convening noteholder meetings as set out in any of the Trust Deeds.

Voting

1.14 Noteholders should refer to the detailed instructions in relation to voting at the Scheme Meeting in the section entitled *Summary of actions to be taken by Scheme Creditors and any person with an interest in the Dated Notes* at pages 21 to 27 above and Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*). Each Noteholder will be required to ensure that its Account Holder has completed and submitted to the Information Agent a valid Account Holder Letter so that it is received by the Information Agent before the Voting Instruction Deadline (being 4.30 p.m. (London time) on 13 December 2013) in order to vote at the Scheme Meeting. Noteholders may vote at the Scheme Meeting either in person or by proxy

1.15 **If a Noteholder has not submitted a valid Account Holder Letter for the purposes of voting to the Information Agent before the Voting Instruction Deadline, that Noteholder will not be entitled to vote at the Scheme Meeting.**

Voting Value

1.16 The 2016 Notes are denominated in Euro and the other series of the Dated Notes are denominated in Sterling. As the Noteholders will be voting in a single class, the Scheme Claims in respect of the 2016 Notes and the other series of the Dated Notes must be in a common currency in order to determine whether the Scheme has been approved at the Scheme Meeting by the statutory majorities of Scheme Creditors. Accordingly, the Scheme Claims in respect of the 2016 Notes of each Noteholder which is entitled to vote at the Scheme Meeting shall be notionally converted into Sterling at the Scheme FX Rate for the purposes of calculating the value of those Scheme Claims in connection with voting at the Scheme Meeting.

1.17 The Scheme FX Rate was determined by the Company on 30 October 2013 on the basis of the rate appearing on or derived from the Bloomberg service designated as the "*FXC*" page for the purpose of displaying the rate of exchange between Sterling and Euro as a rate of £0.85644 to €1.

1.18 The Scheme FX Rate has been fixed by the Company prior to the date of this Explanatory Statement in order to create transparency in relation to the treatment of the 2016 Notes under the terms of the Scheme and to assist Noteholders in determining what their entitlements to Scheme Consideration

and will be if the Scheme is sanctioned by the Court and implemented and whether to elect to participate in the Additional New Ordinary Shares Offer, in particular given the nature of the Additional New Ordinary Shares Offer. The fixing of the Scheme FX Rate prior to the date of this Explanatory Statement is intended to ensure that these determinations are not affected by volatility in the exchange rate between Euro and Sterling.

1.19 As described in paragraphs 2.12 to 2.15 below, the Scheme FX Rate is also used for the purposes of determining entitlements to Scheme Consideration and the allocation of Additional New Ordinary Shares pursuant to the terms of the Additional New Ordinary Shares Offer in respect of the 2016 Notes.

The Lock-up Arrangements

1.20 In October 2013, the Company entered into confidentiality agreements with certain Noteholders in order to facilitate discussions relating to the Liability Management Exercise. As a result of these discussions, Noteholders in respect of approximately 48 per cent. of the principal amount outstanding of the Dated Notes in aggregate (with the principal amount outstanding of the 2016 Notes for the purposes of this calculation notionally converted from Euro into Sterling at the Scheme FX Rate) entered into Lock-Up Agreements (as defined in paragraph 1.21(a) below) with the Company and Co-operative Group on 4 November 2013.

1.21 As originally set out in the Offer Memorandum, each Noteholder who has not already done so is being given the opportunity to enter into a Lock-up Arrangement with the Company either by:

(a) entering into a bilateral agreement with the Company and Co-operative Group (referred to as **Lock-up Agreements**); or

(b) instructing its Account Holder in the Account Holder Letter delivered on behalf of that Noteholder to give undertakings on behalf of that Noteholder in that Account Holder Letter (referred to as **Lock-up Undertakings**),

in each case pursuant to which that Noteholder agrees, among other things and subject to certain conditions, to vote its Scheme Claim in favour of the Scheme.

1.22 The undertakings provided by each Noteholder who enters into a Lock-up Arrangement are substantially the same irrespective of whether a Noteholder locks-up by way of a Lock-up Agreement or a Lock-Up Undertaking. Both the form of Lock-up Agreement and Lock-Up Undertaking provide that a Noteholder will, amongst other things:

(a) attend the Scheme Meeting by proxy or in person and exercise and cast all of its votes in respect of its Dated Notes which are subject to the Lock-up Arrangement (the **Locked-up Notes**) in favour of the Scheme and any amendment or modification to the Scheme or adjournment to the Scheme Meeting, provided that they are proposed by the Company and that the terms of the Scheme as amended or modified are and remain consistent in all material respects with the terms of the Scheme without such amendments or modifications and are consistent with and do not include any additional material terms which are likely to adversely affect or conflict with the terms of the Proposed Restructuring or its implementation;

(b) except where the undertaking set out in paragraph 1.22(a) applies, exercise and cast all of its votes in respect of its Locked-up Notes against any amendment or modification to the Scheme or any proposal to adjourn the Scheme Meeting;

(c) not commence or request or instruct that any Trustee or any other person commence proceedings against the Company or take any other action in connection with any Note Event of Default or Potential Note Event of Default arising as a result of an application for or the making of the Scheme or the Proposed Restructuring;

(d) not commence, take, support or actively assist (or request, instruct or procure that any other person commence, take, support, or actively assist) any judicial, arbitration, regulatory proceedings or any other action inconsistent with the terms of the Lock-up Agreement or Lock-up Undertaking (as applicable) or the Scheme, that would reasonably be expected to impede, prevent or frustrate the implementation of the Scheme or the Proposed Restructuring;

(e) promptly notify the Company, by sending a written notice (a **Locked-up Notes Notice**) in the relevant form (in the case of a Noteholder who has entered into a Lock-up Agreement) or an additional Account Holder Letter (in the case of a Noteholder who has entered into a Lock-up Undertaking, with Part 2 Section 2 (*Lock-up*) of that Account Holder Letter duly completed to provide the undertakings described in this paragraph 1.22) by email to the Company and/or the Information Agent of any change (whether an increase or decrease) to the aggregate principal at issue amount of its Locked-up Notes and upon actual receipt of a request in writing from the Company (or an agent acting on its behalf) provide such other information in relation to any Scheme Claim (to the extent such information cannot be obtained from any Locked-up Notes Notice (in the case of a Noteholder who has entered into a Lock-up Agreement) or an additional Account Holder Letter (in the case of a Noteholder who has entered into a Lock-up Undertaking)) as the Company (or an agent acting on its behalf) may reasonably require in order to enable it to calculate any Scheme Consideration; and

(f) promptly provide to the Company (or an agent acting on its behalf), upon actual receipt of a request in writing from the Company (or an agent acting on its behalf), written confirmation of the aggregate principal amount of its Locked-up Notes.

1.23 In addition, each Lock-up Arrangement provides that the Noteholder agrees that it will not sell, transfer, assign or otherwise dispose of any interests in all or any part of its Locked-up Notes to any person unless that person has already executed and delivered to the Company a Lock-up Agreement or Lock-up Undertaking (as applicable) which Lock-up Arrangement has not terminated and provided that such Dated Notes shall constitute Locked-up Notes of that person pursuant to that Lock-up Arrangement.

1.24 In the form of Lock-up Agreement (but not in the Lock-up Undertaking), the Company and Co-operative Group undertake to the relevant Noteholder as follows:

(a) neither the Company nor Group shall, and Co-operative Group shall ensure that CBGL shall not, take, encourage or support (or procure that any other person takes, encourages or supports) any action which would be, or would be reasonably expected to be inconsistent with the Lock-up Agreement or the implementation of the Proposed Restructuring, or delay, impede or prevent the implementation of the Proposed Restructuring

(b) each of the Company and Group shall (and Group shall ensure that CBGL shall) cooperate with, actively assist and take all actions and steps to implement the Proposed Restructuring on or before the Longstop Date including, without limitation:

(i) taking all reasonable steps to obtain any necessary consents or authorisations required to implement the Proposed Restructuring;

(ii) executing and delivering (as applicable) any and all documents which may be necessary to give effect to the Proposed Restructuring (including, without limitation, the Proposed Restructuring Documents);

(iii) proposing and filing any legal process or proceedings contemplated by or required to implement the Proposed Restructuring;

(iv) calling all creditor meetings required to implement the Proposed Restructuring including, without limitation, any adjourned meetings;

(c) neither the Company nor Co-operative Group shall:

(i) assign, transfer or otherwise deal with any of its rights or obligations under the Lock-up Agreement; or

(ii) take or consent to the taking of any action which supports or favours any proposed composition, compromise, assignment or arrangement with any creditor of the Company or Co-operative Group other than pursuant to the implementation and consummation of the Proposed Restructuring or the Lock-up Agreement excluding for these purposes any proposed amendment or variation to the Proposed Restructuring; and

(d) Co-operative Group shall not sell, transfer, assign or otherwise dispose of any of its equity interest in the Company.

1.25 The undertakings described in paragraph 1.24 above do not apply to any action which is expressly contemplated by the Proposed Restructuring.

1.26 In addition to the above, the form of Lock-up Agreement (but not the Lock-up Undertaking) provides that the Company will, amongst other things:

(a) propose the Scheme and seek the approval of the Scheme Creditors and sanction of the Scheme by the English court and ensure the Scheme Settlement Date occurs as soon as reasonably practicable;

(b) use all reasonable endeavours to procure that the chairman of the Scheme Meeting admits the value of the Locked-up Notes of the relevant Noteholder as at the Record Date for the purposes of voting at the Scheme Meeting. It is acknowledged by the parties to the relevant Lock-up Agreement that any admission of claims by the chairman of the Scheme Meeting for the purposes of voting at the Scheme will not amount to an admission of such claim for any purpose other than voting at the Scheme Meeting; and

(c) procure that a public notice is issued on the Scheme Settlement Date (or failing which on the Business Day following the Scheme Settlement Date) on the London Stock Exchange, stating that the Scheme Settlement Date has occurred and the date on which it has occurred.

1.27 Each form of the Lock-up Arrangement provides that the Lock-up Arrangement will terminate immediately upon the occurrence of any of the following events:

(a) at a Scheme Meeting at which a vote takes place, the Scheme is not approved by the requisite majorities of the Scheme Creditors specified in section 899(1) of the Companies Act;

(b) on the earlier of the Scheme Settlement Date and the Longstop Date; and

(c) the Company gives the Noteholder who is party to the relevant Lock-up Arrangement or any other Noteholder written notice of an intention either:

(i) not to proceed with the Scheme; or

(ii) to proceed with a proposed scheme of arrangement on terms which are different to the Scheme in any material respect;

(d) the Noteholder who is party to the relevant Lock-up Arrangement sells, transfers, assigns or otherwise disposes of all of its Locked-up Notes in accordance with the terms of the relevant Lock-up Arrangement (as described in paragraph 1.23 above); and

(e) if:

(i) the 5.5555% Bondholders vote against the proposals (to the extent related to the 5.5555% Bonds) contemplated in the relevant Proposed Restructuring Documents at the 5.5555% Bondholders Meeting;

(ii) the 13% Bondholders vote against the proposals (to the extent related to the 13% Bonds) contemplated in the relevant Proposed Restructuring Documents at the 13% Bondholders Meeting; or

(iii) the Preference Shareholders vote against the proposals (to the extent related to the Preference Shares) contemplated in the relevant Proposed Restructuring Documents at the Preference Shareholders Meeting.

The form of Lock-up Agreement (but not the Lock-up Undertaking) includes additional rights which permit the Company and the relevant Noteholder to terminate the relevant Lock-up Agreement in certain circumstances.

1.28 Any Noteholder that has not entered into a Lock-up Arrangement at the date of this Explanatory Statement and wishes to take steps to do so, may still do so by entering into a Lock-Up Arrangement prior to the Voting Instruction Deadline and performing its obligations thereunder. Any Noteholder wishing to enter into a Lock-up Arrangement should contact the Information Agent for assistance or in respect of any questions that Noteholder has in relation to what steps it needs to take in order to enter into a Lock-up Arrangement.

When will the Scheme be effective?

Scheme Sanction Hearing

1.29 Under Part 26 of the Companies Act 2006, a scheme of arrangement becomes effective in accordance with its terms and is binding on the company and creditors subject to it when the order of the Court sanctioning the scheme of arrangement is delivered to the Registrar of Companies. The Company expects that the Scheme Sanction Hearing will take place on or about 18 December 2013. Once the date of the Scheme Sanction Hearing is confirmed by the Court, the Company will give notice to the Scheme Creditors through the Clearing Systems and on the Scheme Website at *http://www.co-operative.coop/Bondholders*.

1.30 At the Scheme Sanction Hearing the Company may consent on behalf of all Scheme Creditors to any modification of the Scheme or any term or condition which the Court may think fit to approve or impose and which would not directly or indirectly have a material adverse effect on the interests of any Scheme Creditor under the Scheme.

The Scheme Effective Date

1.31 Pursuant to the Scheme, following:

(a) approval by a majority in number representing at least 75 per cent. in value of the Scheme Claims of the Scheme Creditors present and voting either in person or by proxy at the Scheme Meeting;

(b) the granting by the Court of an order sanctioning the Scheme; and

(c) the delivery of the order sanctioning the Scheme to the Registrar of Companies,

the Scheme Effective Date will occur and certain provisions of the Scheme (described below under the headings *Authority to execute documents on behalf of Scheme Creditors* and *Key Elements of the Scheme* at paragraphs 2.5 to 2.7 and 2.47) will become operative.

The Scheme Settlement Date, the Scheme Settlement Date Condition and the Longstop Date

1.32 Following the occurrence of the Scheme Effective Date, certain authorisations, instructions and obligations take effect under the Scheme.

1.33 The occurrence of the Scheme Settlement Date is conditional upon: (i) an amount in cleared funds equal to or greater than £125,000,000 standing to the credit of the Subscription Escrow Account in connection with the Additional New Ordinary Shares Offer and (ii) the satisfaction of the Scheme Settlement Condition. The Additional New Ordinary Shares Offer is described in greater detail in paragraphs 2.22 to 2.30 below.

1.34 The Scheme Settlement Condition will be satisfied if, on the Scheme Settlement Condition Testing Date:

(a) the Scheme Effective Date has occurred;

(b) the Proposal in respect of the Preference Shares (i) has been approved by the requisite majority of the Preference Shareholders at the Preference Shareholders Meeting (and a resolution in similar terms must also be approved at a general meeting of the shareholders of the Company) and (ii) is capable of being implemented in accordance with the terms of that Proposal as set out in the Offer Memorandum;

(c) the Proposal in respect of the 5.5555% Bonds (i) has been approved by the requisite majority of the 5.5555% Bondholders at the 5.5555% Bondholders Meeting and (ii) is capable of being implemented in accordance with the terms of that Proposal as set out in the Offer Memorandum; and

(d) the Proposal in respect of the 13% Bonds (i) has been approved by the requisite majority of the 13% Bondholders at the 13% Bondholders Meeting and (ii) is capable of being implemented in accordance with the terms of that Proposal as set out in the Offer Memorandum.

1.35 As soon as reasonably practicable after determining that the Scheme Settlement Condition has been satisfied, the Company shall give the Noteholders notice by the issue of an announcement through the Clearing Systems and on the Scheme Website at *http://www.co-operative.coop/Bondholders*.

1.36 The Company shall procure that the Scheme Settlement Date occurs as soon as reasonably practicable following the satisfaction of the conditions referred to in paragraph 1.33 above. Once any steps required to take place prior to the Scheme Settlement Date have been completed in accordance with the terms of the Scheme, the Scheme Settlement Date will occur and the Scheme Consideration will be delivered.

1.37 If the Scheme Settlement Date does not occur on or before 31 December 2013 (referred to in the Scheme as the Longstop Date), the terms of and the obligation on the parties under or pursuant to the Scheme shall lapse and all the compromises and arrangements provided by the Scheme shall be of no effect.

2. WHAT WILL THIS SCHEME DO?

2.1 The Scheme is a compromise and arrangement between the Company and the Scheme Creditors. As the Scheme can only bind the Company and the Scheme Creditors, certain third parties which will be required to perform actions in accordance with the terms of the Scheme have entered, or are expected to enter prior to the date of the Scheme Sanction Hearing, into deeds of undertaking and/or have agreed, or are expected to agree prior to the date of the Scheme Sanction Hearing, to appear at Court to undertake to perform those actions and, where necessary, be bound by the terms of the Scheme. These undertakings are described at paragraph 5 below.

The Liability Management Exercise

2.2 The implementation of the Scheme, as part of the Liability Management Exercise which is described in Part C (*Overview of the Liability Management Exercise*), is dependent on participation by the Preference Shareholders, the 5.5555% Bondholders and the 13% Bondholders in the Liability Management Exercise in order to ensure that the Scheme Settlement Condition is satisfied.

2.3 Failure to achieve sufficient levels of participation by the Preference Shareholders, the 5.5555% Bondholders and the 13% Bondholders in the Liability Management Exercise to satisfy the Scheme Settlement Condition will mean that the conditions to the occurrence to the Scheme Settlement Date cannot be satisfied and the transfer and cancellation of the Dated Notes, the issuance of the Scheme Consideration and the issuance of the Additional Ordinary Shares as contemplated in the Scheme will not occur and the Scheme and the Liability Management Exercise will not be implemented.

2.4 Furthermore, as described in paragraph 1.37 above, if the Scheme Settlement Date does not occur on or before the Longstop Date, the Scheme shall lapse and the transfer and cancellation of the Dated Notes, the issuance of the Scheme Consideration and the issuance of the Additional Ordinary Shares as contemplated in the Scheme will not occur and the Scheme and the Liability Management Exercise will not be implemented.

Authority to execute documents on behalf of the Scheme Creditors

2.5 Pursuant to the Scheme, on and from the Scheme Effective Date each of the Scheme Creditors will irrevocably and unconditionally authorise the Company to issue, enter into, execute and (where applicable) deliver as a deed or otherwise each of the following on behalf of that Scheme Creditor (and any person to whom a Scheme Creditor has transferred its rights in respect of its Scheme Claim after the Record Date):

(a) directions to each relevant Clearing System and any other document in connection with the transfer and cancellation of the Dated Notes in accordance with the terms of the Scheme;

(b) the Deed of Waiver and Release;

(c) the Distribution Agreement; and

(d) any and all other documents that the Company reasonably considers necessary or desirable to give effect to the terms of the Scheme,

on the Scheme Settlement Date (in respect of the documents referred to in Subclauses (a) and (b) above) and on any day from (and including) the Scheme Effective Date (in respect of the documents referred to in Subclauses (c) and (d) above) for the purposes of giving effect to the terms of this Scheme.

2.6 Although the Scheme Creditors are party to the documents referred to in paragraph 2.5 above, the execution and delivery of those documents will be undertaken by the Company on behalf of the Scheme Creditors. Accordingly, no action is required by the Scheme Creditors in respect of the execution or delivery of those documents.

2.7 The terms of the Distribution Agreement and the Deed of Waiver and Release are summarised in paragraphs 3.5 and 4 below.

Scheme Consideration

2.8 The Scheme provides that, on the Scheme Settlement Date and subject to the terms of the Scheme, the Company shall issue the Scheme Consideration.

2.9 The Scheme Consideration to which Noteholders are entitled, subject to the terms of the Scheme, consists of the Bank T2 Notes and the New Ordinary Shares.

2.10 The Bank T2 Notes will be subordinated debt securities issued by the Company. The terms and conditions of the Bank T2 Notes are described in appendix B of the Bank T2 Notes Prospectus which is appended to this Explanatory Statement at Appendix 9 (*Bank T2 Notes Prospectus*). The Noteholders are advised to read and consider carefully the Bank T2 Notes Prospectus in addition to this Explanatory Statement in relation to the Bank T2 Notes.

2.11 The New Ordinary Shares will be ordinary shares issued by the Company. The rights attaching to the New Ordinary Shares and the articles of association of the Company are described in pages 420 to 430 of the Bank T2 Notes Prospectus and the terms of the Relationship Agreement are described in pages 455 to 457 of the Bank T2 Notes Prospectus. Further details of the corporate governance arrangements in respect of the Company are described in pages 191 to 195 and at page 430 (paragraph 2.22 entitled "*Corporate Governance*") of the Bank T2 Notes Prospectus. In addition, the Company has entered into an agreement with CBGL and Co-operative Group (the **2014 Commitment Agreement**) pursuant to which CBGL will subscribe for ordinary shares to be issued by the Company on implementation of the Scheme. The terms of the 2014 Commitment Agreement are described in pages 457 to 460 of the Bank T2 Notes Prospectus. The Noteholders are advised to read and consider carefully the Bank T2 Notes Prospectus in addition to this Explanatory Statement in relation to the New Ordinary Shares.

Calculation of entitlements to Scheme Consideration

2.12 The entitlement of each Noteholder to Scheme Consideration will be calculated by the Company in accordance with the terms of the Scheme on the basis of the Scheme Consideration Calculation Amount with respect to that Noteholder, being the aggregate of:

(a) the aggregate principal amount outstanding of Dated Notes (other than 2016 Notes) held by that Noteholder (if any) and accrued but unpaid interest thereon up to (and including) the Record Date; and

(b) the Sterling-Equivalent of the aggregate principal amount outstanding of the 2016 Notes held by that Noteholder (if any) and accrued but unpaid interest thereon up to (and including) the Record Date.

2.13 As the 2016 Notes are denominated in Euro and the other series of the Dated Notes are denominated in Sterling, the principal amount outstanding and accrued but unpaid interest thereon up to (and including) the Record Date in respect of the 2016 Notes held by any Noteholder shall be notionally converted into Sterling at the Scheme FX Rate for the purposes of calculating entitlements to Scheme Consideration in accordance with the terms of the Scheme.

2.14 If the number of New Ordinary Shares resulting from any calculation of a Noteholder's entitlement to Scheme Consideration in accordance with the terms of the Scheme is not a whole number, that number shall be rounded down to the nearest whole number and that Noteholder shall have no entitlement to any resulting fractional amount.

2.15 If the principal amount of Bank T2 Notes resulting from any calculation of a Noteholder's entitlement to Scheme Consideration in accordance with the terms of the Scheme is not an integral multiple of £10, that amount shall be rounded down to the nearest integral multiple of £10 and that Noteholder shall have no entitlement to any resulting fractional amount.

Issuance of Scheme Consideration and Holding Period arrangements

2.16 In order to receive Scheme Consideration to which it is entitled in accordance with the terms of the Scheme, each Noteholder is required to comply with the procedures described in the section entitled *Summary of actions to be taken by Scheme Creditors and any person with an interest in the Dated Notes* at pages 21 to 27 above and Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*) of this Explanatory Statement.

2.17 The Company will issue Scheme Consideration on the Scheme Settlement Date to Noteholders which have confirmed that they are Eligible Persons (or have appointed other persons to receive Scheme Consideration on their behalf and confirmed that those other persons are Eligible Persons) (such persons are referred to in the Scheme as Designated Recipients and such Noteholders are referred to in the Scheme as Eligible Noteholders) and on whose behalf valid Account Holder Letters have been delivered to and received by the Information Agent before the Voting Instruction Deadline. As described in paragraph 2.18 below, Eligible Noteholders on whose behalf valid Account Holder Letters have been delivered to and received by the Information Agent before the Voting Instruction Deadline may appoint Alternative Recipients to receive some or all of the Scheme Consideration and (if applicable) the Additional New Ordinary Shares to which they are entitled by complying with the steps described in paragraph 2.18 below.

2.18 Any Eligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent before the Voting Instruction Deadline, Sub-purchaser or Modified Scheme Purchaser may elect for some or all of the Scheme Consideration and (if applicable) the Additional New Ordinary Shares to which it is entitled under the terms of the Scheme and (if applicable) the Additional New Ordinary Shares Offer, the Sub-purchasing Offer or the Modified Scheme Purchase Agreement to be issued to another person who is an Eligible Person (such person, an **Alternative Recipient**) by notifying the Company of its election and providing to the Company and the Information Agent (i) confirmation that the Alternative Recipient is an Eligible Person and (ii) all details of the Alternative Recipient required by the Company and/or the Information Agent, in each case by no later than the Scheme Effective Date.

2.19 The Company may also issue Scheme Consideration on the Scheme Settlement Date to Eligible Noteholders (if any) on whose behalf valid Account Holder Letters have been delivered to and received by the Information Agent between the Voting Instruction Deadline and the Business Day preceding the Scheme Settlement Date (or, to the extent applicable their Designated Recipients), in each case at the sole discretion of the Company.

2.20 A trustee (referred to in the Scheme as the Holding Period Trustee) will be appointed on or before the Scheme Settlement Date pursuant to the terms of the Distribution Agreement and the Scheme to hold Scheme Consideration on behalf of:

(a) Noteholders which have confirmed that they are not Eligible Persons and have not appointed Designated Recipients (such Noteholders are referred to in the Scheme as Ineligible

Noteholders) and on whose behalf valid Account Holder Letters have been delivered to and received by the Information Agent before the date of the Voting Instruction Deadline; and

(b) Noteholders on whose behalf a valid Account Holder Letter has not been delivered to and received by the Information Agent before the Voting Instruction Deadline, other than any Eligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent between the Voting Instruction Deadline and the Business Day preceding the Scheme Settlement Date and to whom the Company issues Scheme Consideration on the Scheme Settlement Date as described in paragraph 2.19 above (referred to in the Scheme as Unadmitted Noteholders).

2.21 The Holding Period Trustee will hold Scheme Consideration on behalf of Ineligible Noteholders and Unadmitted Noteholders on bare trust in accordance with the terms of the Distribution Agreement and the Scheme, as described in paragraphs 3.5 to 3.18 below.

Additional New Ordinary Shares Offer

Overview

2.22 The Scheme provides that any Noteholder is entitled to elect to subscribe for Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer. A Noteholder wishing to elect to participate in the Additional New Ordinary Shares Offer will be entitled to elect to subscribe for between 26,667 (the **Minimum Election**) and 33,333,334 Additional New Ordinary Shares, irrespective of the size of the Noteholder's Scheme Claim.

2.23 Any Noteholder wishing to subscribe for Additional New Ordinary Shares in the Additional New Ordinary Shares Offer should instruct its Account Holder to make the appropriate elections in the Account Holder Letter delivered on its behalf, as described in *Summary of actions to be taken by Scheme Creditors and any person with an interest in the Dated Notes* at pages 21 to 27 above and Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*).

2.24 In order for a Noteholder to participate in the Additional New Ordinary Shares Offer, a valid Account Holder Letter in respect of that Noteholder must be delivered to and received by the Information Agent before the Voting Instruction Deadline. The Account Holder Letter must include (i) the amount of the Additional New Ordinary Shares for which that Noteholder wishes to subscribe in accordance with the terms of the Additional New Ordinary Shares Offer and (ii) confirmation that the Noteholder is an Eligible Person or, if that Noteholder has appointed a Designated Recipient, the Designated Recipient is an Eligible Person. The delivery and receipt of a valid Account Holder Letter will constitute an irrevocable offer by the relevant Noteholder to subscribe for up to its Subscription Amount, the acceptance of which by the Company will be effected and evidenced by notification of the number of Additional New Ordinary Shares allocated to that Noteholder as described in paragraph 2.27 below.

Subscribing Noteholder

2.25 Any Noteholder which complies with the above requirements will become a **Subscribing Noteholder** and will be entitled to receive Additional New Ordinary Shares in accordance with and subject to the terms of the Additional New Ordinary Shares Offer.

2.26 In summary, the allocation of Additional New Ordinary Shares to a Subscribing Noteholder in respect of its election to participate in the Additional New Ordinary Shares Offer will be *pro rata* based on the proportion of its Scheme Consideration Calculation Amount to the aggregate Scheme

Consideration Calculation Amounts of all Subscribing Noteholders which have elected to participate in the Additional New Ordinary Shares Offer subject to:

(a) a minimum allocation for a Subscribing Noteholder of 26,667 Additional New Ordinary Shares; and

(b) a maximum allocation of Additional New Ordinary Shares equal to the number of Additional New Ordinary Shares subscribed for by that Noteholder,

provided always that the aggregate number of Additional New Ordinary Shares allocated to all Subscribing Noteholders under the Additional New Ordinary Shares Offer is no greater than 33,333,334.

2.27 On the date of the Scheme Meeting (or on the immediately following Business Day):

(a) the Company will undertake the calculation of allocations to Subscribing Noteholders in accordance with the terms of the Additional New Ordinary Shares Offer (a detailed description of the calculation methodology is set out at paragraph 2.30 below); and

(b) the Company (or the Information Agent on behalf of the Company) will notify each Subscribing Noteholder of (i) the number of Additional New Ordinary Shares allocated to that Subscribing Noteholder, (ii) the aggregate subscription price for such number of Additional New Ordinary Shares (the **Subscription Price**) and (iii) details of the Subscription Escrow Account into which the Subscription Price must be deposited.

2.28 **In order to receive its allocation of Additional New Ordinary Shares, each Subscribing Noteholder must deposit into the Subscription Escrow Account an amount in cleared funds equal to the Subscription Price by no later than two Business Days after the date of the Scheme Meeting. Any Subscribing Noteholder that fails to fund the Subscription Escrow Account in the required amount by the deadline time of 4:30 p.m. (London time) on such date will not be entitled to receive Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer.**

Allocation among Subscribing Noteholders

2.29 The information required to undertake the allocation calculations in respect of the Additional New Ordinary Shares Offer and calculate the Subscription Price for each Subscribing Noteholder will be derived from valid Account Holder Letters received by the Information Agent before the Voting Instruction Deadline. This information will include:

(a) the number of Subscribing Noteholders;

(b) the number of Additional New Ordinary Shares for which each Subscribing Noteholder wishes to subscribe (the **Subscription Amount**);

(c) the aggregate Subscription Amounts of all Subscribing Noteholders (the **Total Subscription Amount**);

(d) the Scheme Consideration Calculation Amount of each Subscribing Noteholder; and

(e) the aggregate Scheme Consideration Calculation Amounts of all Subscribing Noteholders.

2.30 This paragraph 2.30 describes the methodology the Company will use to calculate the number of Additional New Ordinary Shares to be allocated to each Subscribing Noteholder. The allocation

methodology involves a number of allocation rounds. Noteholders may find the illustrative allocation model set out at Appendix 6 (*Illustrative Additional New Ordinary Shares Allocation Model*) of this Explanatory Statement useful when reviewing this paragraph 2.30. The Company will allocate the Additional New Ordinary Shares among Subscribing Noteholders as follows:

(a) First Round Allocation

Subscribing Noteholders that have made an election equal to the Minimum Election will be allocated a number of Additional New Ordinary Shares equal to the Minimum Election unless the aggregate Minimum Elections made by all Subscribing Noteholders exceeds 33,333,334 Additional New Ordinary Shares, in which case the Additional New Ordinary Shares shall be allocated to the first 1,249 Subscribing Noteholders (for the avoidance of doubt, irrespective of whether they have elected the Minimum Election or some larger Subscription Amount) who validly elected to subscribe for Additional New Ordinary Shares pursuant to the terms of the Additional New Ordinary Shares Offer (the **First Round Exception** and each such Subscribing Noteholder, the **Early Subscribing Noteholder**) by delivering a valid Account Holder Letter to the Information Agent such that each receives 26,667 Additional New Ordinary Shares (Account Holder Letters will be date and time stamped upon receipt by the Information Agent for this purpose). The balance of 26,251 Additional New Ordinary Shares that remains unallocated in the First Round Exception will be allocated amongst all Early Subscribing Noteholders that have elected to subscribe for an amount of Additional New Ordinary Shares in excess of the Minimum Election (the **Unfilled Subscribing Noteholders**) pro rata based on the proportion that an Unfilled Noteholder's Scheme Consideration Calculation Amount bears to the aggregate Scheme Consideration Calculation Amounts of all Unfilled Subscribing Noteholders subject to a maximum allocation of Additional New Ordinary Shares equal to the number of Additional New Ordinary Shares subscribed for by that Unfilled Subscribing Noteholder. For the avoidance of doubt, an Unfilled Subscribing Noteholder who, through this process, receives its Subscription Amount, will no longer be an Unfilled Subscribing Noteholder and will cease to be allocated further Additional New Ordinary Shares.

Subject to the First Round Exception, the number of Additional New Ordinary Shares that will be available to be allocated in the first round of allocations will be determined by multiplying the Minimum Election by the number of Subscribing Noteholders that have made an election equal to the Minimum Elections (the **Total First Round Allocation**) provided that the Total First Round Allocation shall not exceed 33,333,334 Additional New Ordinary Shares.

Any Subscribing Noteholder allocated Additional New Ordinary Shares in an allocation round in an amount that brings their total allocation of Additional New Ordinary Shares to an amount equal to their Subscription Amount shall, for the purpose of the allocation procedure, become an allocated noteholder (an **Allocated Noteholder**). All remaining Subscribing Noteholders that have not been allocated an amount of Additional New Ordinary Shares equal to their Subscription Amount shall, for the purpose of the allocation procedure, be unallocated Subscribing Noteholders (each an **Unallocated Subscribing Noteholder**).

Allocated Noteholders will be ignored for the purpose of determining allocations in all subsequent allocation rounds. Accordingly, the aggregate Scheme Consideration Calculation Amounts of all Allocated Noteholders will be ignored when determining allocations of Additional New Ordinary Shares in subsequent rounds.

For the purposes of determining priorities in the First Round Exception, if a valid Account Holder Letter is delivered to and received by the Information Agent in respect of a

Noteholder (which has validly elected to participate in the Additional New Ordinary Shares Offer and/or the Sub-purchasing Offer) on whose behalf an Old Account Holder Letter has, prior to the delivery of that Account Holder Letter, been delivered to and received by the Information Agent (and not revoked), that Account Holder Letter will be deemed to have been received by the Information Agent on the date and at the time that the Old Account Holder Letter was received by the Information Agent.

An illustrative example:

Number of Subscribing Noteholders = 7

Number of Subscribing Noteholders that have made an election equal to the Minimum Election (26,667 Additional New Ordinary Shares) = 2

Total Subscription Amount = 33,678,334 Additional New Ordinary Shares

Total First Round Allocation = 53,334 Additional New Ordinary Shares

The first allocation round will result in:

(i) 53,334 Additional New Ordinary Shares being allocated to 2 Subscribing Noteholders.

(ii) The 2 Subscribing Noteholders referred to immediately above becoming Allocated Noteholders, and the remaining 5 Subscribing Noteholders becoming Unallocated Subscribing Noteholders.

(iii) The individual aggregate Scheme Consideration Calculation Amounts of all Unallocated Subscribing Noteholders being used to determine the allocation of Additional New Ordinary Shares in the second round allocation.

(b) Second Round Allocation

Immediately following the first round allocation above, and provided that Additional New Ordinary Shares remain to be allocated, the Company will identify the Unallocated Subscribing Noteholder with the lowest Subscription Amount (the **Lowest Bidder** and the **Lowest Subscription Amount**). If the Lowest Subscription Amount is held by more than one Unallocated Subscribing Noteholder, the Lowest Bidder will be the Unallocated Subscribing Noteholder that has the highest Allocation Ratio (as defined below) (rounded down to the nearest whole number).

The Company will divide the Lowest Bidder's Subscription Amount by the Lowest Bidder's Allocation Ratio to determine the number of Additional New Ordinary Shares that will be available to be allocated to all Unallocated Subscribing Noteholders on a *pro rata* basis in the second round of allocations (the **Total Second Round Allocation**).

The allocation ratio (the **Allocation Ratio**) with respect to an Unallocated Subscribing Noteholder will be determined by dividing that Unallocated Subscribing Noteholder's Scheme Consideration Calculation Amount by the aggregate Scheme Consideration Calculation Amounts of all Unallocated Subscribing Noteholders.

Subject to the following paragraph, the Total Second Round Allocation will be allocated to all Unallocated Subscribing Noteholders *pro rata* by multiplying their respective Allocation Ratios by the Total Second Round Allocation (the **Second Round Allocations**) (rounded down to the nearest whole number) provided however that no Unallocated Subscribing Noteholder will be allocated more than its respective Subscription Amount.

If the remaining number of Additional New Ordinary Shares to be allocated in the second round of allocation is less than the Total Second Round Allocation, the remaining Additional New Ordinary Shares will be allocated to all Unallocated Subscribing Noteholders *pro rata* to their respective Second Round Allocations provided however that no Unallocated Subscribing Noteholder will be allocated more than its respective Subscription Amount.

An illustrative example:

Lowest Bidder's Subscription Amount = 4,250,000 Additional New Ordinary Shares

Lowest Bidder's Scheme Consideration Calculation Amount = £53,840,410.96

Aggregate Scheme Consideration Calculation Amounts of all Unallocated Subscribing Noteholders = £203,686,937.59

Lowest Bidder's Allocation Ratio = £53,840,410.96 / £203,686,937.59 = 0.26432922796

Total Second Round Allocation = 4,250,000 / 0.26432922796 = 16,078,433 Additional New Ordinary Shares

Second Round Allocations = 16,078,433 Additional New Ordinary Shares x each Unallocated Subscribing Noteholder's Allocation Ratio subject to a maximum aggregate allocation of Additional New Ordinary Shares equal to the Subscription Amount subscribed for by an Unallocated Subscribing Noteholder.

At the conclusion of the second round of allocation and provided that Additional New Ordinary Shares remain to be allocated to Unallocated Subscribing Noteholders in the subsequent round, the relevant Lowest Bidder(s) in the second round of allocation will become Allocated Noteholders, and will therefore be ignored for the purpose of determining allocations in all subsequent allocation rounds. If, due to rounding, a Subscribing Noteholder has been allocated one share less than its Subscription Amount, that Subscribing Noteholder will be allocated one additional Additional New Ordinary Share provided that there are sufficient unallocated Additional New Ordinary Shares.

(c) Third Allocation Round

The Company will repeat the allocation procedure described immediately above, save that when the Company identifies the Unallocated Subscribing Noteholder with the Lowest Subscription Amount for the purpose of calculating the third round of allocations, the Subscription Amount of the relevant Unallocated Subscribing Noteholder will be adjusted downwards to take into account any Additional New Ordinary Shares allocated to that Unallocated Subscribing Noteholder in earlier allocation rounds for the purpose of determining the number of Additional New Ordinary Shares that will be available to be allocated to all Unallocated Subscribing Noteholders on a *pro rata* basis in the third round of allocations (the **Total Third Round Allocation**).

An illustrative example:

Lowest Bidder's Subscription Amount = 6,125,000 Additional New Ordinary Shares

Additional New Ordinary Shares allocated to the Lowest Bidder in earlier allocation rounds = 4,792,330

Lowest Bidder's remaining or adjusted Subscription Amount = 1,332,670 Additional New Ordinary Shares

Lowest Bidder's Scheme Consideration Calculation Amount = £60,710,842.54

Aggregate Scheme Consideration Calculation Amounts of all Unallocated Subscribing Noteholders = £149,846,526.63

Lowest Bidder's Allocation Ratio = £60,710,842.54 / £149,846,526.63 = 0.4051534854

Total Third Round Allocation = 1,332,670 / 0.4051534854 = 3,289,296 Additional New Ordinary Shares

Third Round Allocations = 3,289,296 Additional New Ordinary Shares x each Unallocated Subscribing Noteholder's Allocation Ratio subject to a maximum aggregate allocation of Additional New Ordinary Shares equal to the Subscription Amount subscribed for by each Unallocated Subscribing Noteholder.

(d) Subsequent Allocation Rounds

The Company will repeat the allocation procedure described immediately above as many times as is necessary until either:

(i) all Additional New Ordinary Shares have been allocated to Subscribing Noteholders; or

(ii) allocations have been made in an amount equal to the Total Subscription Amount, in which case the Modified Scheme Purchasers or, if applicable, the Sub-purchasers will be required to subscribe for the remaining Additional New Ordinary Shares in accordance with the terms of the Modified Scheme Purchase Agreement (as discussed in more detail in paragraphs 2.31 and 2.32) and the Sub-purchasing Offer.

In the final allocation round, if, as a result of rounding, there is a balance of unallocated Additional New Ordinary Shares, such balance will be allocated to the Unallocated Subscribing Noteholders in descending order starting with the Unallocated Subscribing Noteholder with the highest Allocation Ratio.

Modified Scheme Purchasers and the Modified Scheme Purchase Agreement

2.31 On 1 December 2013 the Company entered into an agreement (the **Modified Scheme Purchase Agreement**) with certain Noteholders (the **Modified Scheme Purchasers**) pursuant to which the Modified Scheme Purchasers agreed to back-stop the purchase of the Additional New Ordinary Shares Offer (as described in more detail in paragraph 20.9 titled "*Purchase Agreement*" in section 20 (*Additional Information*) of the Bank T2 Notes Prospectus at pages 462 to 464). The terms of the Modified Scheme Purchase Agreement provide that the Modified Scheme Purchasers will subscribe for any Additional New Ordinary Shares that are either (i) unallocated or (ii) not taken up under the Additional New Ordinary Shares Offer because a Subscribing Noteholder or, if applicable, a Sub-purchaser, fails to fund the Subscription Escrow Account with the required amount by the deadline described in paragraph 2.28 above.

2.32 The Modified Scheme Purchasers will, in aggregate, be entitled to a purchase premium of £5,000,000 (being an amount equal to 4 per cent. of the aggregate subscription price for the total amount of the Additional New Ordinary Shares) less any Sub-purchaser Premiums paid to the Sub-purchasers in accordance with the terms of the Sub-purchasing Offer (as described in more detail in paragraphs 2.33 to 2.44 below) (the **Modified Scheme Purchaser Premium**). A Modified Scheme Purchaser's share of the Modified Scheme Purchaser Premium shall not become payable unless that Modified Scheme Purchaser has performed all of its obligations under the Modified Scheme Purchase Agreement.

Sub-purchasers

Overview

2.33 Any Noteholder is entitled to participate in a sub-purchasing of the agreement by the Modified Scheme Purchasers to back-stop the purchase of Additional New Ordinary Shares as set out in the Modified Scheme Purchase Agreement (the **Sub-purchasing Offer** and each such Noteholder, a **Sub-purchaser**). The Sub-purchasing Offer will be available to all Noteholders who wish to participate (not only a Subscribing Noteholder), including the Modified Scheme Purchasers (provided that the Modified Scheme Purchasers are Noteholders at the time the relevant election is made and on the Record Date).

2.34 A Noteholder wishing to elect to participate in the Sub-purchasing Offer will be entitled to elect to nominate a commitment under the Sub-purchasing Offer to back-stop the purchase of between (and including) 26,667 and 33,333,334 Additional New Ordinary Shares.

2.35 Any Noteholder wishing to participate in the Sub-purchasing Offer should instruct its Account Holder to make the appropriate elections in the Account Holder Letter delivered on its behalf, as described in *Summary of actions to be taken by Scheme Creditors and any Person with an Interest in the Dated Notes* at pages 21 to 27 above and Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*).

2.36 In order for a Noteholder to participate in the Sub-purchasing Offer, a valid Account Holder Letter in respect of that Noteholder must be delivered to and received by the Information Agent before the Voting Instruction Deadline. The Account Holder Letter must include (i) the maximum commitment that Noteholder is prepared to sub-purchase on a several basis in accordance with the terms of the Sub-purchasing Offer and (ii) confirmation that the Noteholder is an Eligible Person or, if that Noteholder has appointed a Designated Recipient, the Designated Recipient is an Eligible Person. The delivery and receipt of a valid Account Holder Letter will constitute an irrevocable offer by the relevant Noteholder to subscribe for up to the maximum commitment elected, the acceptance of which will be effected and evidenced by notification of the Sub-purchasing Commitment (as defined in paragraph 2.38 below) by the Company to the relevant Sub-purchaser.

Sub-purchaser

2.37 Any Noteholder which complies with the above requirements will become a Sub-purchaser and will be obliged to subscribe for Additional New Ordinary Shares in the circumstances and in accordance with the terms set out below.

Allocation of Sub-purchasing Commitments among Sub-purchasers

2.38 The methodology for allocating commitments among Sub-purchasers (the **Sub-purchasing Commitments**) will depend on the aggregate amount of Sub-purchasing Commitments nominated by all Sub-purchasers.

2.39 If the aggregate amount of Sub-purchasing Commitments nominated by all Sub-purchasers is less than 33,333,334 Additional New Ordinary Shares, the Sub-purchasing Commitment of a Sub-purchaser will be equal to that Sub-purchaser's maximum nominated commitment.

2.40 If the aggregate amount of the Sub-purchasing Commitments nominated by all Sub-purchasers is greater than 33,333,334 Additional New Ordinary Shares, the allocation of Sub-purchasing Commitment to a Sub-purchaser will be *pro rata* based on the proportion of its Scheme Consideration Calculation Amount to the aggregate Scheme Consideration Calculation Amount of all Noteholders who have elected to participate in the Sub-purchasing Offer subject to:

(a) a minimum Sub-purchasing Commitment of 26,667 Additional New Ordinary Shares; and

(b) a maximum Sub-purchasing Commitment equal to the maximum commitment elected for by that Noteholder,

provided always that the aggregate amount of all Sub-purchasing Commitments allocated to all the Sub-purchasers is no greater than 33,333,334 Additional New Ordinary Shares. In this regard, the allocation procedure for allocating Sub-purchasing Commitments will be substantially similar to the allocation procedure for the Additional New Ordinary Share Offer described in paragraphs 2.22 to 2.30 above save for references to 'Subscribing Noteholders' should be read as 'Sub-purchasers'.

2.41 To the extent that the number of Additional New Ordinary Shares subscribed for by the Subscribing Noteholders is less than 33,333,334 (such difference being the **Sub-purchasing Shares**), the number of Sub-purchasing Shares allocated to a Sub-purchaser will be equal to that Sub-purchaser's *pro-rata* share of the Sub-purchasing Shares based on the proportion that its Sub-purchasing Commitment bears to the aggregate Sub-purchasing Commitments of all Sub-purchasers but provided that the amount to be so allocated to a Sub-purchaser will be subject to a minimum of 26,667 Additional New Ordinary Shares and provided that, if the aggregate minimum allocations exceeds the aggregate number of Sub-purchasing Shares, the obligation to subscribe for Sub-purchasing Shares will be allocated to Sub-purchasers in the order that their Account Holder Letters

were received by the Information Agent (Account Holder Letters will be date and time stamped upon receipt by the Information Agent for this purpose).

2.42 On the date of the Scheme Meeting (or on the immediately following Business Day):

(a) the Company will undertake the calculation of allocations of commitment to Sub-purchasers in accordance with the terms of the Sub-purchasing Offer; and

(b) the Company (or the Information Agent on behalf of the Company) will notify each Sub-purchaser of:

(i) its allocated Sub-purchasing Commitment;

(ii) the amount, if any, by which the number of Additional New Ordinary Shares subscribed for by Subscribing Noteholders in the Additional New Ordinary Shares Offer is less than 33,333,334; and

(iii) the number of Additional New Ordinary Shares (if any) allocated to that Sub-purchaser in accordance with the terms of the Sub-purchasing Offer, the aggregate subscription price for such number of Additional New Ordinary Shares (the **Sub-purchase Amount**) and details of the Subscription Escrow Account into which the Sub-purchase Amount must be deposited.

2.43 If a Sub-purchaser fails to deposit an amount in cleared funds equal to the Sub-purchase Amount in the Subscription Escrow Account by no later than 4.30pm London time on the date falling two Business Days after the date of the Scheme Meeting in accordance with the terms of the Sub-purchasing Offer as set out above, the entitlement of that Sub-purchaser to the relevant Additional New Ordinary Shares on the date of the Scheme Settlement Date and to any Sub-purchaser Premium to which that Sub-purchaser would otherwise have been entitled (in respect of its entire Sub-purchasing Commitment) as described below will lapse and the Modified Scheme Purchasers will be required to subscribe for those Additional New Ordinary Shares in accordance with the terms of the Modified Scheme Purchase Agreement.

2.44 Each Sub-purchaser will be entitled to receive a purchase premium equal to 2 per cent. of its Sub-purchasing Commitment (the **Sub-purchaser Premium**), provided that it has performed all of its obligations in relation to the Sub-purchasing Offer including any requirement to fund the Subscription Escrow Account in accordance with any notice received by it as described in 2.42(b)(iii) above.

Subscription Escrow Account

2.45 The Subscription Escrow Account will be an interest bearing sterling cash account with the Subscription Escrow Bank in the name of Lucid Issuer Services Limited. Monies credited to the Subscription Escrow Account will be held to the order of all Subscribing Noteholders, Sub-purchasers and Modified Scheme Purchasers who fund into the Subscription Escrow Account in accordance with the terms of the Additional New Ordinary Shares Offer, the Sub-purchasing Offer and the Modified Scheme Purchase Agreement, as the case may be.

2.46 The monies standing to the credit of the Subscription Escrow Account will be held on trust for the Subscribers on terms that they will be paid to the Company on the satisfaction of the Scheme Settlement Condition. In the event that the Scheme Settlement Condition is not satisfied on the Scheme Settlement Condition Testing Date or the Scheme Settlement Date does not occur by the Longstop Date, all monies deposited with the Subscription Escrow Bank will be returned to the Subscriber who provided it together with any accrued interest thereon.

Key Elements of the Scheme

2.47 The key elements of the Scheme are as follows:

(a) Following the making by the Court of an order sanctioning the Scheme, a copy of the order will be delivered to the Registrar of Companies. The date of delivery of the order to the Registrar of Companies is the Scheme Effective Date.

(b) On the Scheme Effective Date:

(i) the Scheme Creditors will:

(A) direct each of the Trustees to execute and do, and to instruct any other person which it is entitled to instruct to execute and do, or otherwise procure to be executed and done, all documents, acts or things as may be necessary or desirable to be executed or done by it or such other person for the purposes of giving effect to the terms of the Scheme;

(B) authorise the Company to execute and do, and to instruct any other person which it is entitled to instruct to execute and do, or otherwise procure to be executed and done, all documents (including, without limitation, the New Transaction Documents), acts or things as may be necessary or desirable to be executed or done by it or such other person for the purposes of giving effect to the terms of the Scheme; and

(C) request and to the extent they are entitled to do so instruct the Company to perform each of its obligations arising under the Scheme and each New Transaction Document; and

(ii) if the Company reasonably considers it necessary or desirable to execute any document or documents to give effect to the terms of the Scheme on behalf of any of the Scheme Creditors on any day from (and including) the Scheme Effective Date, the Company may execute such document or documents on behalf of the relevant Scheme Creditor pursuant to the authority granted under the Scheme.

(c) On the Scheme Effective Date, or as soon as reasonably practicable thereafter, the Company for itself and on behalf of each Scheme Creditor pursuant to the authority granted under the Scheme and described in paragraph 2.5 above, the Holding Period Trustee, the Information Agent and the Selling Agent shall execute the Distribution Agreement and perform their obligations thereunder.

(d) On the Scheme Settlement Date, the following steps will happen and those steps will take effect in the order set out below:

(i) the Company for itself and/or on behalf of each relevant Scheme Creditor pursuant to the authority granted under the Scheme shall issue the directions described in paragraph 2.5(a) above and execute any document in connection with the transfer and cancellation of the Dated Notes in accordance with the terms of the Scheme;

(ii) the Company shall procure the transfer and cancellation of the Dated Notes in accordance with the terms of the Scheme;

(iii) the Company shall issue the Scheme Consideration in accordance with the terms of the Scheme;

(iv) the Company shall issue the Additional New Ordinary Shares in accordance with the terms of the Scheme;

(v) the Company shall pay the Sub-purchaser Premium and the Modified Scheme Purchaser Premium in accordance with the terms of the Scheme; and

(vi) the Company shall execute the Deed of Waiver and Release on behalf of each Scheme Creditor pursuant to the authority granted under the Scheme.

(e) On and from the Scheme Settlement Date (but subject to the other provisions of the Scheme), each Scheme Creditor will be entitled to the rights and benefits accruing to that Scheme Creditor under the Scheme and each of the New Transaction Documents (to the extent they are a party) and all of the existing rights and benefits of the Scheme Creditors in respect of the Scheme Claims shall be subject and limited to the compromises and arrangements provided by the Scheme, including without limitation the transfer and cancellation of the Dated Notes on the Scheme Settlement Date, the issuance of the Scheme Consideration and the Additional New Ordinary Shares and the releases and waivers under the Deed of Waiver and Release as described in this Part B (*Overview of the Scheme*).

(f) As described in paragraph 1.37 above, if the Scheme Settlement Date does not occur on or before the Longstop Date, the Scheme shall lapse and the transfer and cancellation of the Dated Notes, the payment or issuance of the Scheme Consideration and the issuance of the Additional Ordinary Shares as contemplated in the Scheme will not occur and the Scheme and the Liability Management Exercise will not be implemented

(g) In order to receive any Scheme Consideration and, if applicable, Additional New Ordinary Shares to which it is entitled in accordance with the terms of the Scheme on the Scheme Settlement Date, each Noteholder is required to comply with certain procedures described in Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*). Failure by a Noteholder to comply with such procedures before the relevant deadlines will mean that any entitlement of that Noteholder to Additional New Ordinary Shares will lapse in accordance with the terms of the Additional New Ordinary Shares Offer and the Scheme Consideration to which it is entitled in accordance with the terms of the Scheme will be delivered to the Holding Period Trustee on the Scheme Settlement Date in accordance with the arrangements described in Section 3 of Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*) and the description of the Distribution Agreement in paragraphs 3.5 to 3.18 below. Any such Noteholder will be required to take certain additional steps described in Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*) in order to receive such Scheme Consideration following the Scheme Settlement Date.

3. MECHANICAL SCHEME DOCUMENTS

3.1 The mechanics of the Scheme described in paragraph 2 above refer to certain documents which are described below.

Directions to the Clearing Systems

3.2 On the Scheme Settlement Date, the Company will issue directions for itself and/or on behalf of each Scheme Creditor pursuant to the authority granted under the Scheme to each relevant Clearing System in accordance with the rules and procedures of that Clearing System to:

(a) debit from the custody account of each Account Holder all the interests in the Dated Notes held by that Account Holder; and

(b) credit to the Company Custody Account the interests in the Dated Notes debited pursuant to subparagraph (a) above.

3.3 Following the transfer of the interests in the Dated Notes to the Company Custody Account as described above, the Company shall procure the cancellation of the Dated Notes.

3.4 If necessary, the Company shall execute any document required in connection with the transfer and cancellation of the Dated Notes on behalf of each relevant Scheme Creditor pursuant to the authority granted under the Scheme.

Distribution Agreement

3.5 On the Scheme Effective Date, or as soon as reasonably practicable thereafter, the Company, the Holding Period Trustee, the Scheme Creditors, the Selling Agent and the Information Agent will execute the Distribution Agreement. As described in more detail in Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*) and the Distribution Agreement, the role of the Holding Period Trustee will be to hold Scheme Consideration on behalf of (i) Ineligible Noteholders on whose behalf valid Account Holder Letters have been delivered to and received by the Information Agent before the Voting Instruction Deadline and (ii) Unadmitted Noteholders.

3.6 The Holding Period Trustee will hold Scheme Consideration on behalf of each Ineligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent before the Voting Instruction Deadline in accordance with the terms of the Scheme and the Distribution Agreement. By no later than 10 Business Days following receipt of the completed Account Holder Letter (provided that the Information Agent shall be under no obligation to deliver a Sale Instruction Certificate to the Holding Period Trustee prior to the Scheme Settlement Date), the Information Agent shall deliver a Sale Instruction Certificate to the Holding Period Trustee and, as soon as reasonably practicable following receipt thereof, the Holding Period Trustee shall instruct the Selling Agent to sell such Scheme Consideration in accordance with the terms of the Distribution Agreement.

3.7 Any sale of Scheme Consideration shall be effected in accordance with the terms of the Distribution Agreement. The Distribution Agreement provides that any such sale shall be effected upon the best terms available in the market at the time of the sale and none of the Holding Period Trustee, the Selling Agent, the Company, the Information Agent, the Bank T2 Notes Registrar, the New Ordinary Shares Registrar or any other person shall be responsible for any loss or alleged loss arising from the price, terms, manner or timing of any such sale or the failure to procure any purchaser for any of the New Ordinary Shares and/or Bank T2 Notes. The Distribution Agreement also provides that, without prejudice to the ability of the Holding Period Trustee to do so, the Holding Period Trustee shall be under no obligation to sell any New Ordinary Shares or distribute any interest, distributions (or any other rights or benefits) or other payments received by the Holding Period Trustee during the Holding Period in respect of such New Ordinary Shares until admission of the New Ordinary Shares to the Official List of the United Kingdom Listing Authority and admission to trading on the London Stock Exchange's market for listed securities.

3.8 As soon as reasonably practicable after the sale of any Scheme Consideration (or any part thereof) to which an Ineligible Noteholder is entitled in accordance with the terms of the Scheme, the Holding Period Trustee shall distribute:

(a) the proceeds of such sale (after deduction of any applicable expenses); and

(b) any interest, dividends, distributions (or any other rights or benefits) or other payments received by the Holding Period Trustee during the Holding Period prior to such sale in respect of such Scheme Consideration,

(in each case net of any applicable taxes (including, without limitation, any withholding taxes)) to that Ineligible Noteholder.

3.9 The Holding Period Trustee will hold Scheme Consideration on behalf of each Unadmitted Noteholder during the Holding Period. The Holding Period will commence on the Scheme Settlement Date and end on the day that is three years after the Scheme Settlement Date.

3.10 An Unadmitted Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent before the end of the Holding Period which includes a confirmation that such Noteholder (or, if such Noteholder has appointed a Designated Recipient, its Designated Recipient) is an Eligible Person will be an Eligible Noteholder for the purposes of the Scheme.

3.11 As soon as reasonably practicable following the date on which the Information Agent delivers a Distribution Instruction Certificate relating to any such Eligible Noteholder to the Holding Period Trustee (which, in accordance with the terms of the Distribution Agreement must be no later than 10 Business Days following the date on which the valid Account Holder Letter delivered in respect of any such Eligible Noteholder has been delivered to and received by the Information Agent (provided that the Information Agent shall be under no obligation to deliver an Instruction Certificate to the Holding Period Trustee prior to the Scheme Settlement Date)), the Holding Period Trustee shall deliver the Scheme Consideration to which that Eligible Noteholder is entitled in accordance with the terms of the Scheme (including any interest, dividends, distributions (or any other rights or benefits) or other payments received by the Holding Period Trustee in respect of such Scheme Consideration, in each case net of any applicable taxes (including, without limitation, any withholding taxes but excluding any stamp duty and/or stamp duty reserve tax payable upon the issue and/or allotment of New Ordinary Shares and Bank T2 Notes to that Eligible Noteholder which the Company will covenant to pay on behalf of that Eligible Noteholder under the terms of the Distribution Agreement)) to that Eligible Noteholder (or, to the extent applicable, its Designated Recipient).

3.12 An Unadmitted Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent before the end of the Holding Period which includes a confirmation that such Noteholder is not an Eligible Person and has not appointed a Designated Recipient will be an Ineligible Noteholder for the purposes of the Scheme.

3.13 As soon as reasonably practicable following the date on which the Information Agent delivers a Sale Instruction Certificate relating to any such Ineligible Noteholder to the Holding Period Trustee (which, in accordance with the terms of the Distribution Agreement must be no later than 10 Business Days following the date on which the Account Holder Letter delivered in respect of that Ineligible Noteholder has been delivered to and received by the Information Agent (provided that the Information Agent shall be under no obligation to deliver an Instruction Certificate to the Holding Period Trustee prior to the Scheme Settlement Date)), the Holding Period Trustee shall instruct the Selling Agent to sell the Scheme Consideration to which that Ineligible Noteholder is entitled in accordance with the terms of the Distribution Agreement, as described in paragraph 3.8 above.

3.14 If, at the end of the Holding Period, the Holding Period Trustee is holding any Scheme Consideration on behalf of any Unadmitted Noteholders, the Holding Period Trustee shall instruct the Selling Agent to sell all such Scheme Consideration in accordance with the terms of the Distribution Agreement.

3.15 Following the sale of any such Scheme Consideration (or any part thereof), the Holding Period Trustee shall distribute:

(a) the proceeds of such sale (after deduction of any applicable expenses); and

(b) any interest, dividends, distributions (or any other rights or benefits) or other payments received by the Holding Period Trustee in respect of such Scheme Consideration,

(in each case net of any applicable taxes (including, without limitation, any withholding taxes)) to the Company in accordance with the terms of the Distribution Agreement and the Scheme.

3.16 If, having used reasonable efforts to sell the Scheme Consideration which the Holding Period Trustee is holding at the end of the Holding Period within three months of the end of the Holding Period and having consulted with the Company, the Holding Period Trustee (or the Selling Agent on behalf of the Holding Period Trustee) has been unable to sell any such Scheme Consideration, the Holding Period Trustee shall be entitled to transfer such Scheme Consideration by way of gift to Carers Trust (registered charity number 1145181) or to any other registered charity selected by the Company in writing for this purpose.

3.17 The Holding Period Trustee will undertake not to exercise any voting, conversion or other rights attaching to any Scheme Consideration which it is holding on behalf of any Noteholders.

3.18 The form of the Distribution Agreement is scheduled to the Scheme at schedule 2.

New Transaction Documents

3.19 In connection with the issuance of the Scheme Consideration, various transaction documents related to the Scheme Consideration including, without limitation, the New Transaction Documents will be entered into by the Company, and various administrative parties (including, without limitation, the New Administrative Parties). As set out on page 419 of the Bank T2 Notes Prospectus, copies of the New Transaction Documents are available for inspection at the registered office of the Company for a period of 12 months from the date of the Bank T2 Notes Prospectus.

4. DEED OF WAIVER AND RELEASE

4.1 The Deed of Waiver and Release is a deed pursuant to which the Scheme Creditors:

(a) waive, release and discharge fully and absolutely, to the fullest extent permitted by law, all Liabilities of the Released Parties to the Scheme Creditors in relation to or in connection with or in any way arising out of the Dated Notes and/or the preparation, negotiation or implementation of the Scheme, the Liability Management Exercise and/or the recapitalisation of the Company; and

(b) waive, to the fullest extent permitted by law, each and every claim which the Scheme Creditors (or any person to whom a Scheme Creditor may have transferred its Scheme Claim after the Record Date) may have in relation to or in connection with or in any way arising out of the Dated Notes and/or the preparation, negotiation or implementation of the Scheme, or the Liability Management Exercise and/or the recapitalisation of the Company against the Released Parties.

4.2 Each release, waiver and discharge described above does not extend to:

(a) any Liability of any Adviser Released Party arising under a duty of care to its client or to another person where such duty has been specifically and expressly accepted or acknowledged in writing by the Adviser Released Party;

(b) any Liability arising or resulting from gross negligence, wilful default or fraud;

(c) any Liability in any Lock-Up Arrangement; or

(d) any Liability of the Company to the Trustees in relation to or in connection with or in any way arising out of the Dated Notes, save to the extent such Liability comprises a Scheme Claim.

In addition, nothing in the Deed of Waiver and Release releases, waives or discharges any Liability of any person under the New Transaction Documents or the Restructuring Documents.

4.3 The form of the Deed of Waiver and Release is scheduled to the Scheme at schedule 1 and the forms of the Restructuring Documents were published on the Scheme Website on or around 4 November 2013.

5. THIRD PARTY INVOLVEMENT

5.1 As set out above, the Scheme will require certain third parties (referred to as the Undertaking Transaction Parties) to perform actions in accordance with the terms of the Scheme.

5.2 The Undertaking Transaction Parties have each:

(a) agreed, or are expected to agree prior to the Scheme Sanction Hearing, to appear by counsel on the petition to sanction the Scheme and to undertake to the Court; and/or

(b) executed, or are expected to execute prior to the Scheme Sanction Hearing, a deed of undertaking in favour of the Court and the Company pursuant to which they undertake and agree:

amongst other matters, to perform those actions which they are required to perform in accordance with the terms of the Scheme and, where necessary, be bound by the terms of the Scheme as sanctioned by the Court.

5.3 The undertakings granted or to be granted by each of the Undertaking Transaction Parties differ slightly in order to reflect their differing roles in the implementation of the Scheme.

6. DIRECTOR NOMINATIONS

6.1 Although not a term of the Scheme, pursuant to the terms of the Relationship Agreement, the terms of which are described in pages 455 to 457 of the Bank T2 Notes Prospectus, the Company has agreed to procure the appointment of up to two directors of the Company to be nominated by the Modified Scheme Purchasers subject to the approval of such nominations by the Noteholders by a separate vote to take place immediately following the vote in respect of the Scheme at the Scheme Meeting.

6.2 The Modified Scheme Purchasers may identify in writing to the Company, no later than 7 Business Days prior to the Scheme Meeting, up to two persons to be nominated as directors of the Company (the **Nominated Directors**) at a vote of all the Noteholders. The written notice identifying the

Nominated Directors will contain reasonable details of the identity (including name, occupation, residential address and date of birth), credentials and experience of each Nominated Director. The Company has agreed to notify the Noteholders of the nominations at least 2 Business Days thereafter by the issue of an announcement through the Clearing Systems and on the Scheme Website at *http://www.co-operative.coop/Bondholders* and will propose each nomination (if any) to a separate resolution of the Noteholders. The notice sent by the Company to the Noteholders will be in the form set out in Appendix 5 (*Notice of Director Nomination Resolution*) of this Explanatory Statement and will include the information about the nominees provided by the Modified Scheme Purchaser.

6.3 Provided that a nomination is approved by a majority in number representing at least 75 per cent. in value of the Noteholders present and voting in person or by proxy at the Scheme Meeting, the Company agrees to procure the appointment of the relevant Nominated Director who has been approved as soon as reasonably practicable following the Scheme Meeting (subject to the completion of certain procedural requirements). The vote on each of these separate resolutions (if any) will take place at the Scheme Meeting following and independently of the vote in respect of the Scheme.

6.4 The Scheme may be approved by the requisite majorities of Scheme Creditors at the Scheme Meeting and be sanctioned by the Court at the Scheme Sanction Hearing and become effective in accordance with its terms, irrespective of whether either resolution to appoint the Nominated Directors is passed.

6.5 In the event that the Noteholders approve the appointment of one or more of the Nominated Directors, the appointment(s) will take effect only if:

(a) the Company has obtained such regulatory approvals required for the appointment of each such Nominated Director as a director of the Company including receipt of approval from the PRA for that Nominated Director to perform controlled functions at the Company under the approved persons regime; and

(b) each such Nominated Director has executed and delivered to the Company a letter of appointment in a form satisfactory to the Company (acting reasonably and having regard, amongst other things, to the terms of any letters of appointment executed by other directors of the Company),

except that, if conditions (a) and (b) are not satisfied within four months of the satisfaction of the conditions to the occurrence of the Scheme Settlement Date in the Scheme (as described in paragraph 1.33 above), the Company shall not be required to take further steps to appoint any Nominated Director.

PART C

OVERVIEW OF THE LIABILITY MANAGEMENT EXERCISE

Details of the Liability Management Exercise to the extent it relates to the 13% Bonds, 5.5555% Bonds and Preference Shares are included below to provide background information to Scheme Creditors. 13% Bondholders, 5.5555% Bondholders and/or Preference Shareholders are referred to the Offer Memorandum and the documents to which they are referred therein.

1. THE LIABILITY MANAGEMENT EXERCISE

1.1 Existing Securities

(a) The Liability Management Exercise is being conducted in respect of the Dated Notes and the securities listed below:

(i) The Preference Shares (ISIN: GB0002224516)

(ii) The 13% Bonds* (ISIN: GB00B3VH4201)

(iii) The 5.5555% Bonds* (ISIN: GB00B3VMBW45) (the 5.5555% Bonds together with the 13% Bonds, the **Perpetual Subordinated Bonds**)

(together with the Dated Notes, the **Existing Securities**):

* Issued by the Company in replacement of Britannia Building Society permanent interest bearing shares upon the Company's acquisition of Britannia Building Society on 1 August 2009

** Originally issued by Britannia Building Society and assumed by the Company upon the Company's acquisition of Britannia Building Society on 1 August 2009.

1.2 Component parts of the Liability Management Exercise

(a) The Preference Shareholders, 13% Bondholders, 5.5555% Bondholders and the Noteholders are being invited, subject to applicable securities laws, to participate in the Liability Management Exercise in the following manner:

(i) Eligible Preference Shareholders and Eligible 13% Bondholders are being invited to either:

(A) offer to exchange their Preference Shares and 13% Bonds for new 11 per cent. Final Repayment Subordinated Notes due 2025 (the **Final Repayment Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group; or

(B) offer to sell their Preference Shares and 13% Bonds to Co-operative Group and receive cash consideration payable in twelve equal instalments over twelve years (up to and including 2025) and represented by new Instalment Repayment Subordinated Notes (the **Instalment Repayment Notes** and, together with the Final Repayment Notes, the **Group Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group;

(ii) Eligible 5.5555% Bondholders are being invited to offer to exchange their 5.5555% Bonds for the Exchange Offer Bank T2 Notes to be issued by the Company; and

(iii) the Noteholders are being invited to vote on the Scheme, the terms of which are described in more detail in Part B (*Overview of the Scheme*), to authorise the Company to exchange all the Dated Notes for a combination of the Bank T2 Notes and New Ordinary Shares to be issued by the Company. The Scheme will also provide that Noteholders may elect to subscribe for Additional New Ordinary Shares in accordance with and subject to the terms of the Additional New Ordinary Shares Offer.

(b) The offers in respect of the Preference Shares and the Perpetual Subordinated Bonds are being conducted by way of exchange offers (the **Exchange Offers**).

(c) In addition, the Company is convening meetings of the Preference Shareholders, 13% Bondholders and 5.55555% Bondholders, respectively, to vote on resolutions which, if passed, will (amongst other things) (i) enable the Company to mandatorily effect the exchange or sale to Co-operative Group of those Preference Shares, 13% Bonds and 5.5555% Bonds (as applicable), which are not exchanged or sold to Co-operative Group (as the case may be) pursuant to the Exchange Offers, on the same economic terms as those upon which Preference Shares, 13% Bonds and 5.5555% Bonds, respectively, are exchanged or sold pursuant to the Exchange Offers (the **Proposals** and each a **Proposal**) and (ii) result in the Holders agreeing to certain waivers and releases in favour of the Company, Co-operative Group, their respective directors and certain other persons.

(d) The Exchange Offers, the Proposals and the Scheme are collectively referred to as the **Liability Management Exercise**.

1.3 Conditionality

(a) The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities is exchanged or sold pursuant to the Liability Management Exercise. The last date on which the Liability Management Exercise may successfully complete is 31 December 2013.

(b) In order for the entire principal amount of all Existing Securities to be exchanged or sold pursuant to the Liability Management Exercise (i) each of the Proposals in respect of the Preference Shares, 13% Bonds and 5.5555% Bonds must be approved by the Preference Shareholders, 13% Bondholders and 5.5555% Bondholders at meetings convened for the purposes of voting on such Proposals and the Proposals must be capable of being implemented in accordance with their terms (and, in the case of the Preference Shares, a resolution in similar terms must also be approved at a general meeting of the shareholders of the Company) and (ii) the Scheme Effective Date must have occurred and the conditions to the occurrence of the Scheme Settlement Date described in paragraphs 1.33 to 1.34 of Part B (*Overview of the Scheme*) must have been satisfied (together referred to as the **Settlement Condition**).

(c) Successful completion of the Liability Management Exercise is conditional upon satisfaction of the Settlement Condition. **The Settlement Condition is not capable of being waived.** Accordingly, if the Settlement Condition is not satisfied, the Liability Management Exercise will not be implemented, and no Existing Securities will be exchanged or sold pursuant to the Liability Management Exercise.

1.4 Early Participation Incentive

(a) If the Early Participation Threshold is achieved by 4.30 p.m. (London time) on 29 November 2013 (the **Early Participation Deadline**), the amount of consideration which all Preference Shareholders, 13% Bondholders and 5.5555% Bondholders will be eligible to receive upon the exchange or sale of their Preference Shares, 13% Bonds and 5.5555% Bonds in the Liability Management Exercise (if

the Liability Management Exercise is successfully completed) will be higher than if the Early Participation Threshold is not achieved by the Early Participation Deadline.

(b) The Early Participation Threshold will be achieved by the Early Participation Deadline only if, by that time, at least 75 per cent. of the aggregate nominal amount outstanding of each of the Preference Shares, the 13% Bonds and the 5.5555% Bonds has been validly offered for exchange or sale and/or otherwise validly voted in favour of the Proposals (and not revoked).

(c) **The number of the New Ordinary Shares and principal amount of the Bank T2 Notes which a Noteholder will be entitled to receive as Scheme Consideration on the basis of its Scheme Consideration Calculation Amount in accordance with the terms of the Scheme will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.**

1.5 Offer restrictions

The Exchange Offers are subject to certain offer restrictions, and applicable securities laws as discussed in the Offer Memorandum.

1.6 Further details

The separate offers in respect of the Preference Shares, the 13% Bonds and the 5.5555% Bonds are summarised briefly below, but these descriptions are subject to the more detailed offer terms and conditions which are set out in the Offer Memorandum and the Bank T2 Notes Prospectus.

2. SUMMARY OFFERING TABLES

2.1 Preference Shares and 13% Bonds

The following table summarises the consideration that Preference Shareholders and 13% Bondholders will be eligible to receive if their Preference Shares and 13% Bonds (as applicable) are exchanged or sold pursuant to the Liability Management Exercise:

Offers in respect of the Preference Shares and the 13% Bonds

Existing Securities	**ISIN**	**Early Consideration Amount**[1] (per £1,000 nominal of Existing Securities)			**Late Consideration Amount**[1] (per £1,000 nominal of Existing Securities)		
		Final Repayment Notes[2]	OR[4]	**Instalment Repayment Notes**[3]	**Final Repayment Notes**[2]	OR[4]	**Instalment Repayment Notes**[3]
Preference Shares[5]	GB0002224516	£601		£1,110	£551		£1,060
13% Bonds	GB00B3VH4201	£844		£1,560	£794		£1,510

Notes:

1 If the Early Participation Threshold is achieved by the Early Participation Deadline (4.30 p.m. (London time) on 29 November 2013) and the Liability Management Exercise successfully completes, all Preference Shares and 13% Bonds will be exchanged or sold at the Early Consideration Amount. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise successfully completes, all Preference Shares and 13% Bonds will be exchanged or sold at the Late Consideration Amount.

2 New sterling-denominated 11 per cent. Final Repayment Notes due 2025 (ISIN: GB00BFXW0630) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group.

3 New sterling-denominated Instalment Repayment Notes (ISIN: GB00BFXWHQ29) (having their last instalment payment date in 2025) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group. The Instalment Repayment Notes represent the instalments of consideration to be received by Holders whose Preference Shares or 13% Bonds are sold to Co-operative Group in the Liability Management Exercise.

4 The amounts of Final Repayment Notes and Instalment Repayment Notes specified in the table above are alternative options. A Holder will not receive both of these amounts. Holders will be able to elect (in accordance with the procedures set out in this document) either the Final Repayment Notes option or the Instalment Repayment Notes option only.

5 The Early Consideration Amount and Late Consideration Amount for the Preference Shares are presented in this table on a "per £1,000 in nominal amount" basis for ease of comparison with the 13% Bonds. Preference Shares can be offered for exchange or sale in any whole multiple of £1 (subject to a minimum of £2 if a holder elects the Final Repayment Notes option (which is the minimum amount required, based on the Late Consideration Amount, in order to receive the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if a Holder elects the Instalment Repayment Notes option).

2.2 5.5555% Bonds

The following table summarises the consideration that 5.5555% Bondholders will be eligible to receive if their 5.5555% Bonds are exchanged pursuant to the Liability Management Exercise:

Offer in respect of the 5.5555% Bonds

Existing Securities	**ISIN**	**Early Consideration Amount**[1] (per £1,000 nominal of Existing Securities)	**Late Consideration Amount**[1] (per £1,000 nominal of Existing Securities)
		Exchange Offer Bank T2 Notes2	**Exchange Offer Bank T2 Notes2**
5.5555% Bonds	GB00B3VMBW45	£530	£480

Notes:

1 If the Early Participation Threshold is achieved by the Early Participation Deadline (4.30 p.m. (London time) on 29 November 2013) and the Liability Management Exercise successfully completes, all 5.5555% Bonds will be exchanged at the Early Consideration Amount. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise successfully completes, all 5.5555% Bonds will be exchanged at the Late Consideration Amount.

2 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Company.

2.3 Dated Notes

The following table summarises the Scheme Consideration that Noteholders will be eligible to receive pursuant to the terms of the Scheme:

Scheme in respect of the Dated Notes

Existing Securities	**ISIN**	**Consideration Amount**[1] (per £1,000 of Scheme Consideration Calculation Amount)		**New Ordinary Shares Conversion Price**[5]
		Bank T2 Notes[2]	**New Ordinary Shares**[3]	
2016 Notes	XS0254625998	£102.57	£897.43	£6.17566631 per share
2019 Notes	XS0189539942	£102.57	£897.43	
April 2021 Notes	XS0620315902	£102.57	£897.43	
November 2021 Notes	XS0274155984	£102.57	£897.43	
2022 Notes	XS0864253868	£102.57	£897.43	
2024 Notes	XS0188218183	£102.57	£897.43	
2033 Notes	XS0145065602	£102.57	£897.43	

Notes:

1 The number of New Ordinary Shares and principal amount of Bank T2 Notes which a Noteholder will be eligible to receive in respect of its Scheme Consideration Calculation Amount will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

2 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Company.

3 New Ordinary Shares to be issued by the Company. If the Liability Management Exercise is successfully completed, Co-operative Group's existing equity stake in the Company will be converted into deferred shares and effectively reduced to nil and a total of 250,000,000 ordinary shares in the Company will be issued at that time, of which:

(i) 75,000,000 (representing 30 per cent. of the total) will be issued to Co-operative Group in consideration for its fresh injection of capital into the Company through the Liability Management Exercise and the 2014 Commitment (representing an effective subscription price of £6.16 per share);

(ii) 141,666,666 (representing approximately 56.67 per cent. of the total) will be issued to Noteholders in the Scheme in exchange for the Dated Notes, to be distributed in the Scheme pro rata amongst the Noteholders based on their respective Scheme Consideration Calculation Amounts (representing, based on the total value of Scheme Consideration Calculation Amounts and the number of New Ordinary Shares issued in the Scheme to Noteholders, an implied subscription price equal to the New Ordinary Shares Conversion Price). The New Ordinary Shares referred to in the table above are these 141,666,666 New Ordinary Shares; and

(iii) 33,333,334 (representing the balance of approximately 13.33 per cent. of the total) will be available for subscription by Noteholders pursuant to, and on the terms of, the Additional New Ordinary Shares Offer for an aggregate consideration equal to £125,000,002.50 (representing an effective subscription price of £3.75 per share).

The Scheme also provides that 33,333,334 Additional New Ordinary Shares will be made available to Noteholders for subscription for an aggregate consideration equal to £125,000,002.50, all pursuant to, and on the terms of, the Scheme, as set out in Part B (*Overview of the Scheme*) of this Explanatory Statement.

3. PREFERENCE SHARES OFFER

3.1 Preference Shareholders are being offered a choice of two options:

(a) to offer to transfer their Preference Shares to Co-operative Group in exchange for Final Repayment Notes; or

(b) to offer to sell their Preference Shares to Co-operative Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by Instalment Repayment Notes.

3.2 Final Repayment Notes

The Final Repayment Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid annually in arrear on each anniversary of the issue date of the Final Repayment Notes up to (and including) the twelfth anniversary. Co-operative Group will be obliged to repay the principal amount of the Final Repayment Notes in full on the twelfth anniversary of their issue date.

3.3 Instalment Repayment Notes

The Instalment Repayment Notes will not bear interest. However, the principal amount of such Instalment Repayment Notes (representing instalments of the cash purchase price for the Preference Shares) will be repaid in twelve equal instalments over twelve years. Those payments will be made on each anniversary of the issue date of the Instalment Repayment Notes, with the final payment

falling on the twelfth anniversary of that issue date. If the Early Participation Threshold is achieved by the Early Participation Deadline, the principal amount of Instalment Repayment Notes which a Preference Shareholder will receive upon the sale of its Preference Shares to Co-operative Group will be equal to twelve times the annual dividend on those Preference Shares (rounded down to the nearest £0.12 (12 pence), which is the minimum denomination of the Instalment Repayment Notes). **Accordingly, (in circumstances where the Early Participation Threshold is achieved by the Early Participation Deadline), by repaying those Instalment Repayment Notes in twelve equal instalments over twelve years, Co-operative Group will pay to the Preference Shareholder, in each of those twelve years, an amount which is broadly equivalent to the amount of dividends which such Preference Shareholder would have received had it continued to hold those Preference Shares which it sells to Co-operative Group in the Liability Management Exercise.**

3.4 Preference Shareholder election

Each Preference Shareholder will have the opportunity to choose one of the two options available.

Since Co-operative Group will repay the principal of the Instalment Repayment Notes in equal instalments over twelve years, the amount payable to a Preference Shareholder in each year, if it elects the Instalment Repayment Notes option, will be higher than the annual interest payment to such Preference Shareholder if it elects the Final Repayment Notes option. However, the final payment on the Instalment Repayment Notes in 2025 will be significantly lower than the final payment under the Final Repayment Notes in 2025 (reflecting the fact that the principal on the Final Repayment Notes is repayable in a single payment in that twelfth year).

After the twelfth and final payment, both the Final Repayment Notes and the Instalment Repayment Notes will have been fully repaid, and Preference Shareholders will have no further entitlement to any amounts under whichever of those securities it elected to receive.

If a Preference Shareholder intends to hold its Final Repayment Notes or Instalment Repayment Notes for the full twelve years, an important point of distinction for such Preference Shareholder will be whether it wishes to receive (i) the higher amount payable each year (except the twelfth) under the Instalment Repayment Notes, or (ii) the lower annual payments of interest under the Final Repayment Notes but a larger one-off payment in twelve years' time, in which latter case it should elect to receive the Final Repayment Notes.

3.5 Principal amount of Group Notes to be delivered upon exchange or sale of Preference Shares

The principal amount of Group Notes which a Preference Shareholder will (if the Liability Management Exercise is successfully completed) receive for each £1,000 in nominal amount of Preference Shares (excluding the Additional Preference Shares referred to below) exchanged or sold to Co-operative Group will depend upon (i) whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option; and (ii) whether or not the Early Participation Threshold is achieved by the Early Participation Deadline:

(a) **Final Repayment Notes**

An Eligible Preference Shareholder who validly offers to exchange its Preference Shares in the Exchange Offer for Final Repayment Notes will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £601 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) exchanged (subject to rounding); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £551 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) exchanged (subject to rounding).

(b) **Instalment Repayment Notes**

An Eligible Preference Shareholder who validly offers to sell its Preference Shares to Co-operative Group in the Exchange Offer for cash consideration payable in instalments under the Instalment Repayment Notes option will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £1,110 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) sold to Co-operative Group (subject to rounding); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £1,060 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) sold to Co-operative Group (subject to rounding).

3.6 Accrued dividends

A Preference Shareholder whose Preference Shares are exchanged or sold in the Liability Management Exercise will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid dividends on its Preference Shares (other than Additional Preference Shares) from (and including) 30 November 2013 to (but excluding) the Settlement Date.

3.7 Preference Share dividend instalment scheduled for 30 November/Additional Preference Shares

The next instalment of the Preference Share dividend is, under the terms of the Preference Shares, scheduled to be paid on 30 November 2013 (which is during the offer period for the Liability Management Exercise).

Under the terms of the Preference Shares, the Company will not be permitted to pay the dividend in cash, but will instead be required to allot additional Preference Shares to each Preference Shareholder in lieu of cash payment (**Additional Preference Shares**). The Company expects to allot such Additional Preference Shares on 29 November 2013 (since 30 November is a Saturday).

However, if the Liability Management Exercise successfully completes, then upon exchange or sale to Co-operative Group of those Additional Preference Shares, Preference Shareholders will not receive Final Repayment Notes or Instalment Repayment Notes in respect thereof but rather will receive an amount in cash (in pounds sterling) equal to the cash dividend which the Company would have paid on 29 November 2013 had it been able to do so under the terms of the Preference Shares.

3.8 Proposal

A meeting of the Preference Shareholders is being convened in order for those Preference Shareholders to vote on a proposed resolution which, if passed and implemented, would enable the Company:

(a) to purchase and cancel any share capital of the Company (which would include, without limitation, Preference Shares) from time to time, without the need for the further consent of the Preference Shareholders; and

(b) to mandatorily effect, at the Company's option, the transfer to Co-operative Group of all (but not some only) of the Preference Shares, which are not offered for exchange or sale in the Exchange Offer, either (1) in exchange for Final Repayment Notes, or (2) in return for the cash consideration to be paid over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as those upon which Preference Shares are exchanged or sold in the Exchange Offer.

The proposed resolution also contains, on behalf of all Preference Shareholders (i) a release, in favour of certain persons (including, amongst others, the Company, Co-operative Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such Preference Shareholders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their Preference Shares; provided, however, that nothing in that resolution shall release the Company or Co-operative Group from their respective obligations or liabilities as the persons responsible for the Bank T2 Notes Prospectus and the Group Notes Prospectus, respectively.

The submission of a valid Exchange Instruction pursuant to the Exchange Offer will also constitute the relevant Preference Shareholder's instructions to appoint the chairman of the meeting as proxy to vote on behalf of the relevant Preference Shareholder in favour of the resolution proposed.

4. 13% BONDS OFFER

4.1 Exchange Offer

13% Bondholders are being offered a choice of two options:

(a) to offer to transfer their 13% Bonds to Co-operative Group in exchange for Final Repayment Notes; or

(b) to offer to sell their 13% Bonds to Co-operative Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by Instalment Repayment Notes.

4.2 Final Repayment Notes

The Final Repayment Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid annually in arrear on each anniversary of the issue date up to (and including) the twelfth anniversary. Co-operative Group will be obliged to repay the principal amount of the Final Repayment Notes in full on the twelfth anniversary of their issue date.

4.3 Instalment Repayment Notes

The Instalment Repayment Notes will not bear interest. However, the principal amount of such Instalment Repayment Notes (representing instalments of the cash purchase price for the 13% Bonds) will be repaid in twelve equal instalments over twelve years. Those payments will be made on each anniversary of the issue date of the Instalment Repayment Notes, with the final payment falling on the twelfth anniversary of that issue date. If the Early Participation Threshold is achieved by the Early Participation Deadline, the principal amount of Instalment Repayment Notes which a 13% Bondholder will receive upon sale of its 13% Bonds to Co-operative Group will be equal to

twelve times the annual interest on those 13% Bonds (rounded down to the nearest £0.12 (12 pence), which is the minimum denomination of the Instalment Repayment Notes). **Accordingly, (in circumstances where the Early Participation Threshold is achieved by the Early Participation Deadline), by repaying those Instalment Repayment Notes in twelve equal instalments over twelve years, Co-operative Group will pay to a 13% Bondholder, in each of those twelve years, an amount which is broadly equivalent to the amount of interest which such 13% Bondholder would have received had it continued to hold those 13% Bonds which it sells to Co-operative Group in the Liability Management Exercise.**

4.4 13% Bondholder election

Each 13% Bondholder will have the opportunity to choose one of the two options available. Since Co-operative Group will repay the principal of the Instalment Repayment Notes in equal instalments over twelve years, the amount payable to a 13% Bondholder in each year if it elects the Instalment Repayment Notes option will be higher than the annual interest payment to such 13% Bondholder if it elects the Final Repayment Notes option. However, the final payment on the Instalment Repayment Notes in 2025 will be significantly lower than the final payment under the Final Repayment Notes in 2025 (reflecting the fact that the principal on the Final Repayment Notes is repayable in a single payment in that twelfth year).

After the twelfth and final payment, both the Final Repayment Notes and the Instalment Repayment Notes will have been fully repaid, and 13% Bondholders will have no further entitlement to any amounts under whichever of those securities it elected to receive.

If a 13% Bondholder intends to hold its Final Repayment Notes or Instalment Repayment Notes for the full twelve years, an important point of distinction for such 13% Bondholders will be whether it wishes to receive (i) the higher amount payable each year (except the twelfth year) under the Instalment Repayment Notes, or (ii) the lower annual payments of interest under the Final Repayment Notes but a larger one-off payment in twelve years' time, in which latter case it should elect to receive the Final Repayment Notes.

4.5 Principal amount of Group Notes to be delivered upon exchange or sale of 13% Bonds

The principal amount of Group Notes which a 13% Bondholder will (if the Liability Management Exercise is successfully completed) receive for each £1,000 in nominal amount of 13% Bonds exchanged or sold to Co-operative Group will depend upon (i) whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option; and (ii) whether or not the Early Participation Threshold is achieved by the Early Participation Deadline:

(a) **Final Repayment Notes**

An Eligible 13% Bondholder who validly offers to exchange its 13% Bonds in the Exchange Offer for Final Repayment Notes will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £844 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of 13% Bonds exchanged (subject to rounding); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £794 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of 13% Bonds exchanged (subject to rounding).

(b) **Instalment Repayment Notes**

An Eligible 13% Bondholder who validly offers to sell its 13% Bonds to Co-operative Group in the Exchange Offer for cash consideration payable in instalments under the Instalment Repayment Notes option will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £1,560 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of 13% Bonds sold to Co-operative Group (subject to rounding); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £1,510 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of 13% Bonds sold to Co-operative Group (subject to rounding).

4.6 Accrued interest

A 13% Bondholder whose 13% Bonds are exchanged or sold in the Liability Management Exercise will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid interest on its 13% Bonds from (and including) 31 July 2013 to (but excluding) the Settlement Date.

4.7 Deferred interest payment originally scheduled for 31 July 2013

In addition, as announced by the Company on 12 July 2013, upon successful completion of the Exchange Offer the Company will pay to all 13% Bondholders the deferred interest payment originally scheduled for 31 July 2013. Such payment will be made in cash on the Settlement Date.

4.8 Proposal

A meeting of the 13% Bondholders is being convened in order for those 13% Bondholders to vote on a proposed resolution which, if passed and implemented, would result in amendments to the terms of the 13% Bonds to enable the Company to mandatorily effect, at the Company's option, the transfer to Co-operative Group of all (but not some only) of the 13% Bonds, which are not offered for exchange or sale in the Exchange Offer, either (1) in exchange for Final Repayment Notes, or (2) in return for the cash consideration to be paid over 12 years and represented by the Instalment Repayment Notes, in either case on the same economic terms as those upon which 13% Bonds are exchanged or sold in the Exchange Offer.

The proposed resolution also contains, on behalf of all 13% Bondholders (i) a release, in favour of certain persons (including, amongst others, the Company, Co-operative Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such 13% Bondholders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their 13% Bonds; provided, however, that nothing in that resolution shall release the Company or Co-operative Group from their respective obligations or liabilities as the persons responsible for the Bank T2 Notes Prospectus and the Group Notes Prospectus, respectively.

The submission of a valid Exchange Instruction pursuant to the Exchange Offer will also constitute the relevant 13% Bondholder's instructions to appoint the chairman of the meeting as proxy to vote on behalf of the relevant 13% Bondholder in favour of the resolution proposed.

5. 5.5555% BONDS OFFER

5.1 Exchange Offer

5.5555% Bondholders are being invited to offer to exchange their 5.5555% Bonds for Exchange Offer Bank T2 Notes.

5.2 Exchange Offer Bank T2 Notes

Exchange Offer Bank T2 Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid on a quarterly basis in arrear on each three-month anniversary of the issue date up to (and including) the tenth anniversary of the issue date. The Company will be obliged to repay the principal amount of the Exchange Offer Bank T2 Notes on the tenth anniversary of their issue date.

5.3 Principal amount of Exchange Offer Bank T2 Notes to be delivered in exchange for 5.5555% Bonds

The principal amount of Exchange Offer Bank T2 Notes which a 5.5555% Bondholder will (if the Liability Management Exercise is successfully completed) receive in exchange for every £1,000 in nominal amount of 5.5555% Bonds will depend upon whether or not the Early Participation Threshold is achieved by the Early Participation Deadline. Accordingly, an Eligible 5.5555% Bondholder who validly offers to exchange its 5.5555% Bonds in the Exchange Offer will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £530 in principal amount of Exchange Offer Bank T2 Notes for every £1,000 in nominal amount of 5.5555% Bonds exchanged; or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £480 in principal amount of Exchange Offer Bank T2 Notes for every £1,000 in nominal amount of 5.5555% Bonds exchanged.

5.4 Accrued interest

A 5.5555% Bondholder whose 5.5555% Bonds are exchanged will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid interest on its 5.5555% Bonds from (and including) 14 December 2013 to (but excluding) the Settlement Date.

5.5 Interest payment scheduled for 14 December 2013

The next scheduled interest payment date for the 5.5555% Bonds is 14 December 2013. The Company intends to defer that interest payment (which it is entitled to do under the terms of the 5.5555% Bonds). If the Liability Management Exercise subsequently successfully settles, the Company will (in addition to the accrued interest referred to in the paragraph above) pay the deferred interest payment originally scheduled for 14 December 2013 (to all 5.5555% Bondholders) upon successful completion of the Liability Management Exercise. Such payment will be made in cash on the Settlement Date.

5.6 Proposal

A meeting of the 5.5555% Bondholders is being convened in order for those 5.5555% Bondholders to vote on a proposed resolution which, if passed and implemented, would result in amendments to

the terms of the 5.5555% Bonds to enable the Company to mandatorily effect the exchange, at the Company's option, of all (but not some only) of the 5.5555% Bonds, which are not exchanged in the Exchange Offer, on the same economic terms as those upon which 5.5555% Bonds are exchanged in the Exchange Offer.

The proposed resolution also contains, on behalf of all 5.5555% Bondholders (i) a release, in favour of certain persons (including, amongst others, the Company, Co-operative Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such 5.5555% Bondholders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their 5.5555% Bonds; provided, however, that nothing in that resolution shall release the Company or Co-operative Group from their respective obligations or liabilities as the persons responsible for the Bank T2 Notes Prospectus and the Group Notes Prospectus, respectively.

The submission of a valid Exchange Instruction pursuant to the Exchange Offer will also constitute the relevant 5.5555% Bondholder's instructions to appoint the chairman of the meeting as proxy to vote on behalf of the relevant 5.5555% Bondholder in favour of the resolution proposed.

PART D

RISK FACTORS

The following risk factors are the principal risk factors that arise in connection with the proposed Scheme. These risk factors should be read in conjunction with all of the other information contained in this Explanatory Statement including, for the avoidance of doubt, the Bank T2 Notes Prospectus.

Additional risks and uncertainties not presently known to the Company or that the Company currently deems immaterial may also have a material adverse effect on the business, financial condition or results of operations of the Company or any other member of the Group. Moreover, except as set forth in the section below entitled "Risks relating to a failure to implement or a delay in implementing the Scheme", these risk factors assume that the Scheme will be implemented and do not describe all of the risks that would be applicable to the Company should the Scheme not be implemented.

All statements in this Explanatory Statement including, for the avoidance of doubt, the Bank T2 Notes Prospectus are to be read subject to, and are qualified in their entirety by, the matters referred to in this section.

For ease of reference only, this part of the Explanatory Statement is divided into two main sections:

(1) Risks relating to the implementation of or a failure to implement or a delay in implementing the Scheme; and

(2) Risks relating to the Scheme, including those relating to the Company, the Scheme Consideration and the Additional New Ordinary Shares.

RISKS RELATING TO THE IMPLEMENTATION OF OR A FAILURE TO IMPLEMENT OR A DELAY IN IMPLEMENTING THE SCHEME

1. Insolvency Proceedings

1.1 If the Scheme is not implemented in accordance with its terms, or is not implemented on or before 31 December 2013, the Company will be unable to implement the Liability Management Exercise. In the event that the Liability Management Exercise is not successfully implemented, the Company would fail to comply with the PRA's stated requirement that the Company raises an additional £1 billion Common Equity Tier 1 Capital by 31 December 2013. In addition, CBGL's undertaking pursuant to the 2014 Commitment Agreement supported by Co-operative Group pursuant to the terms of an intra-group loan between Co-operative Group and CBGL; as described on page 112 of the Bank T2 Notes Prospectus, to contribute up to £333 million additional Common Equity Tier 1 Capital in 2014 would terminate as it is conditional on the implementation of the Scheme in accordance with its terms (including the completion of the Additional New Ordinary Shares Offer) and each of the Exchange Offers having become unconditional in accordance with their respective terms. Co-operative Group will not provide any additional capital contribution to meet the Company's regulatory capital shortfall unless the Liability Management Exercise is successfully implemented (i.e. the entire principal amount of all Existing Securities (including the Dated Notes) are exchanged or sold pursuant to the Liability Management Exercise) on or before 31 December 2013.

1.2 Whilst in the event that the Liability Management Exercise is unsuccessful, the Company would take immediate action to try to address its capital shortfall, including holding urgent discussions with the PRA, the Company believes that in such circumstances the failure of the Liability Management Exercise would result in the Company becoming subject to a resolution procedure under the Banking

Act. The consequences of a failure of the Liability Management Exercise are set out on page 43 of the Bank T2 Notes Prospectus under the paragraph headed "*Consequences of a failure of the Liability Management Exercise*". Risks relating to the implementation of the Liability Management Exercise (of which the Scheme forms an integral part) and the potential failure of the Liability Management Exercise including those referred to in paragraph 1.1 above are set out at pages 41 to 51 of the Bank T2 Notes Prospectus under the section headed "*Risks Relating to the Liability Management Exercise*" in section 2 (*Risk Factors*) of the Bank T2 Notes Prospectus.

2. If the conditions precedent to the effectiveness of the transactions contemplated by the Scheme are not satisfied, the Scheme may not be completed

2.1 The transactions contemplated by the Scheme will not become effective unless all the conditions precedent to the transactions contemplated by the Scheme are satisfied in accordance with the terms of the Scheme, including without limitation the Scheme Settlement Condition (as more fully described in paragraphs 1.33 and 1.34 of Part B (*Overview of the Scheme*). If this does not occur, it will not be possible to complete the transactions contemplated by the Scheme. In this regard, Scheme Creditors are referred to the paragraph entitled "*Failure of Holders to participate in the Liability Management Exercise*" on page 43 of the Bank T2 Notes Prospectus in section 2 (*Risk Factors*) of the Bank T2 Notes Prospectus.

3. Effectiveness of the Scheme requires the approval of Scheme Creditors

3.1 In order for the Scheme to be approved by the Scheme Creditors, at the Scheme Meeting more than 50 per cent. in number representing not less than 75 per cent. in value of those Scheme Creditors present and voting at that Scheme Meeting must vote in favour. If the requisite majority of Scheme Creditors do not vote in favour of the Scheme at the Scheme Meeting, the Scheme will not become effective and the transactions contemplated by the Scheme will not be implemented. As at 18 November 2013 certain Scheme Creditors have given an undertaking to vote in favour of the Scheme, however such undertakings will cease to be binding in certain circumstances as set out under the terms of the Lock-Up Arrangements.

3.2 Even if the Scheme is approved at the Scheme Meeting, it is possible for a person with an interest in the Scheme (whether a Scheme Creditor or otherwise) to object to the Scheme and to attend or be represented at the Scheme Sanction Hearing in order to make representations that the Scheme should not be approved and to appeal against the granting of the order sanctioning the Scheme. Therefore, it is possible that objections will be made at or before the Scheme Sanction Hearing or that an appeal will be made against the granting of the order sanctioning the Scheme by the Court and that any such objections or appeal will delay or possibly prevent the implementation of the transactions contemplated by the Scheme.

3.3 In order for the Scheme to become effective under English law, it must receive the sanction of the Court and the order sanctioning the Scheme must be delivered to the Registrar of Companies. The Court will not sanction the Scheme unless it is satisfied that the class of Scheme Creditors has been properly constituted and, as a matter of discretion, the Court considers that it is proper to sanction the Scheme. There can be no assurance that the Court will sanction the Scheme. If the Court does not sanction the Scheme, or approves it subject to conditions or amendments which (i) the Company and other relevant parties deem unacceptable or (ii) would have (directly or indirectly) a material adverse effect on the interests of any Scheme Creditors and such conditions or amendments are not approved by the Scheme Creditors, the Scheme will not become effective and the transactions contemplated by the Scheme will not be implemented.

RISKS RELATING TO THE SCHEME, INCLUDING THOSE RELATING TO THE COMPANY'S BUSINESS, THE SCHEME CONSIDERATION AND THE ADDITIONAL NEW ORDINARY SHARES

If the Scheme is implemented in accordance with its terms, Scheme Creditors will receive Scheme Consideration (subject to the terms of the Scheme (please see the Scheme and the description of the Scheme in Part B (Overview of the Scheme) of this Explanatory Statement for further details)) comprising New Ordinary Shares of the Company and Bank T2 Notes issued by the Company. Scheme Creditors may also elect to subscribe for Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer.

An investment in any or all of the Scheme Consideration or any Additional New Ordinary Shares (whether effected by way of the Scheme or otherwise) has risks and Scheme Creditors should carefully review and consider the risks set out or referred to in paragraph 4 below in respect of the Company and the Bank T2 Notes, and paragraph 5 below in respect of the New Ordinary Shares and the Additional New Ordinary Shares before making a decision in respect of the Scheme. Scheme Creditors' attention is also drawn to the risk factors at pages 7 to 8 of the Supplementary Prospectus.

The Bank T2 Notes Prospectus cross-referred to in this section can be found at Appendix 9 of this Explanatory Statement.

1. The Company and the Bank T2 Notes

1.1 Scheme Creditors should carefully consider the factors and risks associated with any investment in the Bank T2 Notes, the Company's business and the financial services industry in the United Kingdom (the **UK**) in which the Company operates, together with all the other information contained in the Bank T2 Notes Prospectus and all of the information incorporated by reference into the Bank T2 Notes Prospectus, including, in particular, the risks and uncertainties described below. Scheme Creditors should note that the risks relating to the Company, the financial services industry in the UK and the Bank T2 Notes summarised in section 1 of the Bank T2 Notes Prospectus – (*Summary of the Notes*) are risks that the Company believes to be the most essential to an assessment by a Scheme Creditor of whether to consider an investment in the Bank T2 Notes. However, as the risks which the Company faces relate to events and depend on circumstances that may or may not occur in the future, Scheme Creditors should consider not only the information on key risks summarised in section 1 of the Bank T2 Notes Prospectus headed "*Summary of the Notes*" but also, among other things, the risks and uncertainties described and/or referred to in paragraphs 4.2 and 4.3 below.

1.2 Section 2 (*Risk Factors*) of the Bank T2 Notes Prospectus describes the risk factors which are considered by the Company to be material to the Company and an investment in the Bank T2 Notes. However, these risk factors should not be regarded as a complete and exhaustive statement or explanation of all potential risks and uncertainties which Scheme Creditors may face when making an investment in the Bank T2 Notes and should be used as guidance only. There may be other risks and uncertainties which are currently not known to the Company or which the Company currently does not consider to be material. Should any of the risks described below, or any other risks or uncertainties, occur, this could, individually or cumulatively, have a material adverse effect on the Company's business, results of operation, financial condition or prospects which in turn would be likely to cause the price of the Bank T2 Notes to decline and, as a result, an investor in the Bank T2 Notes could lose some or all of its investment. Scheme Creditors should consider carefully whether an investment in the Bank T2 Notes is suitable for them in the light of the information contained in the Bank T2 Notes Prospectus and their personal circumstances.

1.3 Scheme Creditors are referred to the section entitled "*Risks relating to the Bank and its Business*" on page 51 of the Bank T2 Notes Prospectus and the section entitled "*Risks related to the features of the*

Notes" on page 91 of the Bank T2 Notes Prospectus in which, without prejudice to paragraphs 4.1 and 4.2 above, certain risks relating to the Company and the Bank T2 Notes contemplated therein are more fully described.

1.4 In addition, Scheme Creditors are referred to the following parts of section 2 "Risk Factors" of the Bank T2 Notes Prospectus:

(a) "*Risks related to applicable tax and other legislation*" on page 96;

(b) "*Risks related to the Market generally*" on page 97; and

(c) "*Risks relating to the holding structure of the Notes*" on page 97;

in which, without prejudice to paragraphs 4.1 to 4.3 above, certain other risks other risks relevant for Scheme Creditors in respect of the Scheme are described.

2. The New Ordinary Shares and Additional New Ordinary Shares

The value of New Ordinary Shares and Additional New Ordinary Shares may fluctuate significantly.

2.1 The value of the New Ordinary Shares and the Additional New Ordinary Shares may, in addition to being affected by the Company's actual or forecast operating results, fluctuate significantly as a result of a large number of factors, some specific to the Company and its operations or Co-operative Group and some which may affect the financial sector generally and which are outside the Company's control, including, among others:

(a) changes in the financial performance of the Company, its peers or the financial services industry;

(b) changes in laws, rules and regulations applicable to the Company and its operations;

(c) general economic, political and other conditions; and/or

(d) fluctuations in the equity and debt capital markets.

2.2 Any of these events could result in a decline in the market price of the New Ordinary Shares and the Additional New Ordinary Shares. In general, prospective investors should be aware that the value of an investment in the New Ordinary Shares and/or the Additional New Ordinary Shares may go down as well as up. The Company can give no assurance that the market price of New Ordinary Shares and/or the Additional New Ordinary Shares will not decline below the implied price of the New Ordinary Shares and/or the Additional New Ordinary Shares issued pursuant to the Scheme.

The New Ordinary Shares and Additional New Ordinary Shares are unlisted

2.3 On completion of the Liability Management Exercise, the New Ordinary Shares and Additional New Ordinary Shares will not be listed on the Official List maintained by the FCA or admitted to trading on the London Stock Exchange's Main Market for listed securities or any other market. As a result the Company will not be subject to the Listing Rules and the regulatory regime established thereunder or to monitoring by the FCA beyond those which the Company is already subject pursuant to the listing of certain of its debt securities (including the Bank T2 Notes). Furthermore, the Company will not be obliged to comply with corporate governance disclosure requirements for listed companies under the Disclosure and Transparency Rules, the Listing Rules and the Code.

2.4 However, the Bank T2 Notes to be issued by the Company pursuant to the Liability Management Exercise will be listed on the Official List and admitted to trading on the London Stock Exchange's Regulated Market. As a result, the Company will be subject to certain, but less extensive rules and regulations as a result of the listing of its debt securities. Furthermore under the terms of the Relationship Agreement entered into between Co-operative Group and the Company, the Company has agreed to comply with certain continuing obligations to the extent reasonably practicable and has agreed that it will use reasonable endeavours to comply with the UK Corporate Governance Code (as further described in pages 455 to 457 of the Bank T2 Notes Prospectus).

2.5 There has been no prior trading market for the New Ordinary Shares and the Additional New Ordinary Shares, whilst the ordinary shares of the Company have previously been held by CBGL as the Company's 99.9% shareholder. As a result, the realisation of an investment by a shareholder in the Company given the Company's status as an unlisted company is likely to be more difficult than the realisation of an investment in a company whose shares are listed on the Official List and admitted to trading on the London Stock Exchange's Main Market or on any other stock exchange. The Company has a stated intention to explore the possibility with the UK Listing Authority of seeking a premium listing of the ordinary shares of the Company (see page 152 of the Bank T2 Notes Prospectus) within 12 months of the completion of the Liability Management Exercise subject to meeting the necessary eligibility criteria. However, the Company can give no assurance that such discussions or applications will be successful, that the Company will meet the required eligibility criteria or that, should such discussions or applications be successful, an active trading market for the New Ordinary Shares or the Additional New Ordinary Shares will develop or, if developed, can be sustained. If an active trading market is not developed or maintained, the liquidity and trading price of the New Ordinary Shares and the Additional New Ordinary Shares could be materially and adversely affected. In addition, whilst the Company intends to explore the possibility of obtaining admission to the premium listing segment of the Official List, it is possible that the Company will only be able to satisfy the eligibility criteria for admission to the standard segment of the Official List. A standard listing affords a lower level of regulatory protection than that afforded to investors in companies whose securities are admitted to the premium segment. In particular, and similarly when the Company's ordinary shares are not listed, the UK Listing Authority would not have the authority to (and will not) monitor the Company's compliance with any of the Listing Rules and/or provisions of the Model Code or those aspects of the Disclosure and Transparency Rules which the Company has agreed to voluntarily comply with under the terms of the Relationship Agreement (beyond those which the Company is already subject to pursuant to the listing of its debt securities), nor impose any sanctions in respect of any failure by the Company to so comply. The Company's ordinary shares may therefore be difficult to sell compared to the shares of companies with more liquid trading markets and the share price may be subject to greater fluctuations than might otherwise be the case.

Shareholders may earn a negative or no return on their investment in the Company.

2.6 The Company's results of operations and financial condition are entirely dependent on the trading performance of the Company and the other members of its group. There can be no assurance that the Company will pay dividends in the future nor as to the level of future dividends (please refer to paragraph 9 of section 8 (*Dividend Policy*) of the Bank T2 Notes Prospectus). A dividend may never be paid and at present there is no expectation that the Company will pay dividends in the near future. In any event, the Company has agreed with the PRA not to make any dividend payments until further notice without the prior consent of the PRA. Notwithstanding this, the Directors will reconsider the Company's dividend policy as appropriate as the Company continues to develop and implement its strategy, taking into account factors such as the Company's financial position, cash requirements and liquidity and profits available regulatory requirements, the Company's regulatory outlook, capital position, investment needs and principal relevant risk factors subsisting at the time.

The Company's ability to pay dividends will also depend on the level of distributions, if any, received from its operating subsidiaries.

The issue of additional shares in the Company in connection with any share incentive or share option plan or otherwise may dilute all other shareholdings and may depress the price of the New Ordinary Shares and the Additional New Ordinary Shares.

2.7 The Company may seek to raise equity financing in the future and issue additional shares or convertible equity securities in connection with share incentive and share option plans. Future offers could dilute the holdings of the Company's shareholders (including those shareholders who acquire shares in the Company pursuant to the terms of the Scheme and the Additional New Ordinary Shares Offer), which may adversely affect the market price of the New Ordinary Shares and the Additional New Ordinary Shares and could impair the Company's ability to raise capital through future sales of equity securities.

Changes in taxation legislation or interpretation of tax legislation could affect the Company's ability to provide returns to shareholders of New Ordinary Shares and Additional New Ordinary Shares.

2.8 Any change in taxation legislation or the interpretation of tax legislation could affect the Company's ability to provide returns to shareholders of New Ordinary Shares and Additional New Ordinary Shares. Statements in this Explanatory Statement concerning the taxation of investors in New Ordinary Shares and Additional New Ordinary Shares are based on current tax law and practice in the United Kingdom and the United States, which are subject to change. The taxation of an investment in the Company depends on the individual circumstances of the relevant investor.

Shareholders outside the United Kingdom may not be able to participate in future equity offerings.

2.9 Holders of New Ordinary Shares and Additional New Ordinary Shares are, under the Company's articles of association, entitled to pre-emptive rights in respect of new issues of ordinary shares in the Company unless such rights are waived by a shareholders' resolution. Securities laws of certain jurisdictions may restrict the Company's ability to allow participation by holders of New Ordinary Shares and Additional New Ordinary Shares in future offerings. In particular, holders of New Ordinary Shares and/or Additional New Ordinary Shares in the United States may not be entitled to exercise these rights unless either the rights and the ordinary shares are registered under the Securities Act, or the rights and the ordinary shares are offered pursuant to an exemption from, or transaction not subject to, the registration requirements of the Securities Act.

The ability of ordinary shareholders outside the United Kingdom to bring actions or enforce judgments against the Company or the Directors may be limited.

2.10 The ability of a shareholder outside the United Kingdom to bring an action against the Company may be limited under law. The Company is a public limited company incorporated in England and Wales. The rights of holders of New Ordinary Shares and Additional New Ordinary Shares are governed by English law and by the Company's articles of association. These rights differ from the rights of shareholders in typical US corporations and some other non-UK corporations. A shareholder from outside the United Kingdom may not be able to enforce a judgment against some or all of the Directors and executive officers. The majority of the Directors and executive officers are residents of the United Kingdom. Consequently, it may not be possible for a shareholder outside the United Kingdom to effect service of process upon the Directors and executive officers within that shareholder's country of residence or to enforce against the Directors and executive officers judgments of courts of that shareholder's country of residence based on civil liabilities under that country's laws.

Following the Scheme Settlement Date, the Company may have other major shareholders that will also be able to exercise significant influence over matters requiring shareholder approval in addition to CBGL and Co-operative Group.

2.11 Immediately following the completion of the Liability Management Exercise, it is possible that certain Holders of Dated Notes will have acquired sufficient holdings of ordinary shares such that these shareholders, in addition to Co-operative Group and CBGL, will be able to exercise a degree of influence over matters requiring shareholder approval, including the election of Directors and significant corporate transactions. The concentration of ownership may have the effect of delaying or deterring a change in control of the Company, could deprive investors of an opportunity to receive a premium for their ordinary shares as part of a sale of the Company and might affect the value of the ordinary shares. Any of the major shareholders may sell all or part of its holdings of ordinary shares in the future. Any such sale may adversely affect the value of the ordinary shares.

When the certain restrictions to which Co-operative Group and CBGL are subject expire, more ordinary shares may become available on the market.

2.12 Under the terms of the Relationship Agreement and subject to certain limited exceptions, Co-operative Group and CBGL will be prevented from selling ordinary shares held by them for a period of five years following the effective date of the Relationship Agreement. On the expiry of this period, Co-operative Group and CBGL will be free (subject to applicable law) to sell the ordinary shares in the Company held by them. The potentially increased supply of ordinary shares on the market may have an adverse effect on the market price of the ordinary shares. Similarly, any sale by Co-operative Group and/or CBGL may affect the confidence of the market in the ordinary shares and cause the market price of the ordinary shares to fall.

An investment in the Company is speculative and carries a considerable degree of risk.

2.13 An investment in the Company is highly speculative, involves a considerable degree of risk and is suitable only for persons or entities which have substantial financial means and who can afford to hold their ownership interests for an indefinite amount of time.

US Foreign Account Tax Compliance Act withholding may affect payments on Ordinary Shares.

2.14 Sections 1471 through 1474 of the FATCA impose a new reporting regime and, potentially, a 30 per cent. withholding tax with respect to (i) certain payments from sources within the United States, (ii) "foreign passthru payments" made to certain non-US financial institutions that do not comply with this new reporting regime, and (iii) payments to certain investors that do not provide identification information with respect to interests issued by a participating non-US financial institution. The Company will be classified as a financial institution for these purposes. If an amount in respect of such withholding tax were to be deducted or withheld from payments made in respect of New Ordinary Shares and/or Additional New Ordinary Shares, neither the Company nor any paying agent nor any other person would be required to pay additional amounts as a result of the deduction or withholding. Prospective investors should refer to the section "*Foreign Account Tax Compliance Act*" in "*Section 19 – Taxation*" on page 415 of the Bank T2 Notes Prospectus.

PART E

INFORMATION ON THE COMPANY AND ADDITIONAL INFORMATION RELATING TO THE SCHEME

The Scheme is a scheme of arrangement of the Company and the Scheme Consideration includes the issue of New Ordinary Shares and Bank T2 Notes to the Scheme Creditors by the Company as well as the right to elect to subscribe for Additional New Ordinary Shares pursuant to the terms of the Additional New Ordinary Shares Offer. In order to assist Noteholders in considering the Scheme this section sets out or cross-refers to information about the Company and its business in the Bank T2 Notes Prospectus. Scheme Creditors should carefully review the information in the Bank T2 Notes Prospectus cross-referred to below.

This Part E (Information on the Company and additional information relating to the Scheme) contains or cross-refers to forward looking statements that involve risks and uncertainties. The actual results of the Company could differ materially from those anticipated in these forward looking statements as a result of such risks and uncertainties. Scheme Creditors should read the section headed "Forward looking statements" in the Important Notice of this Explanatory Statement in connection with the risks and uncertainties in relation to those statements.

1. DESCRIPTION OF THE COMPANY AND ITS BUSINESS

1.1 For a summary of the Company and its business, Scheme Creditors are referred to section B entitled "*Issuer*" in part 1 (*Summary*) on pages 7 to 16 of the Bank T2 Notes Prospectus which is made up of certain disclosure requirements known as "*Elements*" of which Elements B.1 – B.17 are the summary disclosure relating specifically to the Company.

1.2 For a more detailed description of the Company and its business, Scheme Creditors are referred to section 8 entitled "*Description of the Bank*" on pages 145 to 185 of the Bank T2 Notes Prospectus which provides a brief history of the Company and its current status, including key strengths and strategy, a discussion of the Company's structure and a business overview including a description of both its core and non-core businesses which includes information on financial performance and strategic objectives.

2. FINANCIAL INFORMATION RELATING TO THE COMPANY

2.1 The Bank T2 Notes Prospectus includes financial information about the Company and its business and analysis and discussion (as applicable) of certain of that financial information to which Scheme Creditors are referred as follows:

(a) the selected financial information of the Company and its subsidiaries, in section 11 entitled "*Selected Financial Information*" on pages 198 to 201 of the Bank T2 Notes Prospectus which contains a consolidated income statement, consolidated balance sheet and consolidated cashflow statement of the Company for the financial years ended 31 December 2012, 2011 and 2010;

(b) the more detailed financial information of the Company and its subsidiaries in section 16 entitled "*Financial Information*" on pages 278 to 396 of the Bank T2 Notes Prospectus which contains audited financial information for the six months ended 30 June 2013 and unaudited pro forma financial information as at 30 June 2013. This section also includes the accountant's reports to the extent applicable;

(c) the financial information regarding the division between the core and non-core business of the Company in section 15 entitled "*Segmental Financial and Other Information*" on pages

265 to 277 of the Bank T2 Notes Prospectus which includes profit and loss accounts and balance sheets, key performance indicators, lending and loan portfolios and the loan risk analysis for each of the core and non-core businesses;

(d) the summary of the Company's audited consolidated capitalisation as at June 2013 in section 10 entitled "*Capitalisation and Indebtedness*" on pages 196 to 197 of the Bank T2 Notes Prospectus; and

(e) the information relating to the capital adequacy of the Company, in section 13 entitled "*Capital Adequacy*" on pages 232 to 243 of the Bank T2 Notes Prospectus which contains an overview of the Company's capital policy and its recapitalisation plan. It also contains an overview of both the Company's capital resources under Basel II and its capital position.

2.2 For a discussion of the results of operations of the Company for the financial periods ending 30 June 2013 and 2012, Scheme Creditors are referred to section 12 entitled "*Operating and Financial Review*" on pages 202 to 231 of the Bank T2 Notes Prospectus which contains a detailed discussion on the Financial Information referred to in paragraph 2.1 above. Section 12 of the Bank T2 Notes Prospectus also includes a discussion of the key factors affecting the results of operations, the current trading of the Company, the profit forecast, the results of operation and liquidity and funding.

2.3 In addition to the information referred to above, the following financial statements can be found at Appendix 8 (*Financial Statements*) of this Explanatory Statement:

(a) Interim Financial Statements and accounts of the Company for the period ending June 2013;

(b) Financial Statements and accounts of the Company for the financial year ended 31 December 2012;

(c) Financial Statements and accounts of the Company for the financial year ended 31 December 2011; and

(d) Financial Statements and accounts of the Company for the financial year ended 31 December 2010.

2.4 For details of the Company's risk management, Scheme Creditors are referred to section 14 entitled "*Risk Management*" on pages 244 to 264 of the Bank T2 Notes Prospectus and for details of the supervision and regulation in respect of the Company, Scheme Creditors are referred to section 17 entitled "*Supervision and Regulation*" on pages 397 to 408 of the Bank T2 Notes Prospectus.

3. DESCRIPTION OF THE ORDINARY SHARE CAPITAL OF THE COMPANY

3.1 The Company was incorporated with an issued share capital of £100 divided into 100 ordinary shares of £1.00 each, which were issued to the subscribers to the Company's articles of association on incorporation.

3.2 On 1 January 2010 (being the date of the commencement of the period for which historical financial information has been provided in the Bank T2 Notes Prospectus), the issued share capital of the Company was £290 million divided into:

(a) 4,600 million ordinary shares of £0.05 each; and

(b) The Preference Shares.

3.3 By a resolution of the Company passed on 15 December 2010, the Company issued a further 3,600 million ordinary shares of £0.05 each.

3.4 The issued and fully paid share capital of the Company as at 18 November 2013 is as follows:

	Number	Amount
Existing Ordinary Shares of £0.05 each	8,200,000,000	£410,000,000
Preference Shares of £1.00 each	60,000,000	£60,000,000

3.5 If:

(a) the Liability Management Exercise is successfully completed;

(b) there are no further issues of ordinary shares of the Company prior to completion of the Liability Management Exercise; and

(c) there are no other issues of preference shares of the Company prior to completion of the Liability Management Exercise, save for any Preference Shares issued in respect of the scheduled dividend payment due on 30 November 2013,

the Existing Ordinary Shares in the Company will be converted into deferred shares and effectively reduced to nil and a total of 250,000,000 ordinary shares of the Company will be issued at that time, such that the issued and fully paid up share capital of the Company immediately following completion of the Liability Management Exercise will be as follows:

	Number	Amount
Number of ordinary shares of the Company of £0.05 each	250,000,000	£12,500,000
Preference Shares of the Company of £1.00 each	63,700,000	£63,700,000

3.6 Upon the successful completion of the Liability Management Exercise:

(a) the Noteholders (and, if applicable, in accordance with the terms of the Additional New Ordinary Shares Offer, the Modified Scheme Purchasers) will acquire in total 175,000,000 ordinary shares of the Company;

(b) Co-operative Group (through CBGL) will control in total 75,000,000 ordinary shares of the Company (representing 30 per cent. of the total); and

(c) Co-operative Group will control in total 63,700,000 preference shares.

3.7 There will be no differences between the voting rights enjoyed by Co-operative Group (through CBGL) and those enjoyed by any other holder of ordinary shares of the Company.

3.8 For a description of the measures in place to ensure that the voting rights exercised over the Company by Co-operative Group and its affiliates (including CBGL) are not abused, see paragraph 20.3 entitled "*Relationship Agreement*" in section 20 entitled "*Additional Information*" on pages 455 to 457 of the Bank T2 Notes Prospectus.

3.9 Save as disclosed in the Bank T2 Notes Prospectus,

(a) no share or loan capital of the Company or any of its subsidiaries has within the period covered by the historical financial information set out in this Bank T2 Notes Prospectus

(other than intra-group issues by wholly owned subsidiaries or pursuant to the offer) been issued or been agreed to be issued fully or partly paid, either for cash or for a consideration other than cash and no such issue is now proposed;

(b) no commissions, discounts, brokerages or other special terms have been granted by the Company or any of its subsidiaries within the period covered by the historical financial information set out in this Bank T2 Notes Prospectus in connection with the issue or sale of any share or loan capital of any such company; and

(c) no share or loan capital of the Company or any of its subsidiaries is under option or agreed, conditionally or unconditionally, to be put under option.

3.10 The New Ordinary Shares will comprise voting ordinary shares in the Company (ISIN: GB00BDW0BX87; SEDOL: BDW0BX8) having a nominal value of £0.05 each.

3.11 The New Ordinary Shares and Additional New Ordinary Shares will be in registered form and, subject to the provisions of the CREST Regulations, the Directors may permit the holding of shares in any class of shares in uncertificated form and title to such shares may be transferred by means of a relevant system (as defined in the CREST Regulations).

Accordingly, it is expected that the New Ordinary Shares and the Additional New Ordinary Shares will be issued in CREST. With respect to New Ordinary Shares and Additional New Ordinary Shares held in CREST, it will be possible to trade interests in such New Ordinary Shares and Additional New Ordinary Shares indirectly in Euroclear and Clearstream, Luxembourg. In this case, the New Ordinary Shares and Additional New Ordinary Shares themselves will be held in a CREST account by a nominee for Euroclear or Clearstream, Luxembourg (as applicable), and Euroclear and Clearstream, Luxembourg will enable interests representing the New Ordinary Shares and Additional New Ordinary Shares held in those nominee accounts to be traded in Euroclear and Clearstream, Luxembourg.

3.12 No application will be made for admission of the New Ordinary Shares and Additional New Ordinary Shares to the Official List maintained by the FCA or to trading on the London Stock Exchange or any other stock exchange.

Going forward, the Company intends to explore the possibility with the UK Listing Authority of seeking a premium listing of the Ordinary Shares on the Official List within 12 months of completion of the Liability Management Exercise, subject to meeting the necessary eligibility criteria.

4. DIRECTORS

4.1 The Bank T2 Notes Prospectus includes the following information on the Directors of the Company to which Scheme Creditors are referred:

(a) a short biography of each of the Directors of the Company on pages 187 to 189 of Section 9 entitled "*Directors, Senior Management, Employees and Corporate Governance*" of the Bank T2 Notes Prospectus;

(b) a list of the directorships that the Directors have held and partnerships that the Directors have been members of within the past five years is set out in Subsection 13 entitled "*Directors and Senior Management*" of section 20 entitled "*Additional Information*" on pages 430 to 433 of the Bank T2 Notes Prospectus; and

(c) information on the Directors' interests in the Company in Subsection 14 entitled "*Directors' and Senior Managers' Interests in the Bank*" in section 20 entitled "*Additional Information*" on pages 434 to 435 of the Bank T2 Notes Prospectus.

5. MATERIAL INTERESTS OF DIRECTORS AND TRUSTEES

5.1 Directors of the Company

(a) The directors of the Company and their functions are:

Name	Position
Richard Pym	Chairman
Niall Booker	Chief Executive Officer
Rodney Jensen Bulmer	Deputy Chief Executive Officer and Executive Director
John Richard Coates	Non-Executive Director
Anne Margaret Gunther	Non-Executive Director
Richard Graeme Barclay Hardie	Non-Executive Director
Merlyn Vivienne Lowther	Non-Executive Director
Euan Angus Sutherland	Non-Executive Director
Bennet Lyle Edward Reid	Non-Executive Director
William Gennydd Thomas	Non-Executive Director

(b) As at 18 November 2013 (being the latest practicable date prior to the publication of this Explanatory Statement) and as is expected to be the position immediately following the Scheme Settlement Date, none of the Directors have any interests in the share capital of the Company which:

(i) are required to be notified to the Company pursuant to Chapter 3 of the Disclosure and Transparency Rules; or

(ii) are interests of a connected person (within the meaning of Schedule 11B of FSMA) which would be required to be disclosed under paragraph (i) above and the existence of which is known to or could with reasonable diligence be ascertained by that Director or Senior Manager, as at 18 November 2013 (being the latest practicable date prior to the publication of this Explanatory Statement).

(c) No Director will have any interest in the share capital or loan capital of the Company on the Scheme Settlement Date and there is no person to whom any capital of any member of the Company or any of its subsidiaries is under award or option or agreed unconditionally to be put under award or option.

(d) The Directors intend to consider after the Scheme Settlement Date incentive arrangements for Company employees, including those over ordinary shares, and will seek shareholder approval in respect of such arrangements, as required.

(e) CBGL, as the holder of approximately 99.9 per cent. of the existing common equity of the Company, and Co-operative Group, as the controller of 100 per cent. of the voting capital in CBGL, are the only persons known to the Company who directly or indirectly could exercise or do exercise control over the Company as described in paragraph (q) below, certain directors of Co-operative Group and/or CBGL are also directors of the Company.

(f) Subject to the voting restrictions in the Relationship Agreement (as described in the Bank T2 Notes Prospectus) there are no differences between the voting rights enjoyed by the shareholder described in paragraph (e) above and those enjoyed by any other holder of New Ordinary Shares in the Company.

(g) Pursuant to the articles of association of the Company, which will be proposed for approval at a general meeting of the Company to be held on 15 November 2013, and as referred to in the Relationship Agreement, Co-operative Group has the right to nominate up to two persons to be members of the Board for so long as certain circumstances continue to exist. As at 18 November 2013, Co-operative Group's nominated directors are Euan Angus Sutherland and Bennett Lyle Edward Reid and they are intended to constitute as such under the articles of association of the Company.

(h) Euan Angus Sutherland is the chief executive of Co-operative Group and a director of CBGL. Bennett Lyle Edward Reid is a director of Co-operative Group Holdings (2011) Limited and Co-operative Group. Euan and Bennett are nominee directors of Co-operative Group and are intended to constitute nominee directors for the purposes of the articles of association of the Company, which will be proposed for approval at a general meeting of the Company to be held on 15 November 2013, and as referred to in the Relationship Agreement. Under the terms of the Relationship Agreement, Co-operative Group acknowledges that its nominee director(s) shall not be able to vote at board meetings of the Company on any matter where there is a conflict of interests or potential conflict of interests between the Company or any of its subsidiaries (on the one hand) and Co-operative Group or any of its subsidiaries (excluding the Company and its subsidiaries) (on the other hand). Save as disclosed in this paragraph (h), none of the directors has any potential conflict of interest between their duties to the Company and their private interests and/or their duties to third parties.

(i) None of the Directors has or has had any interest in any transaction which is or was unusual in its nature or conditions or significant to the business which was effected by the Company or any of its subsidiaries during the current or immediately preceding financial year, or which was effected during an earlier financial year and remains in any respect outstanding or unperformed.

(j) None of the Directors has or had a beneficial interest in any contract to which the Company or any of its subsidiaries was a party during the current or immediately preceding financial year.

(k) Except as disclosed below, no Director was selected to act in such capacity pursuant to any arrangement or understanding with any shareholder, customer, supplier or any other person having a business connection with the Company or any of its subsidiaries.

(l) Apart from the Liability Management Exercise, the result of which, if successful, will reduce CBGL's shareholding of the issued ordinary shares in the Company to approximately 30 per cent., the Company and the Directors are not aware of any arrangement the operation of which may at a subsequent date result in a change in control of the Company.

(m) None of the directors of the Company has any direct interest in the share capital of the Company, nor any non-beneficial interest in the share capital of the Company.

(n) None of the directors of the Company has any material interest (whether as a director, member, creditor or otherwise) in the Scheme, except as disclosed in (o) below. Save as disclosed in this section 5 (*Material interests of Directors and Trustees*), the effect of the

Scheme on interests of the directors of the Company will not be different from the effect on like interests of other persons.

(o) On the Scheme Settlement Date, the directors of the Company will receive the benefit of releases granted under the terms of the Deed of Waiver and Release.

(p) The Modified Scheme Purchasers have agreed to meet certain costs and liabilities of the Company and certain related parties incurred in connection with an application by the Company to the Court on 2 December 2013 to amend this Explanatory Statement from the form published on or around 18 November 2013 and the amendments to this Explanatory Statement made as a result of such application.

(q) Pursuant to the 2014 Commitment Agreement, the Company and Co-operative Group have agreed to waive each and every claim which they may have against the Directors in relation to or in connection with or in any way arising out of the preparation, negotiation or implementation of the Liability Management Exercise or the recapitalisation of the Company and/or the circumstances which gave rise to the requirement for a recapitalisation of the Company (provided that this does not preclude any such persons from enforcing any rights under any of the transaction documentation entered into in connection with the Recapitalisation Plan). For further details on the 2014 Commitment Agreement see subsection 20.4 entitled "*2014 Commitment Agreement*" in section 20 entitled "*Additional Information*" on pages 457 to 460 of the Bank T2 Notes Prospectus.

(r) Some of the directors of the Company are also directors of a number of other companies within the Group, as set out in the table referred to in paragraph 4.1(b) above including Co-operative Group that are directly involved in the Scheme.

5.2 Director confirmations

Save as disclosed below, as at 18 November 2013 none of the Directors has at any time within at least the past five years:

(a) save as disclosed in this Part E, been a director or partner of any companies or partnerships; or

(b) had any convictions in relation to fraudulent offences (whether spent or unspent); or

(c) been adjudged bankrupt or entered into an individual voluntary arrangement; or

(d) been a director of any company at the time of, or within 12 months preceding, any receivership, compulsory liquidation, creditors' voluntary liquidation, administration, company voluntary arrangement or any composition or arrangement with that company's creditors generally or with any class of its creditors; or

(e) been a partner in a partnership at the time of, or within 12 months preceding, any compulsory liquidation, administration or partnership voluntary arrangement of such partnership; or

(f) had his assets form the subject of any receivership or been a partner of a partnership at the time of, or within 12 months preceding, any assets thereof being the subject of a receivership; or

(g) been subject to any official public incrimination and/or sanctions by any statutory or regulatory authority (including any designated professional body); or

(h) ever been disqualified by a court from acting as a director of a company or from acting in the management or conduct of the affairs of any company.

5.3 Richard Graeme Barclay Hardie was a non-executive director of Dunfermline Building Society from September 2008 to March 2009. A sale process was conducted by the Bank of England in March 2009 under the Special Resolution Regime provisions of the Banking Act. Richard was brought in by Dunfermline Building Society to assist with the challenges it was facing at the time.

5.4 Richard Pym has been Chairman of Northern Rock (Asset Management) plc since January 2010. Northern Rock plc was nationalised and taken into Government ownership in February 2008 and was then restructured into two legal entities on 31 December 2009 – Northern Rock plc and Northern Rock (Asset Management) plc. Richard was appointed Chief Executive of Bradford & Bingley in August 2008 and was appointed Chairman in November 2008. On 29 September 2008, all of Bradford & Bingley's retail branches and its savings accounts were transferred to Abbey, and subsequently rebranded Santander. The remainder of the business, including the mortgage books of Bradford & Bingley and specialist lending arm Mortgage Express were nationalised and taken into public ownership by the Government. Since July 2010 Richard has been Chairman of UK Asset Resolution Limited which was established to facilitate the orderly management of the closed mortgage books of both Bradford & Bingley plc and Northern Rock (Asset Management) plc to maximise value for taxpayers.

5.5 Trustee

(a) The Law Debenture Trust Corporation p.l.c. (in its capacity as the trustee for each series of the Dated Notes) has a material interest in the Scheme by reason of being a Scheme Creditor. Law Debenture Trustees Limited will act as the Bank T2 Notes Trustee upon issuance of the Bank T2 Notes on the Scheme Settlement Date pursuant to the terms of the Bank T2 Notes Trust Deed.

(b) Save as disclosed in this section 5 (*Material interests of Directors and Trustees*), the effect of the proposed Scheme on interests of the Trustees described in this section 5 (*Material interests of Directors and Trustees*) will not be different from the effect on like interests of other persons.

(c) On the Scheme Settlement Date, The Law Debenture Trust Corporation p.l.c. (in its capacity as trustee for each series of the Dated Notes) will receive the benefit of releases granted under the terms of the Deed of Waiver and Release.

6. MATERIAL CONTRACTS

6.1 Scheme Creditors are referred to paragraph 20 entitled "*Material Contracts*" in section 20 "*Additional Information*" on pages 441 to 464 of the Bank T2 Notes Prospectus, which includes a summary of each contract that has been entered into (other than in the ordinary course of business) by the Company or any of its subsidiaries, which are material to the Company.

7. MATERIAL LITIGATION

7.1 Scheme Creditors are referred to paragraph 21 entitled "*Litigation and Arbitration*" in section 20 "*Additional Information*" on pages 464 to 467 of the Bank T2 Notes Prospectus, which sets out the governmental, legal or arbitration proceedings which may have or have had in the 12 months prior to the date of this Explanatory Statement a significant effect on the financial position or profitability of the Company and/or the Company and its subsidiaries. Scheme Creditors are also referred to pages 8 and 9 of the Supplementary Prospectus.

8. COSTS IN RELATION TO THE SCHEME

The Company has agreed to meet certain of the costs, charges, expenses and disbursements reasonably incurred by the Information Agent, the Common Depositaries, the Trustees and the LT2 Group in connection with the negotiation, preparation and implementation of the Scheme.

PART F

TAXATION

In view of the number of different jurisdictions where tax laws may apply to Scheme Creditors, this Explanatory Statement does not, save as set out or cross-referred to below in respect of certain United Kingdom taxation matters, discuss the tax consequences for Scheme Creditors arising from the exchange of their Dated Notes in the Scheme, the receipt or transfer of New Ordinary Shares and/or Bank T2 Notes or the receipt of Additional New Ordinary Shares.

*The information regarding United Kingdom taxation set out or cross-referred to below is intended as a general summary of certain United Kingdom tax considerations and does not purport to be a complete analysis of all potential UK tax consequences for Scheme Creditors arising from the exchange of their Dated Notes in the Scheme. It is based on current UK tax law and what is understood to be the published practice of HM Revenue & Customs (**HMRC**) as at 18 November 2013 , both of which are subject to change, possibly with retrospective effect. The information cross-referred to below is intended to apply only to:*

(a) in the case of paragraph 1 below, Scheme Creditors who are resident in the UK for UK tax purposes, who hold their Dated Notes as investments (other than under an individual savings account) and who are the beneficial owners of their Dated Notes;

(b) in the case of paragraph 2 below, holders of the Bank T2 Notes who (unless the position of non-UK resident shareholders is expressly referred to in the part of the Bank T2 Notes Prospectus referred to in paragraph 2) are resident in the UK for UK tax purposes, who hold their Bank T2 Notes as investments (other than under an individual savings account) and who are the beneficial owners of their Bank T2 Notes and any interest paid on them

(c) in the case of paragraph 3 below, holders of the New Ordinary Shares and Additional New Ordinary Shares who (unless the position of non-UK resident shareholders is expressly referred to therein, are resident in the UK for UK tax purposes, who hold their New Ordinary Shares and Additional New Ordinary Shares as investments (other than under an individual savings account) and who are the beneficial owners of their New Ordinary Shares and Additional New Ordinary Shares and any dividends paid on them;

The statements set out or cross-referred to in paragraphs 1, 2 or 3 below may not apply to certain classes of Scheme Creditors such as dealers in securities. The information set out or cross-referred to in paragraphs 1, 2 or 3 below is not exhaustive, nor is it tailored to any specific investor.

The information set out or cross-referred to in paragraphs 1, 2 or 3 below does not constitute tax advice. Scheme Creditors who are in any doubt as to their tax position regarding the exchange of their Dated Notes pursuant to the Scheme are urged to consult their own professional advisers regarding the possible tax consequences under the laws of the jurisdictions that apply to them.

Scheme Creditors are liable for their own taxes and have no recourse to the Company, the Dealer Managers, the Information Agent, the Registrars or any other entity or person named in this Explanatory Statement with respect to taxes arising in connection with the Scheme.

1. LIABILITY MANAGEMENT EXERCISE

Scheme Creditors are referred to the section entitled "Dated Notes" in Section I "Taxation Considerations" on pages C-158 to C-162 of the Offer Memorandum (which is appended to the Bank T2 Notes Prospectus) which discusses, in respect of certain United Kingdom tax matters, certain tax consequences for Scheme Creditors arising from the exchange of their Dated Notes in the Scheme.

2. POTENTIAL UK TAX CONSEQUENCES OF HOLDING THE BANK T2 NOTES

In addition to the above, Scheme Creditors are also directed to section 19 "*Taxation*" on pages 411 to 416 of the Bank T2 Notes Prospectus which contains further information relevant to the potential UK tax consequences of holding Bank T2 Notes.

3. POTENTIAL UK TAX CONSEQUENCES OF HOLDING NEW ORDINARY SHARES (INCLUDING ADDITIONAL NEW ORDINARY SHARES)

3.1 Disposal of New Ordinary Shares

(a) Taxation of Chargeable Gains

A disposal by a shareholder of all or any New Ordinary Shares or Additional New Ordinary Shares following their acquisition pursuant to the terms of the Scheme may, depending on the shareholder's circumstances (including the availability of exemptions and reliefs) give rise to a chargeable gain or an allowable loss.

United Kingdom Resident Individuals

A disposal by a shareholder within the charge to UK capital gains tax, such as an individual, trustee or personal representative, will, subject to the availability to the shareholder of any exemptions, reliefs and/or allowable losses (including the annual exempt amount which is £10,900 for the tax year 2013/2014), be subject to tax on any gain at the rate of 18 per cent. (in the case of individuals subject to income tax at the basic rate) or 28 per cent. (in the case of individuals subject to income tax at the higher or additional rates), with no taper relief or indexation allowance.

Individuals who are temporarily non-UK resident may, in certain circumstances, be subject to tax in respect of gains realised whilst they are not resident in the UK.

United Kingdom Corporation Tax Payers

Shareholders within the charge to UK corporation tax will, for the purposes of computing gains but not losses, be allowed to claim an indexation allowance.

3.2 Taxation of Dividends

(a) Withholding tax

The Company will not be required to withhold tax at source from dividend payments it makes.

(b) Taxation of Dividends

United Kingdom Resident Individuals

An individual shareholder who is resident in the UK for tax purposes and who receives a dividend from the Company will be entitled to a tax credit which may be set off against his total income tax liability on the dividend. The tax credit will be equal to 10 per cent. of the aggregate of the dividend and the tax credit (the gross dividend), or one-ninth of the amount of the cash dividend received.

The gross dividend will be regarded as the top slice of the individual's income.

A UK resident individual shareholder who is liable to income tax at the basic rate will be subject to income tax on the dividend at the rate of 10 per cent. of the gross dividend so that the tax credit will satisfy in full such shareholder's liability to income tax on the dividend.

A UK resident individual shareholder liable to income tax at the higher rate will be subject to income tax on the gross dividend at 32.5 per cent. but will be able to set the tax credit off against part of this liability. The effect of that set-off of the tax credit is that such a shareholder will have to account for additional tax equal to 22.5 per cent. of the gross dividend (or 25 per cent. of the net cash dividend received).

A UK resident individual shareholder liable to income tax at the additional rate will be subject to income tax on the gross dividend at 37.5 per cent. but will be able to set the tax credit off against part of this liability. The effect of that set-off of the tax credit is that such a shareholder will have to account for additional tax equal to 27.5 per cent. of the gross dividend (or just over 30.5 per cent. of the net cash dividend received).

A UK resident individual shareholder who is not liable to income tax in respect of the gross dividend and shareholders which are not generally liable to UK tax on dividends (including pension funds and charities) will not be entitled to any payment from HMRC in respect of the tax credit attached to the dividend.

United Kingdom Corporation Tax Payers

Shareholders which are "small companies" for the purposes of UK taxation of dividends will not generally be subject to tax on dividends received from the Company. Other shareholders within the charge to UK corporation tax will not be subject to tax on dividends received from the Company so long as the dividends fall within an exempt class and certain other conditions are met.

Corporate shareholders will not be entitled to any payment from HMRC in respect of the tax credit attaching to the Company's dividends.

3.3 Stamp Duty and Stamp Duty Reserve Tax

The following statements about UK stamp duty and stamp duty reserve tax (**SDRT**) apply regardless of whether or not a shareholder is resident or domiciled in the UK.

Issue of New Ordinary Shares pursuant to the Scheme

Following recent case law, no stamp duty or SDRT should be payable in the UK on the issue of the New Ordinary Shares or Additional New Ordinary Shares (or interests therein) into the Euroclear and Clearstream clearing systems.

No stamp duty or SDRT will be payable on the issue of New Ordinary Shares or Additional New Ordinary Shares into CREST or in certificated form.

Transfers of New Ordinary Shares or Additional New Ordinary Shares

In the case of transfers of New Ordinary Shares or Additional New Ordinary Shares within the Euroclear and Clearstream clearing systems, provided no election is made or has been made under section 97A of the Finance Act 1986 (that applies to the New Ordinary Shares or the Additional New Ordinary Shares), no stamp duty or SDRT should be payable on such a transfer of the New Ordinary Shares or Additional New Ordinary Shares, without an instrument of transfer.

Transfers of New Ordinary Shares or Additional New Ordinary Shares within the Euroclear and Clearstream clearing systems where an election is made or has been made under section 97A of the Finance Act 1986 (that applies to the New Ordinary Shares or the Additional New Ordinary Shares) will generally be subject to SDRT (rather than stamp duty) at the rate of 0.5 per cent. of the amount or value of the consideration.

Transfers of New Ordinary Share or Additional New Ordinary Shares or Additional New Ordinary Shares s in uncertificated form within the CREST system will generally be subject to SDRT (rather than stamp duty) at the rate of 0.5 per cent. of the amount or value of the consideration.

If New Ordinary Shares are held in certificated form outside CREST and the Euroclear and Clearstream clearing systems, transfers of such New Ordinary Shares or Additional New Ordinary Shares will generally be subject to stamp duty at the rate of 0.5 per cent. of the consideration given (rounded up to the nearest £5). SDRT may be payable on an agreement to transfer such New Ordinary Shares or Additional New Ordinary Shares generally at the rate of 0.5 per cent. of the consideration given under the agreement to transfer the New Ordinary Shares or Additional New Ordinary Shares. This charge to SDRT would be discharged if stamp duty is duly paid on the instrument transferring the New Ordinary Shares or Additional New Ordinary Shares, within six years of the date of the agreement.

If New Ordinary Shares or Additional New Ordinary Shares (or interests therein) are subsequently transferred into the Euroclear and Clearstream clearing systems, stamp duty or SDRT will generally be payable at the rate of 1.5 per cent. of the amount or value of the consideration given or, in certain circumstances, the value of the shares (save to the extent that an election is made or has been made under section 97A of the Finance Act 1986 that applies to the New Ordinary Shares or the Additional New Ordinary Shares as relevant).

THE ABOVE DESCRIPTION OF TAXATION IS GENERAL IN CHARACTER. IF YOU ARE IN ANY DOUBT AS TO YOUR TAX POSITION, YOU SHOULD CONSULT AN APPROPRIATE PROFESSIONAL ADVISER WITHOUT DELAY.

PART G

THE SCHEME

THE SCHEME

No. 7830 of 2013

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

IN THE MATTER OF THE CO-OPERATIVE BANK P.L.C.

and

IN THE MATTER OF THE COMPANIES ACT 2006

SCHEME OF ARRANGEMENT
(under Part 26 of the Companies Act 2006)

between

THE CO-OPERATIVE BANK P.L.C.

and

THE SCHEME CREDITORS
(as hereinafter defined)

Clause **Page**

1. Definitions and Interpretation.....100
2. Recitals 108
3. The Scheme 110

Schedule

1. Form of Deed of Waiver and Release……....122
2. Form of Distribution Agreement...……....133

1. DEFINITIONS AND INTERPRETATION

1.1 In this Scheme, unless inconsistent with the subject or context, the following expressions shall have the following meanings:

5.5555% Bondholders means the holders of the 5.5555% Bonds.

5.5555% Bondholders Meeting means the meeting of the 5.5555% Bondholders convened in connection with the Liability Management Exercise (including any adjournment of such meeting).

5.5555% Bonds means the 5.5555% perpetual subordinated bonds with ISIN: GB00B3VMBW45 issued by the Company in replacement of Britannia Building Society permanent interest bearing shares upon the Company's acquisition of Britannia Building Society on 1 August 2009.

13% Bondholders means the holders of the 13% Bonds.

13% Bondholders Meeting means the meeting of the 13% Bondholders convened in connection with the Liability Management Exercise (including any adjournment of such meeting).

13% Bonds means the 13% perpetual subordinated bonds with ISIN: GB00B3VH4201 issued by the Company in replacement of Britannia Building Society permanent interest bearing shares upon the Company's acquisition of Britannia Building Society on 1 August 2009.

2016 Notes means the floating rate callable step-up dated subordinated notes due 2016 with ISIN: XS0254625998 originally issued by Britannia Building Society and assumed by the Company upon the Company's acquisition of Britannia Building Society on 1 August 2009.

2016 Notes Noteholder means a person who is the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes representing the 2016 Notes as at the Record Date, whose interests in the 2016 Notes are held through records maintained in book entry form by a Clearing System**.**

2019 Notes means the 5.875% subordinated callable notes due 2019 with ISIN: XS0189539942 issued by the Company.

2019 Notes Noteholder means a person who is the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes representing the 2019 Notes as at the Record Date, whose interests in the 2019 Notes are held through records maintained in book entry form by a Clearing System.

2022 Notes means the 7.875% subordinated notes due 2022 with ISIN: XS0864253868 issued by the Company.

2022 Notes Noteholder means a person who is the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes representing the 2022 Notes as at the Record Date, whose interests in the 2022 Notes are held through records maintained in book entry form by a Clearing System.

2024 Notes means the 5.75% dated callable step-up subordinated notes due 2024 with ISIN: XS0188218183 originally issued by Britannia Building Society and assumed by the Company upon the Company's acquisition of Britannia Building Society on 1 August 2009.

2024 Notes Noteholder means a person who is the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes representing the 2024 Notes as at the Record

Date, whose interests in the 2024 Notes are held through records maintained in book entry form by a Clearing System.

2033 Notes means the 5.875% subordinated notes due 2033 with ISIN: XS0145065602 originally issued by Britannia Building Society and assumed by the Company upon its acquisition of Britannia Building Society on 1 August 2009.

2033 Notes Noteholder means a person who is the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes representing the 2033 Notes as at the Record Date, whose interests in the 2033 Notes are held through records maintained in book entry form by a Clearing System.

Account Holder means any person recorded directly in the records of a Clearing System as holding an interest in any Dated Notes in an account with the relevant Clearing System either for its own account or on behalf of its client.

Account Holder Letter means the account holder letter substantially in the form set out in appendix 3 of the Explanatory Statement or such other account holder letter (or similar document or series of documents) as the Company considers appropriate to assist with and/or facilitate the participation by Noteholders who hold their interests in the Dated Notes through Crest, in the Scheme.

Additional New Ordinary Shares means 33,333,334 ordinary shares to be issued by the Company for an aggregate consideration equal to £125,000,002.50 pursuant to the terms of the Additional New Ordinary Shares Offer.

Additional New Ordinary Shares Offer means the offer by the Company to the Noteholders to elect to subscribe for the Additional New Ordinary Shares on the terms described in paragraphs 2.22 to 2.30 of part B (*Overview of the Scheme*) of the Explanatory Statement.

Allowed Proceeding means any Proceeding by a Scheme Creditor to enforce its rights under this Scheme where any person fails to perform its obligations under this Scheme.

Alternative Recipient has the meaning given to that term in Clause 35.

April 2021 Notes means the 9.25% subordinated notes due April 2021 with ISIN: XS0620315902 issued by the Company.

April 2021 Notes Noteholder means a person who is the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes representing the April 2021 Notes as at the Record Date, whose interests in the April 2021 Notes are held through records maintained in book entry form by a Clearing System.

Bank T2 Notes means a principal amount equal to £100,000,000 of the 11 per cent. subordinated notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Company pursuant to Clause 17, the terms of which are described in detail in the Bank T2 Notes Prospectus.

Bank T2 Notes and New Ordinary Shares Registrar Agreement means the agreement between the Company and Computershare Investor Services PLC dated on or about the Scheme Settlement Date in relation to the provision of paying agency and registrar services.

Bank T2 Notes Paying Agent means Computershare Investor Services PLC in its capacity as paying agent for the Bank T2 Notes.

Bank T2 Notes Prospectus means the debt prospectus relating to the Bank T2 Notes dated 4 November 2013, together with the Supplementary Prospectus, both of which are appended to the

Explanatory Statement in appendix 9.**Bank T2 Notes Registrar** means Computershare Investor Services PLC in its capacity as registrar for the Bank T2 Notes.

Bank T2 Notes Trust Deed means the trust deed between the Company and the Bank T2 Notes Trustee relating to the Bank T2 Notes.

Bank T2 Notes Trustee means Law Debenture Trustees Limited in its capacity as trustee for the Bank T2 Notes.

Business Day means a day (other than a Saturday or Sunday) on which banks are open for general business in London and which is a Target Day.

Clearing Systems means Clearstream, Luxembourg and Euroclear.

Clearstream, Luxembourg means Clearstream Banking, *société anonyme*.

Common Depositaries means Bank of New York Mellon, London Branch and Citibank Europe PLC as the common depositaries for Clearstream, Luxembourg and Euroclear with whom the Global Notes have been deposited.

Companies Act means the Companies Act 2006.

Company means The Co-operative Bank p.l.c.

Company Custody Account means one or more custody accounts in the Clearing Systems held on behalf of the Company.

Co-operative Group means The Co-operative Group Limited, an industrial and provident society incorporated in England with registered number IP525R.

Court means the High Court of Justice of England and Wales.

Dated Notes means the 2016 Notes, the 2019 Notes, the April 2021 Notes, the November 2021 Notes, the 2022 Notes, the 2024 Notes and the 2033 Notes.

Deed of Waiver and Release means the deed of waiver and release substantially in the form set out in Schedule 1.

Designated Recipient means any person appointed under a valid Account Holder Letter delivered to and received by the Information Agent on behalf of a Noteholder to receive the Scheme Consideration to which that Noteholder is entitled pursuant to the terms of this Scheme, provided that such person is an Eligible Person.

Distribution Agreement means the distribution agreement substantially in the form set out in Schedule 2.

Distribution Instruction Certificate has the meaning given to that term in the Distribution Agreement.

Eligible Noteholder means a Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent before the end of the Holding Period which includes a confirmation that such Noteholder (or, if such Noteholder has appointed a Designated Recipient, its Designated Recipient) is an Eligible Person.

Eligible Person means a person in relation to whom the offer to, issue to or subscription by such person in respect of any New Ordinary Shares, Bank T2 Notes (and, if applicable, Additional New Ordinary Shares):

(a) would not be unlawful or prohibited under the laws of any applicable jurisdiction; and

(b) would not, or would not be likely to, result in the Company being required to comply with any filing, registration, disclosure or other onerous requirement in any jurisdiction where that person is a citizen or subject to the laws of or in which that person is domiciled or resident.

Euroclear means Euroclear Bank S.A./N.V. as operator of the Euroclear clearing system.

Explanatory Statement means the explanatory statement dated 18 November 2013 (as amended on 4 December 2013) of the Company circulated to the Scheme Creditors in connection with this Scheme pursuant to section 897 of the Companies Act.

Global Notes has the meaning given to that term in Recital (C).

Holding Period means the period of 36 months following the Scheme Settlement Date.

Holding Period Trustee means Lucid Issuer Services Limited.

Ineligible Noteholder means a Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent before the end of the Holding Period which includes a confirmation that such Noteholder is not an Eligible Person and has not appointed a Designated Recipient.

Information Agent means Lucid Issuer Services Limited.

Liability or **Liabilities** means any debt, liability or obligation of a person whether it is present, future, prospective or contingent, whether or not it is fixed or undetermined, whether or not it involves the payment of money or performance of an act or obligation and whether it arises at common law, in equity or by statute, in England and Wales or any other jurisdiction, or in any manner whatsoever.

Liability Management Exercise means the liability management exercise of the Company, the terms of which are described in Part B (*Overview of the Liability Management Exercise*) of the Explanatory Statement.

Lock-up Agreement means an agreement between the Company and a Noteholder, pursuant to which that Noteholder has agreed, among other things and subject to certain conditions, to vote its Scheme Claim in favour of this Scheme.

Lock-up Arrangement means a Lock-up Agreement or a Lock-up Undertaking.

Lock-up Undertaking means an undertaking by an Account Holder given on behalf of a Noteholder in favour of the Company pursuant to a valid Account Holder Letter delivered to and received by the Information Agent on behalf of that Noteholder, pursuant to which that Noteholder has agreed, among other things and subject to certain conditions, to vote its Scheme Claim in favour of this Scheme.

London Stock Exchange means the London Stock Exchange Group plc.

Longstop Date means 31 December 2013.

Modified Scheme Purchase Agreement means the agreement between the Company and the Modified Scheme Purchasers dated on or about 1 December 2013 pursuant to which the Modified Scheme Purchasers have agreed to purchase Additional New Ordinary Shares on the terms set out therein.

Modified Scheme Purchaser Premium means the premium described in paragraph 2.32 of part B (*Overview of the Scheme*) of the Explanatory Statement.

Modified Scheme Purchasers means the persons listed in column 1 of schedule 3 to the Modified Scheme Purchase Agreement, in their capacities as modified scheme purchasers pursuant to the terms of the Modified Scheme Purchase Agreement.

New Administrative Parties means the Bank T2 Notes Trustee, the Bank T2 Notes Registrar, the Bank T2 Notes Paying Agent and the New Ordinary Shares Registrar.

New Ordinary Shares means 141,666,666 ordinary shares to be issued by the Company pursuant to Clause 17.

New Ordinary Shares Conversion Price means £6.17566631.

New Ordinary Shares Registrar means Computershare Investor Services PLC as registrar for the New Ordinary Shares and the Additional New Ordinary Shares.

New Transaction Documents means the Bank T2 Notes Trust Deed and the Bank T2 Notes and New Ordinary Shares Registrar Agreement.

Noteholders means the 2016 Notes Noteholders, the 2019 Notes Noteholders, the April 2021 Notes Noteholders, the November 2021 Notes Noteholders, the 2022 Notes Noteholders, the 2024 Notes Noteholders and the 2033 Notes Noteholders.

November 2021 Notes means the fixed/floating rate subordinated notes due November 2021 with ISIN: XS0274155984 issued by the Company.

November 2021 Notes Noteholder means a person who is the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes representing the November 2021 Notes as at the Record Date, whose interests in the November 2021 Notes are held through records maintained in book entry form by a Clearing System.

Offer Memorandum means the consent and exchange offer memorandum appended to the Bank T2 Notes Prospectus (including any amendments thereto under the Supplementary Prospectus).**Preference Shareholders** means the holders of the Preference Shares.

Preference Shareholders Meeting means the meeting of the Preference Shareholders convened in connection with the Liability Management Exercise (including any adjournment of such meeting).

Preference Shares means the 9.25% non-cumulative irredeemable preference shares with ISIN: GB0002224516 issued by the Company.

Preference Shares Exchange Offer means the offer to exchange the Preference Shares in accordance with the terms of the Liability Management Exercise.

Proceeding means any process, suit, action, legal or other proceeding including without limitation any arbitration, mediation, alternative dispute resolution, judicial review, adjudication, demand,

execution, distraint, restraint, forfeiture, re-entry, seizure, lien, enforcement of judgment or enforcement of any security.

Prohibited Proceedings means any Proceeding against the Company or its property in any jurisdiction whatsoever other than an Allowed Proceeding.

Proposal has the meaning given to that term in the Offer Memorandum.

Record Date means 4.30 p.m. (London time) on 13 December 2013.

Registrar of Companies means the Registrar of Companies of England and Wales.

Released Parties has the meaning given to that term in the Deed of Waiver and Release.

Sale Instruction Certificate has the meaning given to that term in the Distribution Agreement.

Scheme means this scheme of arrangement in respect of the Company under Part 26 of the Companies Act in its present form or with or subject to any modification, addition or condition approved or imposed by the Court or approved in accordance with the terms of this Scheme.

Scheme Claim means any claim in respect of any Liability of the Company to any person arising out of an interest in the Dated Notes, arising on or before the Record Date or which may arise after the Record Date as a result of an obligation or Liability of the Company incurred or as a result of an event occurring or an act done on or before the Record Date (including, for the avoidance of doubt, any interest accruing on, or accretions arising in respect of, such claims before or after the Record Date), excluding any Liability of the Company to the Trustees under the Trust Deeds other than in respect of the covenants to repay principal and interest on the Dated Notes pursuant to the Trust Deeds.

Scheme Consideration means the New Ordinary Shares and the Bank T2 Notes.

Scheme Consideration Calculation Amount means, with respect to a Noteholder, the aggregate of (i) the aggregate principal amount outstanding of the Dated Notes (other than 2016 Notes) and accrued but unpaid interest thereon up to (and including) the Record Date held by that Noteholder (if any) and (ii) the Sterling-Equivalent principal amount outstanding of the 2016 Notes and accrued but unpaid interest thereon up to (and including) the Record Date held by that Noteholder (if any), in each case as at the Record Date.

Scheme Creditor means the Common Depositaries, the Trustees (solely in their capacities as the beneficiaries of the covenants to repay principal and interest on the Dated Notes pursuant to the Trust Deeds) and the Noteholders.

Scheme Effective Date means the date on which an office copy of the order of the Court sanctioning this Scheme under Section 899 of the Companies Act has been delivered to the Registrar of Companies.

Scheme FX Rate means the rate of exchange between Sterling and Euro appearing on or derived from the Bloomberg service designated as the "FXC" page for the purpose of displaying that rate of exchange, as determined by the Company on 30 October 2013, being £0.85644 to €1.

Scheme Meeting means the meeting of the Scheme Creditors to vote on this Scheme convened pursuant to an order of the Court (and any adjournment of such meeting).

Scheme Sanction Hearing means the hearing of the Court at which the Court sanctioned this Scheme pursuant to the order of the Court under Section 899 of the Companies Act.

Scheme Settlement Condition means the condition described in Clause 5.

Scheme Settlement Condition Testing Date means the latest to occur of:

(a) the Scheme Effective Date; and

(b) the date on which the resolutions proposed at each of the Preference Shareholders Meeting, the 5.5555% Bondholders Meeting and the 13% Bondholders Meeting and the general meeting of the Company referred to in Clause 5 have been voted on and each such meeting has been concluded.

Scheme Settlement Date means the date on which the Scheme Consideration and the Additional New Ordinary Shares are issued.

Selling Agent means TFS Derivatives Limited and Tradition (UK) Limited.

Sterling-Equivalent means, with respect to any principal amount outstanding and/or amount of accrued but unpaid interest in respect of the 2016 Notes, the amount of such principal amount outstanding and/or amount of accrued but unpaid interest in Euro notionally converted into Sterling at the Scheme FX Rate.

Subscribing Noteholder means a Noteholder who elects to participate in the Additional New Ordinary Shares Offer.

Subscription Escrow Account means the interest bearing Sterling cash escrow account with the Subscription Escrow Bank in the name of Lucid Issuer Services Limited to hold subscription monies in accordance with the terms of the Additional New Ordinary Shares Offer, the Sub-purchasing Offer and the Modified Scheme Purchase Agreement.

Subscription Escrow Bank means BNP Paribas, London branch.

Sub-purchasers means the Noteholders which elect to participate in the Sub-purchasing Offer.

Sub-purchaser Premium means the premium described in paragraph 2.44 of part B (*Overview of the Scheme*) of the Explanatory Statement.

Sub-purchasing Offer means the entitlement of Noteholders to participate in the sub-purchasing of the agreement by the Modified Scheme Purchasers to back-stop the purchase of Additional New Ordinary Shares as set out in the Modified Scheme Purchase Agreement, as described in paragraphs 2.33 to 2.44 of part B (*Overview of the Scheme*) of the Explanatory Statement.

Supplementary Prospectus means the supplementary prospectus relating to the Bank T2 Notes dated 4 December 2013 which is appended to the Explanatory Statement in appendix 9.

Target Day means a day on which the Trans European Automated Real-Time Gross Settlement Express Transfer payment system is open for settlement of payments in Euro.

Trustees means The Law Debenture Trust Corporation p.l.c. in its capacity as trustee for each of the Dated Notes.

Trust Deeds mean the trust deeds relating to the Dated Notes.

Unadmitted Noteholder means a Noteholder on whose behalf a valid Account Holder Letter has not been delivered to and received by the Information Agent before the Voting Instruction Deadline, other than any Eligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent between the Voting Instruction Deadline and the

Business Day preceding the Scheme Settlement Date and in relation to whom the Company exercises its discretion to issue Scheme Consideration on the Scheme Settlement Date in accordance with Clauses 17(a)(ii) and 17(b)(ii).

Undertaking Transaction Parties means the Trustees, the Common Depositaries, the Holding Period Trustee, the Information Agent, the Selling Agent, the Modified Scheme Purchasers, Co-operative Group and the New Administrative Parties.

Voting Instruction Deadline means 4.30 p.m. (London time) on 13 December 2013.

1.2 In this Scheme, unless the context otherwise requires or otherwise expressly provides for:

(a) references to Recitals, Clauses, Subclauses and Schedules are references to recitals, parts, clauses, subclauses and schedules of this Scheme;

(b) references to a person include a reference to an individual, firm, partnership, company, corporation, unincorporated body of persons or any state or state agency;

(c) references to a statute, statutory provision or regulatory rule or guidance include references to the same as subsequently modified, amended or re-enacted from time to time;

(d) unless the context otherwise requires, references to an agreement, deed or document shall be deemed also to refer to such agreement, deed or document as amended, supplemented, restated, verified, replaced and/or novated (in whole or in part) from time to time and to any agreement, deed or document executed pursuant thereto;

(e) the singular includes the plural and *vice versa* and words importing one gender shall include all genders;

(f) references to “including” shall be construed as references to “including without limitation” and “include”, “includes” and “included” shall be construed accordingly;

(g) headings to Recitals, Clauses, Subclauses and Schedules are for ease of reference only and shall not affect the interpretation of this Scheme;

(h) references to a period of days shall include Saturdays, Sundays and public holidays and where the date which is the final day of a period of days is not a Business Day, that date will be adjusted so that it is the first following day which is a Business Day;

(i) references to "Sterling" or to "£" are references to the lawful currency from time to time of the United Kingdom;

(j) references to "Euro" or to "€" are references to the lawful currency from time to time of the member states of the European Community that adopt or have adopted the euro as their lawful currency under the legislation of the European Community for Economic and Monetary Union; and

(k) references to time shall be to London time (Greenwich Mean Time or British Summer Time, as appropriate).

2. RECITALS

The Company

(A) The Company was incorporated in England on 5 October 1970 with registered number 990937 under the name Co-operative Bank Limited and on 21 May 1981 was re-registered as a public limited company and changed its name to Co-operative Bank Public Limited Company. The Company changed its name to The Co-operative Bank p.l.c. on 10 January 1993.

(B) As at the date hereof, the authorised share capital of the Company is £410,000,000 divided into 8,200,000,000 ordinary shares of par value £0.05 each, all of which have been issued and are fully paid up, and the Preference Shares.

Dated Notes Issued by the Company

(C) The Dated Notes are held under arrangements whereby:

(i) the Dated Notes have been constituted by the Trust Deeds with the trustee for each of the series being the Trustee;

(ii) the Dated Notes were issued wholly in global bearer form, the global notes representing the Dated Notes (the **Global Notes**) being held by the Common Depositaries;

(iii) interests in the Dated Notes while represented by the Global Notes are held by the Noteholders under systems designed to facilitate paperless transactions;

(iv) the systems designed to facilitate paperless transactions involve interests in the Dated Notes being held by Account Holders; each Account Holder may be holding interests in the Dated Notes on behalf of one or more Noteholders; and

(v) in the circumstances set out in the terms and conditions relating to the Dated Notes, Noteholders may exchange their interests in any Dated Note for definitive notes.

(D) The Dated Notes will remain in global form and will not be exchanged into definitive form under or pursuant to this Scheme. References in this Scheme to Dated Notes being held by a Noteholder shall be treated for all purposes as references to the interest held by the relevant Noteholder in the relevant Global Note.

Scheme Consideration and Additional New Ordinary Shares

(E) The Scheme Consideration and the Additional New Ordinary Shares will be issued in registered form and interests in the Scheme Consideration and Additional New Ordinary Shares while represented in registered form will be held under systems designed to facilitate paperless transactions.

(F) References in this Scheme to any Scheme Consideration or Additional New Ordinary Shares being issued or delivered to a person shall be treated for all purposes as references to that person acquiring directly or indirectly through one or more intermediaries interests in the relevant Scheme Consideration or Additional New Ordinary Shares in accordance with the rules and procedures of the relevant Clearing System.

Binding of Third Parties

(G) The Undertaking Transaction Parties have each:

(i) appeared by counsel on the petition to sanction this Scheme and undertaken to the Court to; and/or

(ii) executed a deed of undertaking in favour of the Court and the Company pursuant to which they have undertaken and agreed to:

amongst other matters, execute and do or procure to be executed or done all such documents, acts and things as may be necessary or desirable to be executed or done by it for the purpose of giving effect to this Scheme.

The Purpose of this Scheme

(H) The purpose of this Scheme is to effect a compromise and arrangement between the Company and the Scheme Creditors.

The Dated Notes and this Scheme

(I) The Scheme Creditors consist of:

(i) each of the Common Depositaries as a holder of one or more Global Notes and each of the Trustees solely in its capacity as the beneficiary of the covenant to repay principal and pay interest on the Dated Notes pursuant to the relevant Trust Deed; and

(ii) the Noteholders as the beneficial owners of and/or persons with the ultimate economic interest in the Dated Notes.

Insofar as it relates to a Trustee, any reference in this Scheme to the Scheme Creditors authorising, directing or instructing a Trustee (whether on its own or as part of a wider group) will be treated for all purposes as an authorisation, direction or instruction of that Trustee in its capacity as a Scheme Creditor to that Trustee in its capacity as the trustee under the relevant Trust Deed to the extent that it is entitled to do so.

(J) (i) The Trustees have agreed not to vote in respect of the Dated Notes at the Scheme Meeting;

(ii) the Common Depositaries have agreed not to vote in respect of the Dated Notes at the Scheme Meeting; and

(iii) Noteholders are entitled to vote at the Scheme Meeting in respect of each of their Dated Notes. Noteholders have been invited to instruct their Account Holders as to the manner in which the Account Holder Letters delivered in respect of their Dated Notes should be completed, including, in particular, how they wish to vote in respect of their Dated Notes.

3. THE SCHEME

Application and Effectiveness of this Scheme

1. The compromise and arrangement effected by this Scheme shall apply to all Scheme Claims and bind all Scheme Creditors.

2. This Scheme shall become effective in accordance with its terms on the Scheme Effective Date and all of the right, title and interest of Scheme Creditors to Scheme Claims shall be subject to the compromises and arrangements set out in this Scheme.

3. If the Scheme Settlement Date does not occur on or before the Longstop Date, the terms of and the obligations on the parties under or pursuant to this Scheme shall lapse and all the compromises and arrangements provided by this Scheme shall be of no effect.

Condition Precedent to the Occurrence of the Scheme Settlement Date

4. It shall be a condition precedent to the occurrence of the Scheme Settlement Date (and the actions to be taken pursuant to the terms of this Scheme on the Scheme Settlement Date) that (i) the Scheme Settlement Condition has been satisfied and (ii) an amount in cleared funds equal to or greater than £125,000,000 is standing to the credit of the Subscription Escrow Account.

Scheme Settlement Condition

5. The Scheme Settlement Condition will be satisfied if, on the Scheme Settlement Condition Testing Date:

   (a) the Scheme Effective Date has occurred;

   (b) the Proposal in respect of the Preference Shares (i) has been approved by the requisite majority of the Preference Shareholders at the Preference Shareholders Meeting (and a resolution in similar terms must also be approved at a general meeting of the shareholders of the Company) and (ii) is capable of being implemented in accordance with the terms of that Proposal as set out in the Offer Memorandum;

   (c) the the Proposal in respect of the 5.5555% Bonds (i) has been approved by the requisite majority of the 5.5555% Bondholders at the 5.5555% Bondholders Meeting and (ii) is capable of being implemented in accordance with the terms of that Proposal as set out in the Offer Memorandum; and

   (d) the Proposal in respect of the 13% Bonds (i) has been approved by the requisite majority of the 13% Bondholders at the 13% Bondholders Meeting and (ii) is capable of being implemented in accordance with the terms of that Proposal as set out in the Offer Memorandum.

6. As soon as reasonably practicable after determining whether the Scheme Settlement Condition has been satisfied, the Company shall give the Scheme Creditors notice by the issue of an announcement through the Clearing Systems.

7. The Company shall procure that the Scheme Settlement Date occurs as soon as reasonably practicable following the satisfaction of the conditions precedent referred to in Clause 4.

Compromise of Scheme Claims

8. On the Scheme Settlement Date, subject to the terms of this Scheme:

(a) all of the right, title and interest of the Scheme Creditors in the Scheme Claims shall be transferred absolutely to the Company; and

(b) the Company shall for itself and/or on behalf of each Scheme Creditor pursuant to the authority granted under Clause 13 direct each Clearing System in accordance with the rules and procedures of that Clearing System to:

(i) debit from the custody account of each Account Holder all the interests in the Dated Notes held by that Account Holder; and

(ii) credit to the Company Custody Account the interests in the Dated Notes debited pursuant to Subclause (b)(i) above.

9. Following the transfer of all of the right, title and interest of the Scheme Creditors in the Scheme Claims in accordance with Clause 8, the Dated Notes shall be cancelled and all Scheme Claims shall be satisfied and released fully and absolutely, in each case so as to bind the Scheme Creditors and any person who acquires any interest in or arising out of a Scheme Claim after the Record Date.

10. In consideration for the transfer, satisfaction and release referred to in Clauses 8 and 9, the Company shall issue the Scheme Consideration and each Scheme Creditor shall be entitled to receive its share of the Scheme Consideration, in each case in accordance with and subject to the terms of this Scheme and the terms of the Distribution Agreement.

Instructions, Authorisations and Directions

11. On the Scheme Effective Date, in consideration of the rights of the Scheme Creditors under this Scheme and notwithstanding any term of any relevant document, the Scheme Creditors:

(a) hereby irrevocably direct each of the Trustees to execute and do, and to instruct any other person which it is entitled to instruct to execute and do, or otherwise procure to be executed and done, all documents, acts or things as may be necessary or desirable to be executed or done by it or such other person for the purposes of giving effect to the terms of this Scheme;

(b) hereby irrevocably authorise the Company to execute and do, and to instruct any other person which it is entitled to instruct to execute and do, or otherwise procure to be executed and done, all documents (including, without limitation, the New Transaction Documents), acts or things as may be necessary or desirable to be executed or done by it or such other person for the purposes of giving effect to the terms of this Scheme; and

(c) hereby request and to the extent they are entitled to do so instruct the Company to perform each of its obligations arising under this Scheme and each New Transaction Document.

12. The directions, instructions and authorisations granted under Clause 11 shall be treated, for all purposes whatsoever and without limitation, as having been granted by deed.

Grant of Authority

13. Each of the Scheme Creditors hereby irrevocably authorises the Company on and from the Scheme Effective Date to enter into, execute and deliver as a deed (or otherwise) on behalf of that Scheme Creditor in its capacity as a Scheme Creditor (including any person to whom a Scheme Creditor has transferred its rights in respect of its Scheme Claim after the Record Date) (to the extent applicable):

(a) each direction described in Clause 8 and any document in connection with the actions described in Clauses 8 and 9;

(b) the Deed of Waiver and Release

(c) the Distribution Agreement; and

(d) any and all other documents that the Company reasonably considers necessary or desirable to give effect to the terms of this Scheme,

on the Scheme Settlement Date (in respect of the documents referred to in Subclauses (a) and (b) above) and on any day from (and including) the Scheme Effective Date (in respect of the documents referred to in Subclauses (c) and (d) above) for the purposes of giving effect to the terms of this Scheme. The authority granted under this Clause 13 shall be treated, for all purposes whatsoever and without limitation, as having been granted by deed.

Entitlements of Noteholders to Scheme Consideration

14. Subject to Clauses 18 to 32 of this Scheme, each Noteholder shall be entitled to receive Scheme Consideration pursuant to Clause 17 on the following basis.

(a) **New Ordinary Shares**

Each Noteholder shall be entitled to receive a number of New Ordinary Shares equal to:

$$\frac{(\boldsymbol{N\ x\ 0.89743})}{\boldsymbol{C}}$$

Where:

N equals the Scheme Consideration Calculation Amount for that Noteholder

C equals the New Ordinary Shares Conversion Price

(b) **Bank T2 Notes**

Each Noteholder shall be entitled to receive a principal amount of Bank T2 Notes equal to:

$$\boldsymbol{N\ x\ 0.10257}$$

Where:

N equals the Scheme Consideration Calculation Amount for that Noteholder

Fractional Entitlements

15. If the number of New Ordinary Shares resulting from any calculation made in accordance with Clause 14(a) is not a whole number, that number shall be rounded down to the nearest whole number and the relevant Noteholder shall have no entitlement to any resulting fractional amount.

16. If the principal amount of Bank T2 Notes resulting from any calculation made in accordance with Clause 14(b) is not an integral multiple of £10, that amount shall be rounded down to the nearest integral multiple of £10 and the relevant Noteholder shall have no entitlement to any resulting fractional amount.

Scheme Consideration

17. On the Scheme Settlement Date and subject to the terms of this Scheme, the Company shall issue the Scheme Consideration on the following basis:

(a) the Company shall issue the New Ordinary Shares to:

(i) the Eligible Noteholders on whose behalf valid Account Holder Letters have been delivered to and received by the Information Agent before the Voting Instruction Deadline (or, to the extent applicable, their Designated Recipients and/or Alternative Recipients);

(ii) the Eligible Noteholders (if any) on whose behalf valid Account Holder Letters have been delivered to and received by the Information Agent between the Voting Instruction Deadline and the Business Day preceding the Scheme Settlement Date (or, to the extent applicable their Designated Recipients), in each case at the sole discretion of the Company; and

(iii) the Holding Period Trustee (on behalf of (A) the Ineligible Noteholders on whose behalf valid Account Holder Letters have been delivered to and received by the Information Agent before the Voting Instruction Deadline and (B) the Unadmitted Noteholders); and

(b) the Company shall issue the Bank T2 Notes to:

(i) the Eligible Noteholders on whose behalf valid Account Holder Letters have been delivered to and received by the Information Agent before the Voting Instruction Deadline (or, to the extent applicable, their Designated Recipients and/or Alternative Recipients);

(ii) the Eligible Noteholders (if any) on whose behalf valid Account Holder Letters have been delivered to and received by the Information Agent between the Voting Instruction Deadline and the Business Day preceding the Scheme Settlement Date (or, to the extent applicable their Designated Recipients), in each case at the sole discretion of the Company; and

(iii) the Holding Period Trustee (on behalf of (A) the Ineligible Noteholders on whose behalf valid Account Holder Letters have been delivered to and received by the Information Agent before the Voting Instruction Deadline and (B) the Unadmitted Noteholders).

Eligible Noteholders

18. Each Eligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent before the Voting Instruction Deadline (or, to the extent applicable, its Designated Recipient and/or Alternative Recipient) will receive the Scheme Consideration to which it is entitled in accordance with the terms of this Scheme on the Scheme Settlement Date.

19. Each Eligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent between the Voting Instruction Deadline and the Business Day preceding the Scheme Settlement Date and in relation to whom the Company exercises its discretion to issue Scheme Consideration on the Scheme Settlement Date in accordance with Clauses 17(a)(ii) and 17(b)(ii) (or, to the extent applicable, its Designated Recipient) will receive the Scheme Consideration to which it is entitled in accordance with the terms of this Scheme on the Scheme Settlement Date.

20. Any Scheme Consideration to which an Eligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent after the Voting Instruction Deadline but before the end of the Holding Period (other than any Eligible Noteholder referred to in

Clause 19) will be held by the Holding Period Trustee on trust for such Eligible Noteholder, in accordance with the terms of this Scheme and the Distribution Agreement.

21. In respect of any Eligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent after the Voting Instruction Deadline but before the end of the Holding Period (other than any Eligible Noteholder referred to in Clause 19), as soon as reasonably practicable following the date on which that Account Holder Letter has been delivered to and received by the Information Agent and the Distribution Instruction Certificate relating thereto has been delivered by the Information Agent to the Holding Period Trustee in accordance with the terms of the Distribution Agreement, the Holding Period Trustee shall deliver the Scheme Consideration to which that Eligible Noteholder is entitled in accordance with the terms of this Scheme (including any interest, dividends, distributions (or any other rights or benefits) or other payments received by the Holding Period Trustee in respect of such Scheme Consideration, in each case net of any applicable taxes (including, without limitation, any withholding taxes but excluding any stamp duty and/or stamp duty reserve tax payable upon the issue and/or allotment of New Ordinary Shares and/or Bank T2 Notes to that Eligible Noteholder in accordance with the terms of the Distribution Agreement)) to that Eligible Noteholder (or, to the extent applicable, its Designated Recipient).

Ineligible Noteholders

22. Any Scheme Consideration to which an Ineligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent before the Voting Instruction Deadline is entitled in accordance with the terms of the Scheme shall be delivered to the Holding Period Trustee on the Scheme Settlement Date (as described in Clause 17 and the Distribution Agreement). The Holding Period Trustee shall hold any such Scheme Consideration on trust for that Ineligible Noteholder, in accordance with the terms of this Scheme and the Distribution Agreement.

23. As soon as reasonably practicable after receipt by the Holding Period Trustee of (i) any Scheme Consideration to which an Ineligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent before the Voting Instruction Deadline is entitled in accordance with the terms of the Scheme and (ii) a Sale Instruction Certificate relating thereto delivered in accordance with the terms of the Distribution Agreement, the Holding Period Trustee shall instruct the Selling Agent to sell such Scheme Consideration in accordance with the terms of the Distribution Agreement.

24. Any Scheme Consideration to which an Ineligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent after the Voting Instruction Deadline but before the end of the Holding Period will be held by the Holding Period Trustee on trust for such Ineligible Noteholder, in accordance with the terms of this Scheme and the Distribution Agreement.

25. In respect of any Ineligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent after the Voting Instruction Deadline but before the end of the Holding Period, as soon as reasonably practicable following the date on which that Account Holder Letter has been delivered to and received by the Information Agent and the Sale Instruction Certificate relating thereto has been delivered by the Information Agent to the Holding Period Trustee in accordance with the terms of the Distribution Agreement, the Holding Period Trustee shall instruct the Selling Agent to sell the Scheme Consideration to which that Ineligible Noteholder is entitled in accordance with the terms of the Distribution Agreement.

26. Any sale of Scheme Consideration shall be effected in accordance with the terms of the Distribution Agreement which provide, among other things, that (i) any such sale shall be effected upon the best terms available in the market at the time of the sale and (ii) without prejudice to the ability of the

Holding Period Trustee to do so, the Holding Period Trustee shall be under no obligation to sell or instruct the Selling Agent to sell any New Ordinary Shares or distribute any interest, dividends, distributions (or any other rights or benefits) or other payments received by the Holding Period Trustee during the Holding Period in respect of such New Ordinary Shares until admission of the New Ordinary Shares to the Official List of the United Kingdom Listing Authority and admission to trading on the London Stock Exchange's market for listed securities.

27. As soon as reasonably practicable after the sale of any Scheme Consideration (or any part thereof) to which an Ineligible Noteholder is entitled in accordance with the terms of this Scheme, the Holding Period Trustee shall distribute:

(i) the proceeds of such sale (after deduction of any applicable expenses); and

(ii) any interest, dividends, distributions (or any other rights or benefits) or other payments received by the Holding Period Trustee during the Holding Period prior to such sale in respect of such Scheme Consideration,

(in each case net of any applicable taxes (including, without limitation, any withholding taxes)) to that Ineligible Noteholder.

28. If the Holding Period Trustee is holding any Scheme Consideration on behalf of any Ineligible Noteholders which has not been sold by the end of the Holding Period and the Holding Period Trustee (or the Selling Agent on behalf of the Holding Period Trustee) is not able, after having used reasonable efforts and having consulted with the Company, to sell any such Scheme Consideration within three months of the end of the Holding Period, the Holding Period Trustee shall transfer by way of gift on behalf of such Ineligible Noteholders such Scheme Consideration to Carers Trust (registered charity number 1145181) or to any other registered charity selected by the Company in writing for this purpose.

Unadmitted Noteholders

29. Any Scheme Consideration to which an Unadmitted Noteholder is entitled in accordance with the terms of the Scheme shall be delivered to the Holding Period Trustee on the Scheme Settlement Date (as described in Clause 17 and the Distribution Agreement). The Holding Period Trustee shall hold any such Scheme Consideration on trust for the relevant Unadmitted Noteholder for the Holding Period in accordance with the terms of this Scheme and the Distribution Agreement.

30. If, at the end of the Holding Period, the Holding Period Trustee is holding any Scheme Consideration on behalf of any Unadmitted Noteholders, as soon as reasonably practicable after the end of the Holding Period the Holding Period Trustee shall instruct the Selling Agent to sell all such Scheme Consideration in accordance with the terms of the Distribution Agreement, provided that, to the extent that the Holding Period Trustee (or the Selling Agent on behalf of the Holding Period Trustee) is not able, after having used reasonable efforts and having consulted with the Company, to sell any such Scheme Consideration following the end of the Holding Period, the Holding Period Trustee shall transfer by way of gift on behalf of such Unadmitted Noteholders such Scheme Consideration to Carers Trust (registered charity number 1145181) or to any other registered charity selected by the Company in writing for this purpose.

31. As soon as reasonably practicable after the sale of any such Scheme Consideration (or any part thereof) in accordance with Clause 30, the Holding Period Trustee shall distribute:

(a) the proceeds of such sale (after deduction of any applicable expenses); and

(b) any interest, dividends, distributions (or any other rights or benefits) or other payments received by the Holding Period Trustee in respect of such Scheme Consideration,

(in each case net of any applicable taxes (including, without limitation, any withholding taxes)) to the Company in accordance with the terms of the Distribution Agreement and this Scheme.

32. The Holding Period Trustee will agree under the terms of the Distribution Agreement not to exercise any voting, conversion or other rights attaching to any Scheme Consideration which it is holding on the trusts referred to above.

Additional New Ordinary Shares Offer

33. On the Scheme Settlement Date, subject to the terms of the Additional New Ordinary Shares Offer the Company shall issue the Additional New Ordinary Shares on the following basis:

    (a) the Company shall issue to each Subscribing Noteholder which has performed all its obligations in relation to the Additional New Ordinary Shares Offer (or, to the extent applicable, its Designated Recipient and/or its Alternative Recipient) the number of Additional New Ordinary Shares which that Subscribing Noteholder has been allocated in accordance with the terms of the Additional New Ordinary Shares Offer;

    (b) the Company shall issue to each Sub-purchaser which has performed all its obligations and complied with all applicable conditions in relation to the Sub-purchasing Offer (or, to the extent applicable, its Designated Recipient and/or its Alternative Recipient) the number of Additional New Ordinary Shares which that Sub-purchaser has been allocated in accordance with the terms of the Sub-purchasing Offer; and

    (c) the Company shall issue to each Modified Scheme Purchaser (or, to the extent applicable, its Designated Recipient and/or its Alternative Recipient) the number of Additional New Ordinary Shares which that Modified Scheme Purchaser has been allocated in accordance with the terms of the Modified Scheme Purchase Agreement.

34. On the Scheme Settlement Date, subject to the terms of the Additional New Ordinary Shares Offer the Company shall pay:

    (a) to or at the direction of each Sub-purchaser which has performed all its obligations in relation to the Sub-purchasing Offer, the proportion of the Sub-purchaser Premium to which that Sub-purchaser is entitled in accordance with the terms of the Sub-purchasing Offer; and

    (b) to or at the direction of each Modified Scheme Purchaser which has performed all its obligations under the Modified Scheme Purchase Agreement, the proportion of the Modified Scheme Purchaser Premium to which that Modified Scheme Purchaser is entitled in accordance with the terms of the Modified Scheme Purchase Agreement.

Alternative Recipients

35. Any Eligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent before the Voting Instruction Deadline, Sub-purchaser or Modified Scheme Purchaser may elect for some or all of the Scheme Consideration and (if applicable) the Additional New Ordinary Shares to which it is entitled under the terms of the Scheme and (if applicable) the Additional New Ordinary Shares Offer, the Sub-purchasing Offer or the Modified Scheme Purchase Agreement to be issued to another person who is an Eligible Person (such person, an **Alternative Recipient**) by:

    (a) notifying the Company of its election; and

(b) providing to the Company and the Information Agent (i) confirmation that the Alternative Recipient is an Eligible Person and (ii) all details of the Alternative Recipient required by the Company and/or the Information Agent,

in each case by no later than the Scheme Effective Date.

Implementation of Arrangements

36. If the Company reasonably considers it necessary or desirable to execute any document or documents to give effect to the terms of this Scheme on behalf of any of the Scheme Creditors on any day from (and including) the Scheme Effective Date to (and including) the Scheme Settlement Date, the Company shall execute such document or documents on behalf of the relevant Scheme Creditor pursuant to the authority granted under Clause 13.

37. On the Scheme Effective Date, or as soon as reasonably practicable thereafter, the Company (for itself and on behalf of each Scheme Creditor pursuant to the authority granted under Clause 13), the Holding Period Trustee, the Information Agent and the Selling Agent shall execute the Distribution Agreement and perform their obligations thereunder.

38. On the Scheme Settlement Date, the following steps shall happen and those steps shall take effect in the order set out below:

(a) the Company for itself and/or on behalf of each relevant Scheme Creditor pursuant to the authority granted under Clause 13 shall issue the directions described in Clause 8 and execute any document in connection with the actions described in Clauses 8 and 9;

(b) the Company shall procure the cancellation of the Dated Notes in accordance with Clause 9;

(c) the Company shall issue the Scheme Consideration in accordance with Clause 17;

(d) the Company shall issue the Additional New Ordinary Shares in accordance with Clause 33;

(e) the Company shall pay the Sub-purchaser Premium and the Modified Scheme Purchaser Premium in accordance with Clause 34; and

(f) the Company shall execute the Deed of Waiver and Release on behalf of each Scheme Creditor pursuant to the authority granted under Clause 13.

39. The issuance of the Scheme Consideration and the Additional New Ordinary Shares, the payment of the Sub-purchaser Premium and the Modified Scheme Purchaser Premium and the performance of its other obligations under this Scheme will discharge the Company's obligation to the Scheme Creditors under this Scheme.

40. On and from the Scheme Settlement Date (but subject to the other provisions of this Scheme) each Scheme Creditor shall be entitled to the rights and benefits accruing to that Scheme Creditor under this Scheme and each of the New Transaction Documents (to the extent they are a party) and all of the existing rights and benefits of the Scheme Creditors in respect of the Scheme Claims shall be subject and limited to the compromises and arrangements provided by this Scheme.

Record Date

41. All Scheme Claims shall be determined as at the Record Date.

Assignments or Transfers

42. The Company shall be under no obligation to recognise any assignment or transfer of Scheme Claims after the Record Date for the purposes of determining entitlements under this Scheme, provided that where the Company has received from the relevant parties notice in writing of such assignment or transfer, the Company may, in its sole discretion and subject to the production of such other evidence as it may require and to any other terms and conditions which it may render necessary or desirable, agree to recognise such assignment or transfer for the purposes of determining entitlements under this Scheme. It shall be a term of such recognition that the assignee or transferee of a Scheme Claim so recognised by the Company shall be bound by the terms of this Scheme and for the purposes of this Scheme shall be a Scheme Creditor.

Stay of Proceedings

43. None of the Scheme Creditors shall commence or continue, or instruct, direct or authorise any other person (including, without limitation, any Trustee) to commence or continue, any Prohibited Proceedings in respect of, arising from or relating to a Scheme Claim after the Scheme Effective Date. For the avoidance of doubt, this Clause shall not prohibit a Scheme Creditor from commencing or continuing, or instructing, directing or authorising any other person to commence or continue, any Proceeding against the Company or its property in any jurisdiction whatsoever relating to and subject to the terms of the New Transaction Documents.

44. Subject to any existing contractual restrictions, a Scheme Creditor may commence an Allowed Proceeding against the Company after the Scheme Effective Date provided that it has first given the Company five Business Days' prior notice in writing of its intention to do so.

Costs

45. The Company shall pay, or procure the payment of, in full all costs, charges, expenses and disbursements incurred by it in connection with the negotiation, preparation and implementation of this Scheme as and when they arise, including, but not limited to, the costs of holding the Scheme Meeting, the costs of obtaining the sanction of the Court and the costs of placing the notices (if any) required by this Scheme.

46. The Company shall pay, or procure the payment of, in full the costs, charges, expenses and disbursements reasonably incurred by the Common Depositaries and the Trustees in connection with the negotiation, preparation and implementation of this Scheme.

Modifications

47. The Company may, at any hearing of the Court to sanction this Scheme, consent on behalf of all Scheme Creditors to any modification of this Scheme or any terms or conditions which the Court may think fit to approve or impose and which would not directly or indirectly have a material adverse effect on the interests of any Scheme Creditor under this Scheme.

48. Nothing in this Scheme shall prevent the modification of any of the New Transaction Documents in accordance with their respective terms.

Obligations on Dates other than a Business Day

49. If any sum is due or obligation is to be performed under the terms of this Scheme on a day other than a Business Day, the relevant payment shall be made, or obligation performed on the next Business Day.

Notices

50. Any notice or other written communication to be given under or in relation to this Scheme (other than any Account Holder Letter) shall be given in writing and shall be deemed to have been duly given if it is delivered by hand, pre-paid first class post, airmail, fax or electronically to:

(a) in the case of the Company:

The Co-operative Bank p.l.c.
1 Balloon Street
Manchester M60 4EP
Phone: 0843 751 4493
Attention of: Kathrine Bancroft

(b) in the case of a Noteholder, either:

(i) its last known address, fax number or email address according to the Company; or

(ii) to the relevant Trustee for and on behalf of that Noteholder, at/on the contact details set out at Subclause (d) below.

(c) in the case of the Common Depositaries:

Bank of New York Mellon, London Branch
One Canada Square
Canary Wharf
London E14 5AL
Attention of: CORP TRUST, Transaction Management Group

Citibank Europe PLC
1 North Wall Quay
Dublin D1
Ireland

(d) in the case of the Trustees:
The Law Debenture Trust Corporation p.l.c.
Fifth Floor
100 Wood Street
London EC2V 7EX
Fax: (020) 7606 0643
Attention of: the Manager, Commercial Trusts

(e) in the case of the Holding Period Trustee or the Information Agent:

Lucid Issuer Services Limited
Leroy House
436 Essex Road
London N1 3QP
Email: co-op@lucid-is.com
Phone: 020 7704 0880
Fax: 020 7067 9098
Attention of: Yves Theis

(f) in the case of the Selling Agent:
TFS Derivatives Limited and Tradition (UK) Limited
Beaufort House
15 St. Botolph Street
London EC3A 7QX

Attention of: Mike Reuter/Global Equity

(g) in the case of any other person, any address, fax number or email address set forth for that person in any agreement entered into in connection with this Scheme or the last known address, fax number or email address according to the Company.

51. Any notice or other written communication to be given under or in relation to this Scheme (other than any Account Holder Letter) shall be deemed to have been delivered and served:

(a) if delivered by hand, when actually received provided that, if such receipt occurs after 5.00 p.m. in the place of receipt, the following Business Day;

(b) if sent by pre-paid first class post or airmail, on the second Business Day after posting if the recipient is in the country of dispatch, otherwise the seventh Business Day after posting;

(c) if sent electronically or by fax, when actually received in readable form provided that, if such receipt in readable form occurs after 5.00 p.m. in the place of receipt, the following Business Day; and

(d) if by advertisement, on the date of publication.

52. In proving service, it shall be sufficient proof, in the case of a notice sent by pre-paid first class post or airmail, that the envelope was properly stamped, addressed and placed in the post.

53. The accidental omission to send any notice, written communication or other document in accordance with Clauses 50 to 51, or the non-receipt of any such notice by any Scheme Creditor, shall not affect the provisions of this Scheme.

54. Notwithstanding any provision to the contrary contained in this Scheme:

(a) notices to the Noteholders shall be valid if published in a leading English language daily newspaper published in London (which is expected to be the *Financial Times*) or if such publication is not practicable, in another appropriate newspaper having general circulation in London previously approved in writing by the Trustee. Any such notice shall be deemed to have been given on the date of first publication;

(b) whilst the Dated Notes are represented by Global Notes and deposited with the Common Depositaries for the Clearing Systems, notice to the Noteholders may be given instead by delivery of the notice to the Clearing Systems and such notices shall be deemed to have been given to the Noteholders on the date of delivery to the Clearing Systems;

(c) a Trustee may approve some other method of giving notice to the Noteholders of the relevant Dated Notes if, in its opinion, that other method is reasonable having regard to market practice then prevailing and to the requirements of any stock exchange on which the relevant Dated Notes are then listed and provided that notice of that other method is given to the Noteholders in the manner required by that Trustee; and

(d) a copy of each notice given in accordance with this Clause shall be provided to and the London Stock Exchange for so long as the Dated Notes are listed on the London Stock Exchange and the relevant regulations so require.

Governing Law and Jurisdiction

55. The operative terms of this Scheme and any non-contractual obligations arising out of or in connection with this Scheme shall be governed and construed in accordance with the laws of England and Wales. The Scheme Creditors hereby agree that the Court shall have exclusive jurisdiction to hear and determine any suit, action or Proceeding and to settle any dispute which arises out of or in connection with the terms of this Scheme or their implementation or out of any action taken or omitted to be taken under this Scheme or in connection with the administration of this Scheme and for such purposes the Scheme Creditors irrevocably submit to the jurisdiction of the Court, provided, however, that nothing in this Clause shall affect the validity of other provisions determining governing law and jurisdiction as between the Company and any of the Scheme Creditors, whether contained in contract or otherwise.

56. The terms of this Scheme and the obligations imposed on the Company hereunder shall take effect subject to any prohibition or condition imposed by applicable law.

Dated this [●] day of [●] 2013

SCHEDULE 1

FORM OF DEED OF WAIVER AND RELEASE

DEED OF WAIVER AND RELEASE

DATED [●] 2013

by

THE SCHEME CREDITORS

in favour of

THE RELEASED PARTIES

Clause **Page**

1. INTERPRETATION 3
2. WAIVER AND RELEASE 4
3. FURTHER ASSURANCES 5
4. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 5
5. COUNTERPARTS 5
6. GOVERNING LAW AND JURISDICTION 5

Appendix

1. Released Parties 6
Part 1 Transaction Released Parties 6
Part 2 Adviser Released Parties 7

Signatories 8

THIS DEED is dated [●] 2013 and is made **BY**:

(1) **THE SCHEME CREDITORS** (as defined below), acting by The Co-operative Bank p.l.c. (the **Company**) pursuant to the authority conferred upon the Company by the Scheme Creditors under clause 13 of the Scheme (as defined below),

IN FAVOUR OF:

(2) **THE RELEASED PARTIES** (as defined below).

BACKGROUND

(A) The Company has entered into the Scheme with the Scheme Creditors.

(B) The Company is authorised, under clause 13 of the Scheme, to execute and deliver this Deed on behalf of each of the Scheme Creditors.

(C) It is intended that this document takes effect as a deed notwithstanding the fact that a party may only execute this document under hand.

IT IS AGREED as follows:

1. INTERPRETATION

1.1 Definitions

In this Deed:

Adviser Released Party means the persons listed at Part 2 of Appendix 1 of this Deed.

Brand Agreement means the co-existence principles dated 4 November 2013 between the Company and Co-operative Group.

Bridge Loan Facility Agreement means the intragroup loan agreement dated 4 November 2013 between, amongst others, the Company, Co-operative Group and CBGL.

CBGL means Co-operative Banking Group Limited.

Group Commitment Agreement means the 2014 commitment agreement dated 4 November 2013 between the Company, Co-operative Group and CBGL.

Group Notes Prospectus has the meaning given to that term in the Bank T2 Notes Prospectus.

Relationship Agreement has the meaning given to that term in the Bank T2 Notes Prospectus.

Released Parties means the Adviser Released Parties and the Transaction Released Parties.

Restructuring Documents means the Offer Memorandum, the Bank T2 Notes Prospectus, the Group Notes Prospectus, the Separation Agreement, the Brand Agreement, the Group Commitment Agreement, the Bridge Loan Facility Agreement, the Security Agreement and the Relationship Agreement.

Scheme means the scheme of arrangement pursuant to Part 26 of the Companies Act 2006 between the Company and the Scheme Creditors as sanctioned by the Court on or about the date of this Deed.

Scheme Creditor means the Common Depositaries, the Trustees (solely in their capacities as the beneficiaries of the covenants to repay principal and interest on the Dated Notes pursuant to the Trust Deeds) and the Noteholders.

Security Agreement means the security agreement dated 4 November 2013 entered into between CBGL and Co-operative Group in connection with the Bridge Loan Facility Agreement.

Separation Agreement means the statement of separation principles dated 4 November 2013 entered into between the Company and Co-operative Group in connection with the separation of the Company from Co-operative Group.

Transaction Released Parties means the persons listed at Part 1 of Appendix 1 of this Deed

1.2 **Construction**

(a) Capitalised terms defined in the Scheme have, unless expressly defined in this Deed, the same meaning in this Deed.

(b) In this Deed, unless the context otherwise requires or otherwise expressly provides for:

(i) references to Clauses are references to Clauses of this Deed;

(ii) references to a person include references to an individual, firm, partnership, company, corporation, unincorporated body of persons or any state or state agency;

(iii) references to a statute or statutory provision include references to the same as subsequently modified, amended or re-enacted from time to time;

(iv) the singular includes the plural and vice versa and words importing one gender shall include all genders; and

(v) headings to Clauses are for ease of reference only and shall not affect the interpretation of this Deed.

2. WAIVER AND RELEASE

2.1 With effect from the date of this Deed and without prejudice to the provisions of the Scheme, the Scheme Creditors (on their own behalf and on behalf of any person to whom they may have transferred their Scheme Claims after the Record Date) hereby irrevocably and unconditionally:

(a) waive, release and discharge fully and absolutely, to the fullest extent permitted by law, all Liabilities of the Released Parties to the Scheme Creditors in relation to or in connection with or in any way arising out of the Dated Notes and/or the preparation, negotiation or implementation of the Scheme, the Liability Management Exercise and/or the recapitalisation of the Company; and

(b) waive, to the fullest extent permitted by law, each and every claim which the Scheme Creditors (or any person to whom a Scheme Creditor may have transferred its Scheme Claim after the Record Date) may have in relation to or in connection with or in any way arising out of the Dated Notes and/or the preparation, negotiation or implementation of the Scheme, the Liability Management Exercise and/or the recapitalisation of the Company against the Released Parties.

2.2 Each release, waiver and discharge effected by the terms of Clause 2.1 above shall not extend to:

(a) any Liability of any Adviser Released Party arising under a duty of care to such Adviser Released Party's client or arising under a duty of care to another person which has been specifically and expressly accepted or acknowledged in writing by that Adviser Released Party;

(b) any Liability arising or resulting from gross negligence, wilful default or fraud;

(c) any Liability in any Lock-up Arrangement; or

(d) any Liability of the Company to the Trustee in relation to or in connection with or in any way arising out of the Dated Notes, save to the extent such Liability comprises a Scheme Claim.

2.3 Nothing in this Deed shall release, waive or discharge any Liability of any person under the New Transaction Documents or the Restructuring Documents.

3. FURTHER ASSURANCES

The Scheme Creditors will take whatever action is reasonably necessary to achieve the waiver, release and discharge referred to in Clause 2 (*Waiver and Release*) of this Deed.

4. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT

4.1 Other than as provided in Clause 4.2 below, a person who is not party to this Deed has no right under the Contracts (Rights of Third Parties) Act 1999 to enforce or to enjoy the benefit of any term of this Deed.

4.2 A Released Party may rely on and enforce the terms of this Deed.

5. COUNTERPARTS

This Deed may be executed in any number of counterparts. This has the same effect as if the signatures on the counterparts were on a single copy of the Deed.

6. GOVERNING LAW AND JURISDICTION

This Deed and any non-contractual obligations arising out of or in connection with it are governed by English law. The courts of England have exclusive jurisdiction to settle any dispute arising out of or in connection with this Deed or any non-contractual obligations connected with it.

This Deed has been entered into and delivered as a deed on the date stated at the beginning of this Deed.

APPENDIX 1

RELEASED PARTIES

PART 1

TRANSACTION RELEASED PARTIES

1. The Company and its directors, members and representatives
2. Co-operative Group and its directors, members and representatives
3. CBGL and its directors, members and representatives
4. The Law Debenture Trust Corporation p.l.c. in its capacity as trustee for each series of the Dated Notes
5. Archview Master Fund Ltd
6. Archview Fund LP
7. Aurelius Opportunities Fund, LLC
8. Amundi Alternatives Beach Point Distressed Master Fund
9. dbX-High Yield 2 Ltd
10. LumX Beach Point Total Return Fund
11. MLIS – Beach Point Diversified Credit UCITS Fund
12. BPC UKI, L.P.
13. Canyon Balanced Master Fund, Ltd.
14. Canyon Distressed Opportunity Master Fund, L.P.
15. Canyon Distressed Opportunity Investing Fund, L.P.
16. Citi Canyon Ltd.
17. The Canyon Value Realization Master Fund, L.P.
18. Canyon Blue Credit Investment Fund L.P.
19. Canyon-GRF Master Fund II, L.P.
20. Permal Canyon Fund Ltd.
21. Canyon Value Realization MAC 18 Ltd.
22. Canyon-TCDRS Fund, LLC

23. Canyon Value Realization Fund, L.P.
24. Mariner LDC
25. Caspian Select Credit Master Fund, Ltd.
26. Caspian Solitude Master Fund, L.P.
27. Caspian HLSC1, LLC
28. Super Caspian Cayman Fund Limited
29. Caspian SC Holdings, L.P.
30. GoldenTree Master Fund II, Ltd.
31. GoldenTree EnTrust Master Fund SPC, on behalf of and for the account of Segregated Portfolio I
32. GN3 SIP L.P.
33. GoldenTree Master Fund, Ltd.
34. Knighthead Master Fund, LP
35. LMA SPC for and on behalf of MAP84 Segregated Portfolio
36. MatlinPatterson Fund (IV) Hedge Master Account L.P.
37. Monarch Master Funding 2 (Luxembourg) S.à r.l.
38. Silver Point Capital Offshore Master Fund, L.P.
39. Silver Point Capital Fund, L.P.
40. Stone Lion Portfolio L.P.
41. Permal Stone Lion Fund Ltd.
42. Taconic Master Fund 1.5 LP
43. Taconic Opportunity Master Fund LP
44. Archview Investment Group LP
45. Aurelius Capital Management, LP
46. Beach Point Capital Management LP
47. Canyon Capital Advisors LLC
48. Caspian Capital LP
49. GoldenTree Asset Management LP
50. Knighthead Capital Management LLC

51. MatlinPatterson Global Advisers LLC
52. Monarch Alternative Capital LP
53. Silver Point Capital, L.P.
54. Stone Lion Capital Partners L.P.
55. Taconic Capital Advisors LP.
56. CSS, LLC
57. GoldenTree EnTrust Distressed Debt Master Fund LP
58. GoldenTree EnTrust Distressed Debt Fund LP
59. GoldenTree SG Partners LP
60. Perry Partners International Master Inc
61. Perry Partners LP
62. Perry Capital, LLC
63. Absolute Return Income Master Fund LP
64. Serengeti Opportunities MM L.P.
65. Serengeti Lycaon MM LP
66. Rapax OC Master Fund LTD
67. Serengeti Asset Management
68. Silver Point Luxembourg Platform S.à r.l.
69. Strategic Value Master Fund, Ltd.
70. Strategic Value Special Situations Master Fund II, LP
71. Strategic Value Partners LLC
72. Fortelus Special Situations Master Fund Ltd
73. P Fortelus Ltd
74. Indaba Capital Fund, L.P.
75. BSMEH LLC
76. BLAFH LLC
77. ARKS LLC
78. EZTM LLC

79. HATHB LLC

80. DJM3 LLC

81. JHNEW LLC

82. MAMBS LLC

83. MWE LLC

84. SL Portfolio Investments LLC

85. Fortelus Capital Management LLP

PART 2

ADVISER RELEASED PARTIES

1. HSBC Bank plc
2. UBS Limited
3. Allen & Overy LLP
4. Linklaters LLP
5. Clifford Chance LLP
6. Greenhill & Co. International LLP
7. Deloitte LLP
8. Pricewaterhouse Coopers LLP
9. Alix Partners
10. Stephenson Harwood LLP
11. Shearman & Sterling (London) LLP and Shearman & Sterling LLP
12. Moelis & Company UK LLP
13. Sacker & Partners LLP

SIGNATORIES

SCHEME CREDITORS

EXECUTED AND DELIVERED AS A DEED by)
THE CO-OPERATIVE BANK P.L.C.)
)
acting pursuant to the authority conferred on The Co-operative)
Bank p.l.c. for this purpose under the Scheme)

acting by

Director

Director/Secretary

SCHEDULE 2

FORM OF DISTRIBUTION AGREEMENT

DISTRIBUTION AGREEMENT

[●] 2013

THE CO-OPERATIVE BANK P.L.C.

LUCID ISSUER SERVICES LIMITED
(in its capacity as holding period trustee and information agent)

THE SCHEME CREDITORS

TFS DERIVATIVES LIMITED and TRADITION (UK) LIMITED
(in their capacity as selling agent)

ALLEN & OVERY

Allen & Overy LLP

CONTENTS

Clause **Page**

1. Definitions 1
2. Commencement 5
3. Representations and Warranties 5
4. Agreement to Act 5
5. Establishment of Escrow Accounts and Transfers to Holding Period Trustee 5
6. Undertakings 6
7. Tax 8
8. Distributions 8
9. Rights, Powers and Duties of the Holding Period Trustee 12
10. Rights, Powers and Duties of the Selling Agent 15
11. Investments 16
12. Closure of Escrow Accounts and Resignation of Holding Period Trustee 16
13. Fees and Expenses 17
14. Further Assurance 18
15. Other Agreements 18
16. Notices 18
17. Assignment 19
18. Force Majeure 19
19. Counterparts 19
20. Severability 19
21. Entire Agreement 19
22. Third Party Rights 19
23. Amendments 19
24. Governing Law and Jurisdiction 19

Schedule

1. Form of Instruction Certificates 21
   Part 1 Distribution Instruction Certificate 21
   Part 2 Sale Instruction Certificate 23

Signatories 25

THIS AGREEMENT is made by way of deed on [●] 2013

BETWEEN:

(1) **THE CO-OPERATIVE BANK P.L.C.**, a company incorporated in England and Wales with registered number 00990937 whose registered office is at 1 Balloon Street, Manchester, M60 4EP (the **Company**);

(2) **LUCID ISSUER SERVICES LIMITED**, a company incorporated in England and Wales with registered number 05098454 whose registered office is at Leroy House, 436 Essex Road, London, N1 3QP in its capacity as the information agent (the **Information Agent**) and the holding period trustee (the **Holding Period Trustee**);

(3) **THE SCHEME CREDITORS** under and as defined in the Scheme (as defined below) (the **Scheme Creditors**); and

(4) **TFS DERIVATIVES LIMITED**, a company incorporated in England and Wales with registered number 04051930 whose registered office is at Beaufort House, 15 St. Botolph Street, London EC3A 7QX (**TFSD**); and

(5) **TRADITION (UK) LIMITED**, a company incorporated in England and Wales with registered number 00937647 whose registered office is at Beaufort House, 15 St. Botolph Street, London EC3A 7QX (**TUK**) (TFSD and TUK collectively, the **Selling Agent**).

WHEREAS:

(A) The Company has proposed a scheme of arrangement (the **Scheme**) under Part 26 of the Companies Act 2006 (the **Act**) with the Scheme Creditors.

(B) The Scheme effects the full and final compromise and settlement of the claims of the Scheme Creditors against the Company by, amongst other things, the Scheme Creditors exchanging their Scheme Claims (as defined in the Scheme) for the Scheme Consideration (as defined in the Scheme). For this purpose, the Scheme provides for the appointment of a bare trustee who will be responsible for, inter alia, holding certain amounts of the Scheme Consideration on trust for, and distributing the Scheme Consideration to, or to the order of, certain of the Scheme Creditors.

(C) This Agreement is entered into in contemplation of, and certain provisions of this Agreement are conditional upon, the satisfaction of the Scheme Settlement Condition (as defined in the Scheme) and the occurrence of the Scheme Settlement Date (as defined in the Scheme).

(D) It is the intention of the parties that this Agreement be entered into as a deed.

IT IS AGREED AND THIS DEED WITNESSES as follows:

1. DEFINITIONS

1.1 Capitalised terms used in this Agreement and not otherwise defined herein will have the meanings ascribed to them in the Scheme.

1.2 In this Agreement:

Account Holder means any person recorded directly in the records of a Clearing System as holding an interest in any Dated Notes at the Record Date in an account with the relevant Clearing System either for its own account or on behalf of its client;

Accruals means any interest, dividends or distributions (or any other rights or benefits) paid from time to time in respect of the Bank T2 Notes and the New Ordinary Shares held by the Holding Period Trustee;

Admission means admission of the New Ordinary Shares to the Official List of the United Kingdom Listing Authority and admission to trading on the London Stock Exchange plc's market for listed securities;

Admitted Noteholders means the Noteholders other than the Noteholder Beneficiaries;

Business Day means a day on which banks are open for general business (other than a Saturday, Sunday or bank holiday) in London;

Cash Escrow Account means the cash account established in the name of the Holding Period Trustee (or its nominee) for the purpose of receiving and holding any Accruals or proceeds of sale of the Bank T2 Notes or New Ordinary Shares held by the Holding Period Trustee;

Clearing System means Clearstream, Luxembourg and/or Euroclear (as the case may be);

Clearstream, Luxembourg means Clearstream Banking, *société anonyme*;

CREST means the relevant system (as defined in the CREST Regulations) in respect of which CRESTCo is the operator (as defined in the CREST Regulations);

CREST Regulations means the Uncertificated Securities Regulations 2001 (S.I. 2001/3755) including any modifications thereof or any regulations in substitution therefore;

CRESTCo means CRESTCo Limited;

Designated Recipient means any person appointed under a valid Account Holder Letter delivered to the Information Agent on behalf of a Noteholder to receive the Scheme Consideration to which that Noteholder is entitled pursuant to the terms of this Scheme, provided that such person is an Eligible Person;

Distribution Notice means the irrevocable notice served on the Information Agent by the Company upon the Scheme having been sanctioned and the Scheme Settlement Condition having been met, instructing the Information Agent to give instructions to the Registrars to distribute the Scheme Consideration to Admitted Noteholders or the Holding Period Trustee in accordance with the instructions from the Information Agent;

Distribution Instruction Certificate means a certificate substantially in the form set out in Part 1 of Schedule 1 to this Agreement prepared by the Information Agent and served on the Holding Period Trustee in respect of distributions to be made to an Eligible Noteholder (or, if applicable, its Designated Recipient);

Eligible Noteholder means a Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent before the end of the Holding Period which includes a confirmation that such Noteholder (or, if such Noteholder has appointed a Designated Recipient, its Designated Recipient) is an Eligible Person;

Engagement Letters means the letter agreements or contracts for service between the Company and each of the Information Agent, the Holding Period Trustee and the Selling Agent setting out, inter alia, their fees and expenses;

Escrow Accounts means each of the following accounts:

(a) the Securities Escrow Account; and

(b) the Cash Escrow Account;

and a reference to one or more Escrow Accounts is a reference to any one or more of these accounts;

Euroclear means Euroclear Bank S.A./N.V. as operator of the Euroclear system;

Force Majeure means any act of God, government act, war, fire, flood, explosion, civil commotion or act of terrorism;

Holding Period means the period of 36 months after the Scheme Settlement Date;

Ineligible Noteholder means a Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent before the end of the Holding Period which includes a confirmation that such Noteholder is an Ineligible Person and has not appointed a Designated Recipient;

Instruction Certificate means a Distribution Instruction Certificate or a Sale Instruction Certificate (as the context may require);

Noteholder Beneficiaries means (i) the Ineligible Noteholders on whose behalf valid Account Holder Letters have been delivered to and received by the Information Agent before the Voting Instruction Deadline and (ii) the Unadmitted Noteholders.

Registrars means Computershare Investor Services PLC as the registrars of both the New Ordinary Shares and the Bank T2 Notes, whose registered office is at The Pavilions, Bridgwater Road, Bristol BS13 8AE or such other person as the Company may appoint as its registrars for the purposes of this Agreement;

Relevant Conditions means:

(a) a duly completed (in the sole determination of the Information Agent) Account Holder Letter has been delivered to and received by the Information Agent (howsoever received); and

(b) the Information Agent has received confirmation satisfactory to it that the Noteholder on whose behalf such Account Holder Letter has been submitted was, at the Record Date, the ultimate beneficial holder of the Dated Notes specified in the relevant Account Holder Letter (which may comprise such evidence as the Information Agent may reasonably require);

Sale Instruction Certificate means a certificate substantially in the form set out in Part 2 of Schedule 1 to this Agreement prepared by the Information Agent and served on the Holding Period Trustee in respect of distributions to an Ineligible Noteholder;

Securities Escrow Account means the Clearstream, Luxembourg securities account to be established in the name of the Holding Period Trustee (or its nominee) for the purpose of receiving and holding the Bank T2 Notes and the New Ordinary Shares;

Security Interest means any mortgage or sub-mortgage, standard security, sub-standard security, charge or sub-charge (whether legal or equitable), encumbrance, pledge, lien, hypothecation, assignment by way of security, assignation in security or other security interest or title retention

arrangement, any agreement, trust or arrangement having substantially the same economic or financial effect as any of the foregoing;

Trust Fund means:

(a) the New Ordinary Shares (including any Accruals relating to those New Ordinary Shares); and

(b) the Bank T2 Notes (including any Accruals relating to those Bank T2 Notes),

which, in each case, have not been distributed to Noteholders in accordance with this Agreement or the Scheme from time to time, such fund to be held by the Holding Period Trustee on bare trust as legal, but not beneficial, title holders for the Noteholder Beneficiaries from time to time;

Unadmitted Noteholder means a Noteholder on whose behalf a valid Account Holder Letter has not been delivered to and received by the Information Agent before the Voting Instruction Deadline, other than any Eligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent between the Voting Instruction Deadline and the Business Day preceding the Scheme Settlement Date and in relation to whom the Company exercises its discretion to issue Scheme Consideration on the Scheme Settlement Date in accordance with the terms of the Scheme;

VAT means value added tax as imposed by the Value Added Tax Act 1994 and any other tax from time to time replacing it or of a similar fiscal nature; and

Voting Instruction Deadline means 4.30 p.m. (London time) on 10 December 2013.

In this Agreement:

(a) references to a person include an individual, firm, partnership, company, corporation, unincorporated body of persons and any state or state agency;

(b) references to a natural person include his estate and personal representatives;

(c) references to a party to this Agreement include references to the successors or assigns (immediate or otherwise) of that party; and

(d) references to the singular include the plural and vice versa and words importing one gender shall include all genders.

1.3 In this Agreement any reference, express or implied, to an enactment includes references to:

(a) that enactment as re-enacted, amended, extended or applied by or under any other enactment (before or after the signature of this Agreement);

(b) any enactment which that enactment re-enacts (with or without modification); and

(c) any subordinate legislation made (before or after the signature of this Agreement) under that enactment, as re-enacted, amended, extended or applied as described in paragraph (a) above or under any enactment referred to in paragraph (b) above,

and **enactment** includes any legislation in any jurisdiction.

1.4 Clauses 1.1 to 1.3 above apply unless the contrary intention appears.

1.5 The headings in this Agreement do not affect its interpretation.

2. COMMENCEMENT

2.1 Save for Clauses 2 to 4, 5.1, 8.1 and 13 to 24 which shall have effect immediately from the date of this Agreement, the obligations of the parties pursuant to this Agreement shall have effect from the Scheme Settlement Date.

2.2 The Company shall promptly notify the Holding Period Trustee, the Information Agent, the Selling Agent and the Scheme Creditors upon the Scheme Settlement Condition having been met.

3. REPRESENTATIONS AND WARRANTIES

3.1 Each of the parties to this Agreement represents and warrants to each of the others that it has the legal capacity, power and authority to enter into this Agreement and to carry out the transactions contemplated by and perform the obligations assumed by it under this Agreement.

3.2 Each of the parties to this Agreement represents and warrants to each of the others that neither the execution by it, nor the performance by it, of its respective obligations (if any) in accordance with the terms, conditions and provisions of this Agreement will:

(a) so far as that party is aware, violate or conflict with, or constitute a default under, any agreement or other obligation to which that party is subject or by which it is bound; or

(b) so far as that party is aware, contravene or conflict with or constitute a violation of any provision of any law, rule, regulation, judgment, order or decree which is binding on it.

4. AGREEMENT TO ACT

4.1 The Holding Period Trustee is hereby appointed by the Company and agrees to act only as a bare trustee for each Noteholder Beneficiary in relation to certain amounts of the Scheme Consideration in accordance with the terms, conditions and provisions of the Scheme, this Agreement and the relevant Engagement Letter.

4.2 The Information Agent is hereby appointed by the Company and agrees to act as information agent in relation to the Scheme in accordance with the terms, conditions and provisions of the Scheme, this Agreement and the relevant Engagement Letter.

4.3 TFSD and TUK are hereby appointed by the Company and agree to act as selling agents in relation to the Scheme in accordance with the terms, conditions and provisions of the Scheme, this Agreement and the relevant Engagement Letter.

4.4 For the avoidance of doubt, none of the Holding Period Trustee, the Information Agent and the Selling Agent shall at any time whatsoever have any beneficial interest in the Scheme Consideration or any part of it or any cash held by it pursuant to the Scheme and this Agreement.

5. ESTABLISHMENT OF ESCROW ACCOUNTS AND TRANSFERS TO HOLDING PERIOD TRUSTEE

5.1 The Holding Period Trustee shall establish the Escrow Accounts (if not already established) and each such account shall be designated as a trust account. The Holding Period Trustee shall provide to the Company prompt confirmation of the establishment of the Escrow Accounts and the relevant account details as soon as reasonably practicable after the date of this Agreement and in any event prior to the Scheme Settlement Date.

5.2 On the Scheme Settlement Date, the Company shall:

(a) issue and allot the New Ordinary Shares; and

(b) issue and allot the Bank T2 Notes,

to which the Noteholder Beneficiaries are entitled in accordance with the Scheme, credited as fully paid (in the case of the New Ordinary Shares), to the Holding Period Trustee, as bare trustee for the Noteholder Beneficiaries, and shall instruct that the New Ordinary Shares and the Bank T2 Notes are credited to the relevant Escrow Account. The Holding Period Trustee shall hold the New Ordinary Shares and the Bank T2 Notes allotted to it on bare trust in accordance with Clause 5.4 below.

5.3 The Holding Period Trustee shall, promptly upon being notified by Clearstream, Luxembourg and/or CREST as the case may be, of the receipt of the Scheme Consideration on behalf of the Noteholder Beneficiaries pursuant to Clause 5.2 above, provide to the Company an acknowledgement of the receipt of each part of the Scheme Consideration paid, transferred, issued or allotted to it.

5.4 The Holding Period Trustee hereby declares that it shall hold the Trust Fund on bare trust for the Noteholder Beneficiaries absolutely.

5.5 It shall be a term of the trust constituted by Clause 5.4 above that the Holding Period Trustee is authorised by the Scheme Creditors and obliged to take any action which is contemplated by this Agreement and which it is instructed to take by the Information Agent under and in connection with this Agreement.

5.6 Other than as set out in Clauses 8.3 and 8.8, the Holding Period Trustee shall not have, and shall procure that none of its respective delegates shall have, any right of indemnity, set off, combination of accounts or any other right whatsoever to apply the assets comprised in the Trust Fund or any part thereof in discharge or satisfaction of any cost, right of reimbursement, expense, loss or other liability of the Holding Period Trustee, and all such rights are hereby released by the Holding Period Trustee.

6. UNDERTAKINGS

6.1 The Holding Period Trustee hereby undertakes in favour of the Company and the Noteholder Beneficiaries that it shall deal with the Trust Fund and each Escrow Account as contemplated by this Agreement and as instructed by the Information Agent pursuant to the terms of this Agreement and the trusts constituted hereby.

6.2 The Information Agent hereby directs the Holding Period Trustee that it shall not, and shall not purport to (and the Holding Period Trustee hereby undertakes that it shall not nor purport to):

(a) create or permit to subsist any Security Interest whatsoever (unless arising by operation of law) upon any of the assets comprised in the Trust Fund;

(b) save as expressly set out in this Agreement or as required (and to the extent necessary) to perform its obligations as trustee of the trusts constituted by this Agreement, sell, transfer or otherwise dispose of, or deal with, the Trust Fund, any interest, estate, right, title or benefit therein or thereto or any cash amounts or instruments standing to the credit of any Escrow Account; or

(c) save as expressly set out in this Agreement or in respect of the trusts created by this Agreement, permit any person other than itself to have any interest, estate, right, title or benefit in any of the assets comprised in the Trust Fund.

6.3 The Holding Period Trustee agrees that it shall have no discretion in the making or withholding of any distribution to, or to the order of, the Noteholder Beneficiaries.

6.4 The Holding Period Trustee hereby undertakes in favour of the other parties to this Agreement that, without prejudice to Clause 9.3, it will act honestly and in good faith and will exercise the diligence expected of a reasonably prudent trustee in the fulfilment and/or exercise of its duties and obligations under this Agreement.

6.5 The Information Agent hereby undertakes in favour of the other parties to this Agreement that it will act honestly and in good faith and will exercise the diligence of a reasonably prudent expert in comparable circumstances in the fulfilment and/or exercise of its duties and obligations under this Agreement.

6.6 The Selling Agent hereby undertakes in favour of the other parties to this Agreement that it will act honestly and in good faith and will exercise the diligence of a reasonably prudent expert in comparable circumstances in the fulfilment and/or exercise of its duties and obligations under this Agreement.

6.7 The Information Agent hereby undertakes in favour of each Noteholder Beneficiary, the Holding Period Trustee and the Company:

(a) to ensure that the information provided to the Company and the Holding Period Trustee (including that contained in each Instruction Certificate) is true and correct in all respects;

(b) to liaise with Account Holders to ensure that duly completed (in the sole determination of the Information Agent) Account Holder Letters are provided, and to collate all such Account Holder Letters received;

(c) to liaise with the relevant Account Holders (as applicable) to complete any missing information and correct any errors in each Account Holder Letter delivered to and received by it (in accordance with the terms of the Account Holder Letter);

(d) to check the confirmations contained in each Account Holder Letter;

(e) with respect to each duly completed (in the sole determination of the Information Agent) Account Holder Letter delivered to and received by the Information Agent in respect of a Noteholder Beneficiary prior to the end of the Holding Period, provided that the Relevant Conditions have been satisfied, to deliver an Instruction Certificate to the Holding Period Trustee not later than 10 Business Days from the date of receipt of that Account Holder Letter (provided that the Information Agent shall be under no obligation to deliver an Instruction Certificate to the Holding Period Trustee prior to the Scheme Settlement Date);

(f) in circumstances where:

(i) an Account Holder Letter has been delivered to and received by the Information Agent in accordance with paragraph (e) above; and

(ii) the relevant Noteholder Beneficiary is an Ineligible Noteholder,

to provide the Holding Period Trustee with a Sale Instruction Certificate in respect of the New Ordinary Shares and Bank T2 Notes that the Ineligible Noteholder would otherwise have been entitled to receive under the terms of the Scheme had the Noteholder Beneficiary been an Eligible Noteholder in accordance with paragraph (e) above;

(g) in circumstances where:

(i) an Account Holder Letter has been delivered to and received by the Information Agent in accordance with paragraph (e) above; and

(ii) the relevant Noteholder Beneficiary is an Eligible Noteholder,

to provide the Holding Period Trustee with a Distribution Instruction Certificate in respect of the New Ordinary Shares and Bank T2 Notes which that Noteholder Beneficiary is entitled to receive under the terms of the Scheme in accordance with paragraph (e) above; and

(h) to maintain records and copies of all Account Holder Letters received (whether in hard copy or electronic form) and all Instruction Certificates issued and to make such records (or copies thereof) available to the Company and the Holding Period Trustee at all reasonable times upon request.

7. TAX

It is acknowledged that the Company's expectation is that no stamp duty and/or stamp duty reserve tax (**SDRT**) should be payable upon the issue and/or allotment of New Ordinary Shares and/or Bank T2 Notes. Insofar as is reasonably practicable, all issues of New Ordinary Shares and Bank T2 Notes pursuant to the Scheme and this Agreement shall be made on terms that no stamp duty and/or SDRT becomes payable by the recipient. If any such stamp duty and/or SDRT is payable, the Company shall take reasonable steps to avoid incurrence by any person of such liability. If notwithstanding such efforts, stamp duty and/or SDRT is payable upon the issue and/or allotment of New Ordinary Shares and/or Bank T2 Notes to an Eligible Noteholder (or, if applicable, its Designated Recipient), then the Company covenants to the Noteholder Beneficiaries that it shall pay such stamp duty and/or SDRT on behalf of the relevant Eligible Noteholder (or, if applicable, its Designated Recipient).

8. DISTRIBUTIONS

8.1 Delivery of Distribution Notice

Immediately prior to the Scheme Settlement Date:

(a) the Company will deliver the Distribution Notice to the Information Agent; and

(b) the Information Agent will, immediately upon receipt of the Distribution Notice, deliver to the Registrars, instructions with respect to the allocation of the Scheme Consideration:

(i) directly to Account Holders for Admitted Noteholders in accordance with the Account Holder Letters received and processed by the Information Agent at that date; or

(ii) to the Holding Period Trustee otherwise in accordance with the Scheme and this Agreement,

in each case on the Scheme Settlement Date.

8.2 Delivery of Instruction Certificates

(a) The Information Agent will deliver to the Holding Period Trustee Instruction Certificates in accordance with Clause 6.7 above.

(b) Each Distribution Instruction Certificate shall:

(i) identify the Eligible Noteholder (or, if applicable, the Designated Recipient) to which a distribution is to be made in accordance with Clauses 8.4 below;

(ii) specify the amount of New Ordinary Shares and Bank T2 Notes (in each case, if any) comprising the Scheme Consideration which is to be distributed to that Eligible Noteholder (or, if applicable, the Designated Recipient);

(iii) provide details of:

(A) the Clearing System account to which the relevant portion of the Bank T2 Notes, if any, and New Ordinary Shares, if any, are to be credited; and

(B) the cash account to which the relevant portion of Accruals, if any, is to be credited; and

(iv) provide the further information set out in the form of the Distribution Instruction Certificate.

(c) Each Sale Instruction Certificate shall:

(i) identify the Ineligible Noteholder to which a distribution is to be made in accordance with Clause 8.3 below;

(ii) specify the number of New Ordinary Shares and Bank T2 Notes which are to be sold, subject to Clause 8.9, on behalf of such Ineligible Noteholder;

(iii) provide details of the cash account to which the proceeds of the disposal of such New Ordinary Shares and Bank T2 Notes and any related Accruals should be transferred once deposited in the Cash Escrow Account; and

(iv) provide the further information set out in the form of the Sale Instruction Certificate.

8.3 **Distributions on behalf of the Noteholder Beneficiaries**

Subject to this Clause 8, each of the Noteholder Beneficiaries hereby instructs the Holding Period Trustee:

(a) to distribute (subject to Clause 8.4) such number of New Ordinary Shares and (subject to Clause 8.5) such number of Bank T2 Notes to the Eligible Noteholders (or, if applicable, their Designated Recipients) identified in the relevant Distribution Instruction Certificate in an amount and to the account(s) specified in the relevant Distribution Instruction Certificate;

(b) to the extent received by the Holding Period Trustee prior to a distribution to any Eligible Noteholder (or, if applicable, its Designated Recipient) or Ineligible Noteholder, in accordance with an Instruction Certificate, pay to such Eligible Noteholder (or, if applicable, its Designated Recipient) or Ineligible Noteholder (in each case at the time of the distribution of the relevant Scheme Consideration or the net cash proceeds of the sale of the relevant Scheme Consideration (as the case may be) as described in Clauses 8.3(a) and 8.3(c)) cash equal to any Accruals received (net of any amount deducted or withheld in respect of tax) in respect of the New Ordinary Shares and the Bank T2 Notes in an amount calculated by reference to the New Ordinary Shares and Bank T2 Notes in the amount and to the account(s) specified in the relevant Instruction Certificate;

(c) subject to Clause 8.9, to sell or procure the sale, by the Selling Agent on behalf of the relevant Ineligible Noteholder, of such number of Bank T2 Notes and New Ordinary Shares specified in a Sale Instruction Certificate and to distribute from the Cash Escrow Account to the account of the Ineligible Noteholder identified in such Sale Instruction Certificate as soon as reasonably practicable the net cash proceeds of the sale in sterling (after deduction for and on account of all applicable taxes and expenses including, without limitation, the Selling Agent's selling commission calculated in accordance with the Engagement Letter relating to the Selling Agent) as specified in the relevant Sale Instruction Certificate; and

(d) to continue to hold as bare trustee any Bank T2 Notes and New Ordinary Shares and/or cash (including any Accruals that remain for the time being undistributed) to the order of the relevant Noteholder Beneficiary and, upon the expiry of the Holding Period, to deal with such Scheme Consideration in accordance with Clause 8.8.

Subject to Clause 8.9(b), the Holding Period Trustee shall make any such sale and/or distribution as is referred to in paragraphs (a) to (c) above as soon as reasonably practicable after receipt of the relevant Instruction Certificate.

8.4 **Distribution of New Ordinary Shares**

Subject to Clause 8.7, where a Distribution Instruction Certificate specifies that any New Ordinary Shares shall be distributed to an Eligible Noteholder (or, if applicable, its Designated Recipient), each of the Noteholder Beneficiaries hereby directs the Holding Period Trustee to distribute or transfer (or permit to be distributed or transferred) such number of New Ordinary Shares specified in the relevant Distribution Instruction Certificate to the Clearing System account specified in the relevant Distribution Instruction Certificate for onward delivery by the relevant Clearing System participant to the relevant Eligible Noteholder (or, is applicable, its Designated Recipient) specified in such Distribution Instruction Certificate and confirms that such transfer shall satisfy the obligations of the Holding Period Trustee to distribute such New Ordinary Shares pursuant to Clause 8.3(a) above.

8.5 **Distribution of Bank T2 Notes**

Subject to Clause 8.7, where a Distribution Instruction Certificate specifies that any Bank T2 Notes shall be distributed to an Eligible Noteholder (or, if applicable, its Designated Recipient), each of the Noteholder Beneficiaries hereby authorises the Holding Period Trustee to distribute or transfer (or permit to be distributed or transferred) such number of Bank T2 Notes to the Clearing System account specified in such Distribution Instruction Certificate for onward delivery by the relevant Clearing System participant to the relevant Eligible Noteholder (or, if applicable, its Designated Recipient) specified in such Distribution Instruction Certificate and confirms that such distribution or transfer shall satisfy the obligations of the Holding Period Trustee to distribute such Bank T2 Notes pursuant to Clause 8.3(a) above.

8.6 **Distribution of Accruals**

Where an Instruction Certificate specifies that any Accruals shall be distributed to a Noteholder Beneficiary, each of the Noteholder Beneficiaries hereby directs the Holding Period Trustee to distribute or transfer (or permit to be distributed or transferred) such Accruals (after deduction for and on account of all applicable taxes and expenses) to the Clearing System or other account specified in the relevant Instruction Certificate for onward delivery to the Noteholder Beneficiary specified in such Instruction Certificate and confirms that such transfer shall satisfy the obligations of the Holding Period Trustee to distribute such Accruals pursuant to Clause 8.3(c) above.

8.7 **Fractional Entitlements to Bank T2 Notes and New Ordinary Shares**

(a) If the number of New Ordinary Shares to be delivered to a Noteholder Beneficiary resulting from any calculation made in accordance with the Scheme is not a whole number, that number shall be rounded down to the nearest whole number and the relevant Noteholder Beneficiary shall have no entitlement to any resulting fractional amount.

(b) If the principal amount of Bank T2 Notes to be delivered to a Noteholder Beneficiary resulting from any calculation made in accordance with the Scheme is not an integral multiple of £10, that amount shall be rounded down to the nearest integral multiple of £10 and the relevant Noteholder Beneficiary shall have no entitlement to any resulting fractional amount.

8.8 **Distribution upon the end of the Holding Period**

Upon the end of the Holding Period:

(a) subject to Clause 8.9, each Noteholder Beneficiary in respect of which a duly completed (in the sole determination of the Information Agent) Account Holder Letter has not been delivered to and received by the Information Agent at the end of the Holding Period, hereby instructs the Holding Period Trustee to sell or procure the sale by the Selling Agent (on behalf of such Noteholder Beneficiary) of any Bank T2 Notes and New Ordinary Shares held in each relevant Escrow Account which such Noteholder Beneficiary would otherwise have been entitled to receive under the terms of the Scheme had that Noteholder Beneficiary been an Eligible Noteholder and pay the net proceeds of such sale (after deduction for or on account of all applicable taxes and costs of the sale including, without limitation, the Selling Agent's selling commission calculated in accordance with the Engagement Letter) to the Cash Escrow Account; and

(b) each Noteholder Beneficiary in respect of which a duly completed (in the sole determination of the Information Agent) Account Holder Letter has not been delivered to and received by the Information Agent at the end of the Holding Period, hereby instructs the Holding Period Trustee to transfer the cash (if any) in the Cash Escrow Account (including any cash resulting from interest earned on the Escrow Accounts) (after receipt of the proceeds of any sale made in accordance with paragraph (a) above and after deduction for or on account of all applicable taxes and costs of the distribution) to the Company.

8.9 **Sales by the Selling Agent on behalf of the Holding Period Trustee**

(a) Any sale made pursuant to Clauses 8.3 or 8.8 above shall be effected by the Selling Agent on behalf of the Holding Period Trustee and shall be made on behalf of the relevant Noteholder Beneficiary upon the best terms reasonably available in the market at the time of the sale. None of the Holding Period Trustee, the Selling Agent, the Company, the Information Agent, the Registrars or any other person shall be responsible for any loss or alleged loss arising from the price, terms, manner or timing of any such sale or the failure to procure any purchaser for such New Ordinary Shares and/or Bank T2 Notes.

(b) Without prejudice to the ability of the Holding Period Trustee to do so, the Holding Period Trustee shall be under no obligation to sell or instruct the Selling Agent to sell any New Ordinary Shares or distribute the related Accruals until Admission. Without prejudice to the foregoing, the Holding Period Trustee shall use all reasonable endeavours to achieve or procure a sale of such New Ordinary Shares within 30 days following Admission.

(c) To the extent that the Holding Period Trustee (or the Selling Agent on behalf of the Holding Period Trustee) is not able, after having used reasonable efforts and having consulted with the Company, to sell any New Ordinary Shares and/or Bank T2 Notes within the three month period following the end of the Holding Period, then the Holding Period Trustee is hereby irrevocably authorised and

instructed by each relevant Noteholder Beneficiary to transfer the Bank T2 Notes and/or New Ordinary Shares then held by the Holding Period Trustee by way of gift on its behalf to Carers Trust (registered charity number 1145181) or to any other registered charity selected by the Company in writing for this purpose.

9. RIGHTS, POWERS AND DUTIES OF THE HOLDING PERIOD TRUSTEE

9.1 The Scheme Creditors hereby direct the Holding Period Trustee not to exercise any voting, conversion or any other rights attaching to any New Ordinary Shares or Bank T2 Notes whilst they are held in the Trust Fund and the Holding Period Trustee agrees that it will not exercise any such rights.

9.2 The duties, responsibilities and obligations of the Holding Period Trustee shall be limited to those expressly set forth herein and no duties, responsibilities or obligations shall be inferred or implied. The Holding Period Trustee shall not be required to and shall not expend or risk any of its own funds or otherwise incur any financial liability in the performance of any of its duties under this Agreement, save where the same arises as a result of its negligence, wilful default or fraud.

9.3 Subject to Clause 9.4, other than in the case of manifest error or in the case of an error subsequently notified in writing to the Holding Period Trustee prior to the relevant distribution being made, the Holding Period Trustee shall be entitled to rely upon each Instruction Certificate served upon it and all information provided to it by the Information Agent without the need for further investigation or inquiry and shall have no liability to any person for acting on the basis of such information.

9.4 If the content or meaning of any Instruction Certificate or other information provided to the Holding Period Trustee is unclear or ambiguous so that the Holding Period Trustee is unable to determine the intention of such Instruction Certificate or other information, the Holding Period Trustee shall promptly notify the Information Agent of such lack of clarity or ambiguity and shall be entitled to refuse to take any action in respect of such Instruction Certificate or other information until any such lack of clarity or ambiguity has, in the opinion of the Holding Period Trustee, been satisfactorily resolved. For the avoidance of doubt, the Holding Period Trustee shall have no liability for refusing to take any action in accordance with this Clause 9.4.

9.5 The Holding Period Trustee shall not be charged with knowledge of the terms and conditions of any other agreement, instrument or document executed between the other parties and to which it is not a party, other than the Scheme, the explanatory statement prepared in connection with the Scheme or such other instrument, agreement or document the content of which the Holding Period Trustee is expressly required to have knowledge of pursuant to the terms of this Agreement.

9.6 The Company agrees (subject as provided in Clause 9.7) to reimburse the Holding Period Trustee on demand for, and to indemnify (on an after tax basis) and hold the Holding Period Trustee harmless against and with respect to, any and all loss, liability, damage or expense (including, without limitation, proper legal fees, costs and disbursements and any liabilities to tax other than any taxes charged on the fees and expenses charged by the Holding Period Trustee under this Agreement) that the Holding Period Trustee may suffer or incur in connection with it acting in accordance with the Scheme or this Agreement, except to the extent that such loss, liability, damage or expense arises from its own negligence, wilful default or fraud.

9.7 In case any action shall be brought against the Holding Period Trustee (the **indemnified person**) in respect of which recovery may be sought from the Company (the **indemnifier**) under Clause 9.6, the indemnified person shall promptly notify the indemnifier in writing but (subject as provided below) failure to do so will not relieve the indemnifier from any liability under this Agreement. Subject to Clause 9.8, the indemnifier may participate at its own expense in the defence of any action.

9.8 If it so elects within a reasonable time after receipt of the notice referred to in Clause 9.7, the indemnifier may assume the defence of the action with legal advisers chosen by it. Notwithstanding such election the indemnified person may employ separate legal advisers, and the indemnifier shall bear the fees and expenses of such separate legal advisers if:

(a) the use of the legal advisers chosen by the indemnifier to represent the indemnified person would present such legal advisers with a conflict of interest;

(b) the actual or potential defendants in, or targets of, any such action include both the indemnified person and the indemnifier and the indemnified person concludes that there may be legal defences available to it which are different from or additional to those available to the indemnifier;

(c) the indemnifier has not employed legal advisers satisfactory to the indemnified person (acting reasonably) to represent the indemnified person within a reasonable time after notice of the institution of such action; or

(d) the indemnifier authorises the indemnified person to employ separate legal advisers at the expense of the indemnifier.

Without prejudice to Clause 9.6, if the indemnifier assumes the defence of the action, the indemnifier shall not be liable for any fees and expenses of legal advisers of the indemnified person incurred thereafter in connection with the action, except as stated above.

9.9 The indemnifier shall not be liable in respect of any settlement of any action effected without its consent, such consent not to be unreasonably withheld or delayed. Without prejudice to Clause 9.6, the indemnifier shall not, without the prior written consent of the indemnified person, where the indemnified person is an actual, or is reasonably likely to be a potential, party to such claim or action, settle or compromise or consent to the entry of any judgment with respect to any pending or threatened claim or action in respect of which recovery may be sought hereunder unless such settlement, compromise or consent includes an unconditional release of the indemnified person from all liability arising out of such claim or action and does not include a statement as to or an admission of fault, culpability or failure to act by or on behalf of the indemnified person.

9.10 The Holding Period Trustee may obtain and pay for such legal or other expert advice or services as it may reasonably consider necessary in relation to this Agreement, and may rely on the opinion or advice obtained from any accountant, lawyer or other expert of good repute and shall incur no liability and shall be fully protected if acting in good faith in accordance with such opinion or advice.

9.11 The Holding Period Trustee may call for and shall be at liberty to accept as sufficient evidence of any fact or matter or the expediency of any transaction or thing, a certificate signed by the Company or two authorised representatives of the Company and the Holding Period Trustee shall not be bound in any such case to call for further evidence or be responsible for any liability that may be occasioned by it or any other person acting on such certificate.

9.12 The Holding Period Trustee shall be at liberty to hold this Agreement and any other documents relating to it or to deposit them in any part of the world with any banker or banking company or company whose business includes undertaking the safe custody of documents or lawyer or firm of lawyers considered by the Holding Period Trustee to be of good repute and the Holding Period Trustee shall not be responsible for or required to insure against any liability incurred in connection with any such holding or deposit and may pay all sums required to be paid on account of or in respect of any such deposit.

9.13 Subject to Clause 9.25, the Holding Period Trustee shall not (unless and to the extent ordered to do so by a court of competent jurisdiction) be required to disclose to any Scheme Creditor any information (including, without limitation, information of a confidential, financial or price sensitive nature) made available to it by any other party to this Agreement or any other person in connection with this Agreement.

9.14 The Holding Period Trustee shall not be required to take any legal action or proceedings unless it has been indemnified and/or provided with security to its satisfaction against all actions, proceedings, claims and demands to which it may render itself liable and all costs, charges, damages, expenses and liabilities which it may incur by so doing.

9.15 Each of the parties to this Agreement agrees (i) that it will not take any proceedings, or assert or seek to assert any claim, against any officer or employee of any of the Holding Period Trustee or the Information Agent in respect of any claim it might have against the Holding Period Trustee or the Information Agent (as the case may be) in respect of this Agreement and (ii) that any officer or employee of the Holding Period Trustee or the Information Agent may enforce this provision.

9.16 The Holding Period Trustee may (without any responsibility for any resulting loss) rely on:

(a) any written communication, certificate, legal opinion, instruction or other document received or obtained by it (including, without limitation, an Instruction Certificate) in the course of performing its obligations under this Agreement and believed by it to be genuine and correct and to have been signed by, or with the authority of, the proper person; and

(b) any written statement made to it in the course of, and as part of, performing its obligations under this Agreement by a director, officer, partner or employee or authorised representative of any person regarding any matters which may reasonably be assumed to be within the maker's knowledge or within the maker's power to verify.

9.17 Any opinion, advice or information described in Clause 9.16 on which the Holding Period Trustee relies or intends to rely may be sent or communicated by letter, email or facsimile transmission. The Holding Period Trustee shall not be liable for acting properly where in accordance with this Agreement it has acted in reliance upon any opinion, advice or information which is so conveyed, unless the opinion, advice or information contains some error of which the Holding Period Trustee is aware or which is manifest.

9.18 The Holding Period Trustee may retain for its own benefit, without liability to account to any other person, any fee or other sum received by it for its own account.

9.19 The Holding Period Trustee may provide advisory or other services to or engage in any kind of business with any person party to, or affected by, the arrangements which are the subject of this Agreement and may do so without any obligation to account to or disclose any such arrangements to any person but not (i) in respect of the Scheme unless permitted by the Scheme or this Agreement or (ii) to the extent that to do so would place the Holding Period Trustee in a position where it has a conflict of interest with its rights, duties and obligations under this Agreement or the Scheme.

9.20 The Holding Period Trustee may exercise any of its rights and perform any of its duties, obligations and responsibilities under this Agreement through its paid or unpaid agents, which may be corporations, partnerships or individuals (whether or not lawyers or other professional persons) or employees and, provided that it has exercised reasonable care in the selection of any such agent or employees, shall not be responsible for any misconduct or omission on the part of, or be bound to supervise the proceedings or acts of, any such agent or employee save where the same arises as a result of the negligence, wilful default or fraud on the part of the agent or employee. Any such agent

or employee which is reasonably engaged in any profession or business shall be entitled to charge and be paid all usual fees, expenses and other charges for its services.

9.21 The Holding Period Trustee may refrain from doing anything which would or might in its opinion be contrary to any law or any directive or regulation of, or having the force of law in, any jurisdiction to which it is subject or which would or might otherwise render it liable to any person and may do anything which is, in its reasonable opinion, necessary to comply with such law, directive or regulation.

9.22 The Holding Period Trustee shall not have any responsibility for the legality, effectiveness, adequacy, enforceability or admissibility in evidence of this Agreement or the Scheme unless the lack of any such thing is caused by its own negligence, wilful default or fraud.

9.23 The Holding Period Trustee shall have no obligation to monitor or supervise (and shall assume no responsibility for) the actions or functions of the Company, the Information Agent, the Registrars, CRESTCo, Clearstream, Luxembourg or Euroclear or any other party under the Scheme or this Agreement and shall, subject to Clause 9.4, be under no obligation to seek or solicit any communication or certificate and in the absence of knowledge to the contrary shall be entitled to assume that each party to the Scheme and this Agreement is properly performing and complying with its obligations. For the avoidance of doubt, the Holding Period Trustee shall have no liability to any person for any loss, liability, damages or expense (together, **loss**) which that person may suffer or incur where such loss arises in connection with or as a result of any failure or delay on the part of the Registrars, CRESTCo, Euroclear or Clearstream, Luxembourg in complying with instructions provided to it in connection with any transfer of Scheme Consideration.

9.24 Section 1 of the Trustee Act 2000 shall not apply to the duties of the Holding Period Trustee in relation to the trusts constituted by this Agreement. Where there are any inconsistencies between the Trustee Act 1925 and the Trustee Act 2000 of England and Wales and the provisions of this Agreement, the provisions of this Agreement shall, to the extent allowed by law, prevail and, in the case of any such inconsistency with the Trustee Act 2000, the provisions of this Agreement shall constitute a restriction or exclusion for the purposes of that Act.

9.25 The Holding Period Trustee shall:

(a) provide copies of all instructions given by the Holding Period Trustee to banks, the Registrars or any Clearing System and of all Instruction Certificates received, in each case, by the Holding Period Trustee to the Company at all reasonable times upon request;

(b) within five Business Days of a request in writing from the Company (and at the Company's cost and expense in relation to the costs or expenses of third parties in obtaining such information) provide the Company with:

(i) a statement identifying the instructions given by the Holding Period Trustee to any Clearing System and the undistributed balances contained in each of the Escrow Accounts; and

(ii) a summary of the transactions in each Escrow Account, including details of the Accruals earned and charges (in each case, if any) on the Escrow Accounts.

10. RIGHTS, POWERS AND DUTIES OF THE SELLING AGENT

10.1 The Selling Agent is appointed by the Holding Period Trustee under Clause 4.3 above as the Holding Period Trustee's agent to procure the sale of the Bank T2 Notes and New Ordinary Shares on the terms and subject to the conditions of this Agreement.

10.2 The Holding Period Trustee confers on the Selling Agent all powers, authorities and discretions on behalf of the Holding Period Trustee which are necessary for, or reasonably incidental to the sale of the Bank T2 Notes and the New Ordinary Shares as contemplated by this Agreement and the Holding Period Trustee agrees to ratify and confirm everything which the Selling Agent shall lawfully and properly do in the exercise of such appointment, powers, authorities and discretions.

10.3 The Company confirms to the Selling Agent that it has appointed the Registrars to act in connection with administering the registers for the Bank T2 Notes and the New Ordinary Shares. The Holding Period Trustee authorises the Selling Agent to give to the Registrars any instructions consistent with this Agreement which the Selling Agent considers necessary for, or incidental to, the sale of the Bank T2 Notes and the New Ordinary Shares.

10.4 In accordance with instructions from the Holding Period Trustee, the Selling Agent agrees, as agent for the Holding Period Trustee, to use its reasonable endeavours to sell the Bank T2 Notes and New Ordinary Shares which are the subject of a Sale Instruction Certificate, subject to and in accordance with Clause 8.9 above.

10.5 In connection with any sale of the Bank T2 Notes and New Ordinary Shares to be made by the Selling Agent, the Holding Period Trustee shall procure the crediting of the Bank T2 Notes and/or the New Ordinary Shares to the Clearing System account of the Selling Agent not later than 7:30am on the date prior to the intended settlement date for the relevant sale (as notified by the Selling Agent to the Holding Period Trustee). The Selling Agent undertakes to direct any purchaser of Bank T2 Notes and/or New Ordinary Shares under and in accordance with this Agreement to pay the purchase price for such Bank T2 Notes and/or New Ordinary Shares directly to the Cash Escrow Account.

11. INVESTMENTS

11.1 The Holding Period Trustee hereby agrees to credit all Accruals to the relevant Escrow Account until payment or transfer to, or to the order of, the relevant Noteholder Beneficiary (or, if applicable, its Designated Recipient) in accordance with the provisions of this Agreement.

11.2 The Holding Period Trustee shall not be under any obligation to invest Accruals and shall have the express power to retain the Accruals in their existing condition in the appropriate Escrow Account.

12. CLOSURE OF ESCROW ACCOUNTS AND RESIGNATION OF HOLDING PERIOD TRUSTEE

12.1 Promptly after any Escrow Account ceases to have any cash or securities credited to it by virtue of distribution to all Noteholder Beneficiaries or following the end of the Holding Period, the Holding Period Trustee shall, subject to obtaining the prior consent (such consent not to be unreasonably withheld or delayed) of the Company arrange for that Escrow Account to be closed.

12.2 Once all of the Escrow Accounts have been closed and the Holding Period Trustee's obligations fulfilled, the trusts set out in this Agreement shall be wound up.

12.3 Upon closure of all of the Escrow Accounts in accordance with the terms of this Agreement, each of the Holding Period Trustee, the Selling Agent and the Information Agent shall have no further duties, responsibilities or obligations hereunder save for such obligations as may have arisen prior to such closure, which obligations have not as at the time of such closure been fulfilled or discharged.

12.4 The Holding Period Trustee may resign its appointment at any time by giving no less than 90 days' prior written notice to the Company and without any liability for any costs arising from such resignation (other than its own).

12.5 If the Holding Period Trustee provides notice of resignation in accordance with Clause 12.4, a successor Holding Period Trustee shall be appointed by the Company.

12.6 On 30 days' prior written notice to the Holding Period Trustee (or immediate notice, in the case of a breach of this Agreement by the Holding Period Trustee) the Company may terminate the appointment of the Holding Period Trustee and appoint a financial institution of good standing as a successor Holding Period Trustee.

12.7 The resignation or removal of a retiring Holding Period Trustee and the appointment of a successor holding period trustee will only become effective upon the successor holding period trustee accepting its appointment as Holding Period Trustee in writing at which time:

(a) the successor holding period trustee will become bound by all the obligations of the Holding Period Trustee and become entitled to all the rights, privileges, powers, authorities and discretions of the Holding Period Trustee hereunder;

(b) the appointment of the retiring Holding Period Trustee will terminate but without prejudice to any rights of the Holding Period Trustee hereunder or any liabilities which the Company or the Holding Period Trustee may have incurred prior to the termination of its appointment; and

(c) subject to paragraph (b) above, the retiring Holding Period Trustee will be discharged from any further liability or obligation under this Agreement.

12.8 The resignation (or removal) of a retiring Holding Period Trustee will not take effect until all necessary deeds and documents have been entered into and all necessary steps and actions have been taken in order to substitute the successor Holding Period Trustee as legal owner of the New Ordinary Shares and Bank T2 Notes held by the retiring Holding Period Trustee under the terms of this Agreement and all other cash held by the Holding Period Trustee for the benefit of the Noteholder Beneficiaries under the terms, conditions and provisions of this Agreement including but not limited to amounts standing to the credit of the Escrow Accounts.

13. FEES AND EXPENSES

13.1 The Holding Period Trustee, the Selling Agent and the Information Agent shall each be paid fees and expenses for its services under this Agreement in accordance with the Engagement Letters.

13.2 If the Company asks the Holding Period Trustee to carry out any task other than one which it is obliged to carry out under this Agreement or the Engagement Letter or as trustee of the trusts expressly constituted by this Agreement and which will not in the sole opinion of the Holding Period Trustee cause the role of the Holding Period Trustee hereunder to be anything other than a bare trustee, the Holding Period Trustee will discuss and agree with the Company reasonable remuneration for such work prior to any obligation to carry out such task being incurred.

13.3 The fees and expenses referred to in Clauses 13.1 and 13.2 shall be paid by the Company without recourse to any of the Escrow Accounts or exercise of any right of set off against other monies however payable.

13.4 For the avoidance of doubt, none of the Scheme Creditors shall have any liability or any obligations whatsoever to the Holding Period Trustee, the Selling Agent, the Information Agent, or any other person in relation to fees, expenses, claims or otherwise arising from or under this Agreement.

13.5 Where any party is required by the terms of this Agreement to reimburse or indemnify any other party for or against any cost or expense, such first party shall reimburse or indemnify such other

party for or against the full amount of such cost or expense, including such part thereof as represents VAT, save to the extent that such other party is entitled to credit or repayment in respect of such VAT from HM Revenue and Customs.

14. FURTHER ASSURANCE

The parties shall at the cost of the Company do and execute, or procure to be done and executed, all necessary acts, deeds and documents, including but not limited to giving the necessary instructions/notifications to Euroclear, Clearstream, Luxembourg, the Registrars and CRESTCo (and any parties' solicitors, as required) to effect the release of the contents of any of the Escrow Accounts in connection with the transfer or sale of Scheme Consideration in accordance with the terms of this Agreement and the termination of any Escrow Account pursuant to Clause 10, and shall provide each other with all necessary mutual support for the purposes of doing so and giving effect to the terms of this Agreement.

15. OTHER AGREEMENTS

Nothing in this Agreement is intended to limit any rights or obligations of the Company or any Scheme Creditor under the Scheme or under any other agreement entered into in connection with the transactions contemplated by the Scheme.

16. NOTICES

16.1 Any notice, instructions or other communication to be served under this Agreement may be (i) delivered (ii) sent by post by prepaid first class post (if within the United Kingdom) or prepaid airmail (if elsewhere), or (iii) sent by facsimile transmission to the recipient at the address or facsimile number as follows:

If to the Company at:
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester M60 4EP
Attention of: The Company Secretary
Phone: 0843 751 4493
Attention of: Kathrine Bancroft

If to the Holding Period Trustee or the Information Agent, at:

Lucid Issuer Services Limited
Leroy House
436 Essex Road
London N1 3QP
Email: co-op@lucid-is.com
Phone: 020 7704 0880
Fax: 020 7067 9098
Attention of: Yves Theis

or at such other address, email address or facsimile number as one party may have notified to the other parties in writing in accordance with this clause.

16.2 A notice served by first class post shall be deemed duly served on the business day after posting. A notice sent by facsimile transmission shall be deemed to have been served at the time of transmission. A notice delivered by hand shall be deemed to have been served at the time of delivery. In proving service of the same it will be sufficient to prove, in the case of a notice posted

or delivered, that such notice was properly stamped or franked first class, addressed and posted or delivered by hand and, in the case of a facsimile transmission, that such facsimile was duly transmitted to the facsimile number referred to in Clause 16.1.

17. ASSIGNMENT

All rights and benefits of this Agreement are personal to the parties hereto and may not be assigned at law or in equity without the prior written consent of the other parties to this Agreement.

18. FORCE MAJEURE

None of the parties to this Agreement shall be in breach of its obligations (if any) under this Agreement as a result of any delay or non-performance of its obligations (if any) under this Agreement arising from any Force Majeure.

19. COUNTERPARTS

This Agreement may be executed in any number of counterparts, all of which taken together shall constitute one and the same instrument.

20. SEVERABILITY

If a provision of this Agreement is or becomes invalid, illegal or unenforceable, that shall not affect the validity, legality and enforceability of any other provision of this Agreement.

21. ENTIRE AGREEMENT

This Agreement, the Engagement Letter, the Scheme and the explanatory statement prepared in connection with the Scheme set out the entire agreement between the parties relating to the subject matter hereof and supersede all prior agreements, representations or understandings among or between any of the parties relating to subject matter hereof.

22. THIRD PARTY RIGHTS

22.1 Subject to Clause 9.15, a person who is not a party to this Agreement may not enforce any of its terms, conditions or provisions under the Contracts (Rights of Third Parties) Act 1999.

22.2 Notwithstanding Clause 9.15, the consent of any person who is not a party to this Agreement is not required to amend or modify this Agreement from time to time.

22.3 No person shall have a right to disturb a prior distribution under the Scheme or this Agreement.

23. AMENDMENTS

Any amendment, variation, waiver or modification in relation to this Agreement shall be in writing and shall require the agreement of all the parties hereto.

24. GOVERNING LAW AND JURISDICTION

This Agreement is governed by, and shall be construed in accordance with the laws of England. Each party irrevocably agrees that the Courts of England are to have non-exclusive jurisdiction to settle any dispute which may arise out of or in connection with this Agreement and accordingly any suit, action or proceedings arising out of or in connection with this Agreement (together referred to as **Proceedings**) may be brought in such Courts. Each party irrevocably waives any objection which

it may have now or hereafter to the laying of the venue of any Proceedings in the Courts of England and any claim that any Proceedings have been brought in an inconvenient forum.

IN WITNESS whereof this Agreement has been executed as a deed by the parties hereto and is intended to be and is hereby delivered on the date above first written.

SCHEDULE 1

FORM OF INSTRUCTION CERTIFICATES

PART 1

DISTRIBUTION INSTRUCTION CERTIFICATE

To: Lucid Issuer Services Limited in its capacity as the Holding Period Trustee under the Distribution Agreement (as defined below) (the **Holding Period Trustee**)

From: Lucid Issuer Services Limited in its capacity as Information Agent under the Distribution Agreement (as defined below) (the **Information Agent**)

Dated: [●]

Dear Sirs

Distribution Agreement dated [●] 2013 between, among others, The Co-operative Bank p.l.c. (the **Company), the Holding Period Trustee, the Information Agent and TFS Derivatives Limited and Tradition (UK) Limited in their capacity as selling agent (**the **Selling Agent) (**the **Distribution Agreement)**

1. We refer to the Distribution Agreement. This is a Distribution Instruction Certificate. Terms defined in the Distribution Agreement have the same meaning in this Distribution Instruction Certificate unless given a different meaning in this Distribution Instruction Certificate.

2. We hereby instruct you, in accordance with the terms of the Distribution Agreement, to release the following parts of the Trust Fund from the relevant Escrow Account and to transfer to the below stipulated account:

Trust Property	**Number/Amount**	**Account Details**
New Ordinary Shares (*units*)		☐ EUROCLEAR ☐ CLEARSTREAM Account Number: Account Name:
Bank T2 Notes (*principal amount*)	GBP	
Cash (after deduction for or on account of all applicable taxes and expenses, subject to clause 7 of the Distribution Agreement)	GBP	

3. This Distribution Instruction Certificate is governed by English law.

4. This Distribution Instruction Certificate may be enforced and relied upon only by you and us. No third party shall have any right under the Contracts (Rights of Third Parties) Act 1999 to enjoy or enforce any term of this Distribution Instruction Certificate.

Yours faithfully

……..

For and on behalf of

LUCID ISSUER SERVICES LIMITED

In its capacity of Information Agent

PART 2

SALE INSTRUCTION CERTIFICATE

To: Lucid Issuer Services Limited in its capacity as the Holding Period Trustee under the Distribution Agreement (as defined below) (the **Holding Period Trustee**)

From: Lucid Issuer Services Limited in its capacity as Information Agent under the Distribution Agreement (as defined below) (the **Information Agent**)

Dated: [●]

Dear Sirs

Distribution Agreement dated [●] 2013 between, among others, The Co-operative Bank p.l.c. (the **Company), the Holding Period Trustee, the Information Agent and TFS Derivatives Limited and Tradition (UK) Limited in their capacity as selling agent (**the **Selling Agent) (**the **Distribution Agreement)**

1. We refer to the Distribution Agreement. This is a Sale Instruction Certificate. Terms defined in the Distribution Agreement have the same meaning in this Sale Instruction Certificate unless given a different meaning in this Sale Instruction Certificate.

2. We hereby instruct you, in accordance with the Distribution Agreement, to instruct the Selling Agent to sell and to release for sale in accordance with the Distribution Agreement:

   (a) **Number of New Ordinary Shares:**

   (b) **Principal Amount of Bank T2 Notes:**

   and to procure that the net cash proceeds (after deduction for and on account of all applicable taxes and expenses including, without limitation, the Selling Agent's selling commission calculated in accordance with the Engagement Letter) from the sale of the foregoing parts of the Trust Fund is paid into the relevant Escrow Account.

3. We further hereby instruct you, following the receipt of the net cash proceeds in accordance with paragraph (2) above, to debit the Escrow Account and to credit the stipulated account(s):

   ☐ EUROCLEAR

   ☐ CLEARSTREAM

   Account Number:

   Account Name:

4. This Sale Instruction Certificate and any non-contractual obligations arising out of or in connection with it are governed by English law.

5. This Sale Instruction Certificate may be enforced and relied upon only by you and us. No third party shall have any right under the Contracts (Rights of Third Parties) Act 1999 to enjoy or enforce any term of this Sale Instruction Certificate.

Yours faithfully

……..

For and on behalf of

LUCID ISSUER SERVICES LIMITED

In its capacity of Information Agent

SIGNATORIES

EXECUTED as a **DEED** by)
THE CO-OPERATIVE BANK P.L.C.)
acting by)

Director _____

In the presence of: _____

Name: .....

Address:.....

.....

.....

EXECUTED as a **DEED** by)
LUCID ISSUER SERVICES LIMITED)
in its capacity as Information Agent)
Acting by:)

Director _____

In the presence of: _____

Name: .....

Address:.....

.....

.....

EXECUTED as a **DEED** by)
LUCID ISSUER SERVICES LIMITED)
in its capacity as Holding Period Trustee)
Acting by:)

Director _____

In the presence of: _____

Name: .....

Address:.....

.....

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.....

EXECUTED as a **DEED** by)
THE SCHEME CREDITORS)
)
Acting by)
THE CO-OPERATIVE BANK P.L.C.)
Pursuant to powers under the Scheme)
Acting by)

Director _____

In the presence of: _____

Name: .....

Address:.....

.....

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.....

EXECUTED as a **DEED** by)
TFS DERIVATIVES LIMITED)
in its capacity as Selling Agent)
Acting by:)

Director _____

In the presence of: _____

Name: .....

Address:.....

.....

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.....

.....

EXECUTED as a **DEED** by)
TRADITION (UK) LIMITED)
in its capacity as Selling Agent)
Acting by:)

Director .....

In the presence of: .....

Name: .....

Address:.....

.....

.....

.....

.....

APPENDIX 1

DEFINITIONS AND INTERPRETATION

1. DEFINITIONS AND INTERPRETATION

1.1 Definitions

In this Explanatory Statement:

13% Bondholders means the holders of the 13% Bonds.

13% Bondholders Meeting means the meeting of the 13% Bondholders convened in connection with the Liability Management Exercise (including any adjournment of such meeting).

13% Bonds means the 13% perpetual subordinated bonds with ISIN GB00B3VH4201 issued by the Company in replacement of Britannia Building Society permanent interest bearing shares upon the Company's acquisition of Britannia Building Society on 1 August 2009.

2014 Commitment has the meaning given to that term in paragraph 3 of Part A (*Background to and reasons for the Recapitalisation Plan*) of this Explanatory Statement.

2014 Commitment Agreement has the meaning given to that term in paragraph 2.11 of Part B (*Overview of the Scheme*) of this Explanatory Statement.

2016 Notes means the floating rate callable step-up dated subordinated notes due 2016 with ISIN XS0254625998 originally issued by Britannia Building Society and assumed by the Company upon the Company's acquisition of Britannia Building Society on 1 August 2009.

2016 Notes Noteholder means a person who is the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes representing the 2016 Notes as at the Record Date, whose interests in the 2016 Notes are held through records maintained in book entry form by a Clearing System.

2019 Notes means the 5.875% subordinated callable notes due 2019 with ISIN XS0189539942 issued by the Company.

2019 Notes Noteholder means a person who is the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes representing the 2019 Notes as at the Record Date, whose interests in the 2019 Notes are held through records maintained in book entry form by a Clearing System.

2022 Notes means the 7.875% subordinated notes due 2022 with ISIN XS0864253868 issued by the Company.

2022 Notes Noteholder means a person who is the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes representing the 2022 Notes as at the Record Date, whose interests in the 2022 Notes are held through records maintained in book entry form by a Clearing System.

2024 Notes means the 5.75% dated callable step-up subordinated notes due 2024 with ISIN XS0188218183 originally issued by Britannia Building Society and assumed by the Company upon the Company's acquisition of Britannia Building Society on 1 August 2009.

2024 Notes Noteholder means a person who is the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes representing the 2024 Notes as at the Record Date, whose interests in the 2024 Notes are held through records maintained in book entry form by a Clearing System.

2033 Notes means the 5.875% subordinated notes due 2033 with ISIN XS0145065602 originally issued by Britannia Building Society and assumed by the Company upon its acquisition of Britannia Building Society on 1 August 2009.

2033 Notes Noteholder means a person who is the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes representing the 2033 Notes as at the Record Date, whose interests in the 2033 Notes are held through records maintained in book entry form by a Clearing System.

5.5555% Bondholders means the holders of the 5.5555% Bonds.

5.5555% Bondholders Meeting means the meeting of the 5.5555% Bondholders convened in connection with the Liability Management Exercise (including any adjournment of such meeting).

5.5555% Bonds means the 5.5555% perpetual subordinated bonds with ISIN GB00B3VMBW45 issued by the Company in replacement of Britannia Building Society permanent interest bearing shares upon the Company's acquisition of Britannia Building Society on 1 August 2009.

Account Holder means any person recorded directly in the records of a Clearing System as holding an interest in any Dated Notes in an account with the relevant Clearing System either for its own account or on behalf of its client.

Account Holder Letter means the account holder letter substantially in the form set out in Appendix 3 (*Form of Account Holder Letter*) of this Explanatory Statement or such other account holder letter (or similar document or series of documents) as the Company considers appropriate to assist with and/or facilitate the participation by Noteholders who hold their interests in the Dated Notes through Crest, in the Scheme.

Actual Treatment has the meaning given to that term in paragraph 4 of Appendix 7 (*Resolution Analysis*) of this Explanatory Statement.

Additional New Ordinary Shares means 33,333,334 ordinary shares to be issued by the Company for an aggregate consideration equal to £125,000,002.50 pursuant to the terms of the Additional New Ordinary Shares Offer.

Additional New Ordinary Shares Offer means the offer by the Company to the Noteholders to elect to subscribe for the Additional New Ordinary Shares on the terms described in paragraphs 2.22 to 2.30 of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Adviser Released Party means has the meaning given to that term in the Deed of Waiver and Release.

Additional Preference Shares has the meaning given to that term in paragraph 3.7 of Part C (*Overview of the Liability Management Exercise*) of this Explanatory Statement.

Allocated Noteholder has the meaning given to that term in paragraph 2.30(a) of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Allocation Ratio has the meaning given to that term in paragraph 2.30(b) of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Alternative Recipient has the meaning given to that term in paragraph 2.18 of Part B (*Overview of the Scheme*) of this Explanatory Statement.

April 2021 Notes means the 9.25% subordinated notes due April 2021 with ISIN XS0620315902 issued by the Company.

April 2021 Notes Noteholder means a person who is the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes representing the April 2021 Notes as at the Record Date, whose interests in the April 2021 Notes are held through records maintained in book entry form by a Clearing System.

Banking Act has the meaning given to that term in the Letter from the Chairman of the Company in preliminary section 2 of this Explanatory Statement.

Bank T2 Notes means a principal amount equal to £100,000,000 of the 11 per cent. subordinated notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Company, the terms of which are described in detail in the Bank T2 Notes Prospectus.

Bank T2 Notes and New Ordinary Shares Registrar Agreement means the agreement between the Company and Computershare Investor Services PLC dated on or about the Scheme Settlement Date in relation to the provision of paying agency and registrar services.

Bank T2 Notes Paying Agent means Computershare Investor Services PLC in its capacity as paying agent for the Bank T2 Notes.

Bank T2 Notes Prospectus means the debt prospectus relating to the Bank T2 Notes dated 4 November 2013, together with the Supplementary Prospectus, both of which are appended to this Explanatory Statement in Appendix 9.

Bank T2 Notes Registrar means Computershare Investor Services PLC in its capacity as registrar for the Bank T2 Notes.

Bank T2 Notes Trust Deed means the trust deed between the Company and the Bank T2 Notes Trustee relating to the Bank T2 Notes.

Bank T2 Notes Trustee means Law Debenture Trustees Limited in its capacity as trustee for the Bank T2 Notes.

Business Day means a day (other than a Saturday or Sunday) on which banks are open for general business in London and which is a Target Day.

CBGL means Co-operative Banking Group Limited.

Chairman means the chairman appointed for the purposes of the Scheme Meeting.

City Code has the meaning given to that term on page 11 (*Important Securities Law Notice*) of this Explanatory Statement.

Clearing Systems means Clearstream, Luxembourg and Euroclear.

Clearstream, Luxembourg means Clearstream Banking, *société anonyme*.

Code means the UK Corporate Governance Code.

Common Equity Tier 1 has the meaning ascribed thereto (or to any equivalent term) at such time in CRD IV.

Common Equity Tier 1 Capital means capital meeting the definition of Common Equity Tier 1.

Common Depositaries means Bank of New York Mellon, London Branch and Citibank Europe PLC as common depositaries for Clearstream, Luxembourg and Euroclear with whom the Global Notes have been deposited.

Companies Act means the Companies Act 2006.

Company means Co-operative Bank P.L.C., a company incorporated in England with registered number 00990937.

Company Custody Account means one or more custody accounts in the Clearing Systems held on behalf of the Company.

Co-operative Group means Co-operative Group Limited, an industrial and provident society incorporated in England with registered number IP525R.

Co-operative Life Insurance and Asset Management has the meaning given to that term in paragraph 3 of Part A (*Background to and Reasons for the Recapitalisation Plan*) of this Explanatory Statement.

Co-operative Life Insurance and Asset Management Deferred Amount means the deferred consideration payable (subject to the approval of the court under a transfer of the life insurance fund of Co-operative Life Insurance Society Ltd (now named RC (CIS) Ltd) into Royal London under Part VII of FSMA) pursuant to the sale of Co-operative Life Insurance and Asset Management to The Royal London Mutual Insurance Society Limited, which completed on 31 July 2013.

Court means the High Court of Justice of England and Wales.

CRD IV means the EU's implementation of Basel III via the PRD and the PRR.

Crest means the relevant system (as defined in the CREST Regulations) in respect of which EUI is the operator (as defined in the CREST Regulations).

CREST Regulations means the Companies Act 1990 (Uncertificated Securities) Regulations 1996 (S.I. No 68/1996) and the UK Uncertificated Securities Regulations 2001 (SI No. 2001/3755), including any modifications thereof or any regulations in substitution therefor and for the time being in force.

Custody Instructions means instructions given by any relevant Account Holder to the Clearing System in which any relevant Dated Notes are held instructing that Clearing System to block those Dated Notes in accordance with the instructions contained in this Explanatory Statement.

Custody Instruction Deadline has the meaning given to that term in the Expected Timetable of Principal Events at page 16 of this Explanatory Statement.

Custody Instruction Reference Number means a reference number provided by a Clearing System to an Account Holder which has delivered Custody Instructions to that Clearing System, confirming

that the blocking instructions contained in those Custody Instructions have been complied with by that Clearing System.

Dated Notes means the 2016 Notes, the 2019 Notes, the April 2021 Notes, the November 2021 Notes, the 2022 Notes, the 2024 Notes and the 2033 Notes.

Dealer Managers has the meaning given to that term on page 6 (*Important Notice*) of this Explanatory Statement.

Deed of Waiver and Release means the deed of waiver and release substantially in the form set out in schedule 1 to the Scheme.

Designated Recipient means any person appointed under a valid Account Holder Letter delivered to and received by the Information Agent on behalf of a Noteholder to receive the Scheme Consideration to which that Noteholder is entitled pursuant to the terms of the Scheme, provided that such person is an Eligible Person.

Directors means the executive and non-executive directors of the Company and **Director** means any one of them.

Disclosure and Transparency Rules means the disclosure and transparency rules made by the FCA under Part VI of the FSMA.

Distribution Agreement means the distribution agreement substantially in the form set out in schedule 3 to the Scheme.

Distribution Instruction Certificate has the meaning given to that term in the Distribution Agreement.

Early Consideration Amount has the meaning given to that term in the Offer Memorandum.

Early Participation Deadline has the meaning given to that term in paragraph 1.4(a) of Part C (*Overview of the Liability Management Exercise*) of this Explanatory Statement.

Early Participation Threshold has the meaning given to that term in the Offer Memorandum.

Early Subscribing Noteholders has the meaning give to that term in paragraph 2.30 of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Eligible 5.5555% Bondholder means a 5.5555% Bondholder that is eligible to participate in the Liability Management Exercise, or the relevant component part thereof, in accordance with the Offer Restrictions.

Eligible 13% Bondholder means a 13% Bondholder that is eligible to participate in the Liability Management Exercise, or the relevant component part thereof, in accordance with the Offer Restrictions.

Eligible Noteholder means a Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent before the end of the Holding Period which includes a confirmation that such Noteholder (or, if such Noteholder has appointed a Designated Recipient, its Designated Recipient) is an Eligible Person.

Eligible Person means a person in relation to whom the offer to, issue to or subscription by such person in respect of any New Ordinary Shares, Bank T2 Notes (and, if applicable, Additional New Ordinary Shares):

(a) would not be unlawful or prohibited under the laws of any applicable jurisdiction; and

(b) would not, or would not be likely to, result in the Company being required to comply with any filing, registration, disclosure or other onerous requirement in any jurisdiction where that person is a citizen or subject to the laws of or in which that person is domiciled or resident.

Eligible Preference Shareholder means a Preference Shareholder that is eligible to participate in the Liability Management Exercise, or the relevant component part thereof, in accordance with the Offer Restrictions.

Euroclear means Euroclear Bank S.A./N.V. as operator of the Euroclear clearing system.

Exchange Act has the meaning given to that term on page 10 (*Important Securities Law Notice*) of this Explanatory Statement.

Exchange Offer Bank T2 Notes means a principal amount of up to £106 million of the 11 per cent. subordinated notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Company, the terms of which are described in detail in the Bank T2 Notes Prospectus.

Exchange Offers has the meaning given to that term in paragraph 1.2(b) of Part C (*Overview of the Liability Management Exercise*).

Exchange Instruction has the meaning given to that term in the Offer Memorandum.

Existing Ordinary Shares means the ordinary shares of the Company with a nominal value of £0.05 per share as at date of this Explanatory Statement.

Existing Securities has the meaning given in paragraph 1.1(a) of Part C (*Overview of the Liability Management Exercise*) of this Explanatory Statement.

Explanatory Statement has the meaning given to that term on page 1 of this Explanatory Statement.

FCA means the UK Financial Conduct Authority.

FCSC means the Financial Services Compensation Scheme, being the UK compensation fund of last resort for customers of financial services firms authorised under the Financial Services and Markets Act 2000, such fund being established under the Financial Services and Markets Act 2000.

Final Repayment Notes has the meaning given to that term in paragraph 1.2(a)(i)(A) of Part C (*Overview of the Liability Management Exercise)* of this Explanatory Statement.

Financial Promotion Order has the meaning given to that term on page 7 (*Important Notice*) of this Explanatory Statement.

First Round Exception has the meaning given to that term in paragraph 2.30 of Part B (*Overview of the Scheme*) of this Explanatory Statement.

FPC has the meaning given to that term in paragraph 2 of Part A (*Background to and reasons for the Recapitalisation Plan*).

FSMA has the meaning given to that term on page 1 of this Explanatory Statement.

Global Notes has the meaning given to that term in recital (C) of the Scheme.

Group means Co-operative Group and its subsidiaries (other than the Company).

Group Notes has the meaning given to that term in paragraph 1.2(a)(i)(B) of Part C (*Overview of the Liability Management Exercise*) of this Explanatory Statement.

Group Notes Prospectus means the prospectus dated 4 November 2013 and issued by Co-operative Group in connection with the issue, offer and listing and admission to trading of the Group Notes, including any supplement(s) thereto (if any) which may be issued after that date.

Holders means the Preference Shareholders, the 13% Bondholders and the 5.5555% Bondholders.

Holding Period means the period of 36 months following the Scheme Settlement Date.

Holding Period Trustee means Lucid Issuer Services Limited.

Ineligible Noteholder means a Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent before the end of the Holding Period which includes a confirmation that such Noteholder is not an Eligible Person and has not appointed a Designated Recipient.

Information Agent means Lucid Issuer Services Limited.

Insolvency Act 1986 means the Insolvency Act 1986 (c.45).

Insolvency Treatment has the meaning given to that term in paragraph 4 of Appendix 7 (*Resolution Analysis*) of this Explanatory Statement.

Instalment Repayment Notes has the meaning given to that term in paragraph 1.2(a)(i)(B) of Part C (*Overview of the Liability Management Exercise*) of this Explanatory Statement.

Instruction Certificate has the meaning given to that term in the Distribution Agreement.

Insurance Proceeds has the meaning given to that term in paragraph 3 of Part A (*Background to and Reasons for the Recapitalisation Plan*) of this Explanatory Statement.

Interim Financial Information means the historical financial information for the Bank for the six months ended 30 June 2013, as set out in the Bank T2 Prospectus.

Intermediary means any person holding an interest at the Record Date in any Dated Notes on behalf of another person or other persons who does not hold that interest as an Account Holder.

Intra-group Loan has the meaning given to that term in paragraph 3 of Part A (*Background to and Reasons for the Recapitalisation Plan*) of this Explanatory Statement.

June Announcement means the announcement by the Company and Co-operative Group on 17 June 2013 that, following the conclusion of the Company's review of its capital position and discussion with the PRA, the company required additional aggregate Common Equity Tier 1 Capital of £1.5 billion.

Late Consideration Amount has the meaning given to that term in the Offer Memorandum.

Liability or **Liabilities** means any debt, liability or obligation of a person whether it is present, future, prospective or contingent, whether or not it is fixed or undetermined, whether or not it involves the payment of money or performance of an act or obligation and whether it arises at common law, in equity or by statute, in England and Wales or any other jurisdiction, or in any manner whatsoever.

Liability Management Exercise means the Exchange Offers, the Proposals and the Scheme.

Listing Rules means the listing rules of the FCA relating to admission to the Official List made in accordance with section 73A(2) of the FSMA.

Locked-up Notes has the meaning given to that term in paragraph 1.22(a) of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Locked-up Notes Notice has the meaning given to that term in paragraph 1.22(e) of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Lock-up Agreement means an agreement between the Company and a Noteholder, pursuant to which that Noteholder agrees, among other things and subject to certain conditions, to vote its Scheme Claim in favour of the Scheme.

Lock-up Arrangement means a Lock-up Agreement or a Lock-up Undertaking.

Lock-up Undertaking means an undertaking by an Account Holder given on behalf of a Noteholder in favour of the Company pursuant to a valid Account Holder Letter delivered to and received by the Information Agent on behalf of that Noteholder, pursuant to which that Noteholder agrees, among other things and subject to certain conditions, to vote its Scheme Claim in favour of the Scheme.

London Stock Exchange has the meaning given to that term on page 1 of this Explanatory Statement.

Longstop Date means 31 December 2013.

Lowest Bidder has the meaning given to that term in paragraph 2.30(b) of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Lowest Subscription Amount has the meaning given to that term in paragraph 2.30 (b) of Part B (*Overview of the Scheme*) of this Explanatory Statement.

LT2 Group has the meaning given to that term in the Letter from the Chairman of the Company in preliminary section 2 of this Explanatory Statement.

Minimum Election has the meaning given to that term in paragraph 2.22 of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Model Code means the code published as an annex to the Listing Rules in the FCA handbook which imposes restrictions (beyond those required by law) on the dealing of listed securities by certain of a company's directors, officers and employees.

Modified Scheme Purchase Agreement means the agreement between the Company and the Modified Scheme Purchasers dated on or about 1 December 2013 pursuant to which the Modified Scheme Purchasers have agreed to purchase Additional New Ordinary Shares on the terms set out therein.

Modified Scheme Purchaser Premium means the premium described in paragraph 2.32 of part B (*Overview of the Scheme*) of the Explanatory Statement.

Modified Scheme Purchasers means the persons listed in column 1 of schedule 3 to the Modified Scheme Purchase Agreement, in their capacities as modified scheme purchasers pursuant to the terms of the Modified Scheme Purchase Agreement.

New Administrative Parties means the Bank T2 Notes Trustee, the Bank T2 Notes Registrar, the Bank T2 Notes Paying Agent and the New Ordinary Shares Registrar.

New Ordinary Shares means 141,666,666 ordinary shares to be issued by the Company pursuant to the terms of the Scheme.

New Ordinary Shares Conversion Price means £6.17566631.

New Ordinary Shares Registrar means Computershare Investor Services PLC as registrar for the New Ordinary Shares and the Additional New Ordinary Shares.

New Securities means the New Ordinary Shares, the Bank T2 Notes, the Instalment Repayment Notes, the Final Repayment Notes and the Exchange Offer Bank T2 Notes.

New Transaction Documents means the Bank T2 Notes Trust Deed and the Bank T2 Notes and New Ordinary Shares Registrar Agreement.

Nominated Directors has the meaning given to that term in paragraph 6.2 of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Noteholders means the 2016 Notes Noteholders, the 2019 Notes Noteholders, the April 2021 Notes Noteholders, the November 2021 Notes Noteholders, the 2022 Notes Noteholders, the 2024 Notes Noteholders and the 2033 Notes Noteholders.

Note Event of Default means an event of default under and as defined in the terms and conditions of any series of Dated Notes.

November 2021 Notes means the fixed/floating rate subordinated notes due November 2021 with ISIN XS0274155984 issued by the Company.

November 2021 Notes Noteholder means a person who is the beneficial owner of and/or the owner of the ultimate economic interest in any of the Dated Notes representing the November 2021 Notes as at the Record Date, whose interests in the November 2021 Notes are held through records maintained in book entry form by a Clearing System.

Offer Memorandum means the consent and exchange offer memorandum appended to the Bank T2 Notes Prospectus (including any amendments thereto under the Supplementary Prospectus).

Offer Restrictions means the offer restrictions set out in section F of the Offer Memorandum (in respect of the Exchange Offers).

Official List means the Official List maintained by the FCA.

Old Account Holder Letter means a valid account holder letter for the purposes of the version of this Explanatory Statement which was uploaded to the Scheme Website on or around 18 November 2013 prior to the amendments on 4 December 2013, which includes a valid election to participate in

the Additional New Ordinary Shares Offer and/or the Sub-purchasing Offer (as each such term was defined in that version of this Explanatory Statement).

PACE means The Co-operative Pension Scheme.

Perpetual Subordinated Bonds has the meaning given to that term in paragraph 1.1(a) of Part C (*Overview of the Liability Management Exercise*) of this Explanatory Statement.

Potential Note Event of Default means any event which may become (with the passage of time, the giving of notice, the making of any determination of any combination thereof) a Note Event of Default.

PRA means the Prudential Regulation Authority.

PRD means Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC

Preference Shareholders means the holders of the Preference Shares.

Preference Shareholders Meeting means the meeting of the Preference Shareholders convened in connection with the Liability Management Exercise (including any adjournment of such meeting).

Preference Shares means the 9.25% non-cumulative irredeemable preference shares issued by the Company with ISIN GB002224516.

Preference Shares Exchange Offer means the offer to exchange the Preference Shares in accordance with the terms of the Liability Management Exercise.

Proposal or **Proposals** has the meaning given to that term in the Offer Memorandum.

Proposed Bail in Power has the meaning given to that term in paragraph 8 of Appendix 7 (*Resolution Analysis*).

Proposed Restructuring means the restructuring of the company described and provided for in the Proposed Restructuring Documents.

Proposed Restructuring Documents means the practice statement letter from the Company to the Scheme Creditors relating to the Scheme dated 4 November 2013, the articles of association of the Company proposed to be adopted at a general meeting of the Company as contemplated in section 20 of the Bank T2 Notes Prospectus, the, the Relationship Agreement, the 2014 Commitment Agreement, the RNS issued by the Company in connection with the Liability Management Exercise on 4 November 2013 and the forms of the intra-group loan agreement between the Company, Co-operative Group and CBGL, the security agreement relating thereto, the co-existence principles between the Company and Co-operative Group, the statement of separation principles between Company and Co-operative Group and the pension liability undertaking, in each case published on the Scheme Website on or around 4 November 2013, and the Offer Memorandum, this Explanatory Statement (including the Scheme), the Group Notes Prospectus, the Bank T2 Notes Prospectus and the Modified Scheme Purchase Agreement.

Prospectus Directive has the meaning given to that term on page 1 of this Explanatory Statement.

Prospectus Rules means the prospectus rules of the FCA made under Part VI of the FSMA relating to offers of securities to the public and admission of securities to trading on a regulated market.

PRR means Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 Text with EEA relevance.

Recapitalisation Plan means the Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Company's Existing Securities.

Record Date means 4.30 p.m. (London time) on 13 December 2013.

Registrar of Companies means the Registrar of Companies of England and Wales.

Registrars means Computershare Investor Services PLC (in respect of the Preference Shares) and Equiniti Limited (in respect of each series of Perpetual Subordinated Bonds).

Relationship Agreement has the meaning given to that term in the Bank T2 Notes Prospectus.

Released Parties has the meaning given to that term in the Deed of Waiver and Release.

Resolution Authorities has the meaning given to that term in paragraph 1 of Appendix 7 (*Resolution Analysis*) of this Explanatory Statement.

Restructuring Consideration has the meaning given to that term in paragraph 2 of Appendix 7 (*Resolution Analysis*) of this Explanatory Statement.

Restructuring Documents has the meaning given to that term in the Deed of Waiver and Release.

Royal London has the meaning given to that term in paragraph 3 of Part A (*Background to and Reasons for the Recapitalisation Plan*) of this Explanatory Statement.

Sale Instruction Certificate has the meaning given to that term in the Distribution Agreement.

Scheme means the scheme of arrangement in respect of the Company under Part 26 of the Companies Act in the form set out in Part F (*Scheme*) of this Explanatory Statement (with or subject to any modification, addition or condition approved or imposed by the Court or approved in accordance with the terms of the Scheme).

Scheme Claim means any claim in respect of any Liability of the Company to any person arising out of an interest in the Dated Notes, arising on or before the Record Date or which may arise after the Record Date as a result of an obligation or Liability of the Company incurred or as a result of an event occurring or an act done on or before the Record Date (including, for the avoidance of doubt, any interest accruing on, or accretions arising in respect of, such claims before or after the Record Date), excluding any Liability of the Company to the Trustees under the Trust Deeds other than in respect of the covenants to repay principal and interest on the Dated Notes pursuant to the Trust Deeds.

Scheme Consideration means the New Ordinary Shares and the Bank T2 Notes.

Scheme Consideration Calculation Amount means, with respect to a Noteholder, the aggregate of (i) the aggregate principal amount outstanding of the Dated Notes (other than 2016 Notes) and accrued but unpaid interest thereon up to (and including) the Record Date held by that Noteholder (if any) and (ii) the Sterling-Equivalent principal amount outstanding of the 2016 Notes and accrued but

unpaid interest thereon up to (and including) the Record Date held by that Noteholder (if any), in each case as at the Record Date.

Scheme Creditor means the Common Depositaries, the Trustees (solely in their capacities as the beneficiaries of the covenants to repay principal and interest on the Dated Notes pursuant to the Trust Deeds) and the Noteholders.

Scheme Effective Date means the date on which an office copy of the order of the Court sanctioning the Scheme under Section 899 of the Companies Act is delivered to the Registrar of Companies.

Scheme FX Rate means the rate of exchange between Euro and Sterling appearing on or derived from the Bloomberg service designated as the "*FXC*" page for the purpose of displaying that rate of exchange, as determined by the Company on 30 October 2013, being £0.85644 to €1.

Scheme Meeting means the meeting of the Scheme Creditors to vote on the Scheme convened pursuant to an order of the Court (and any adjournment of such meeting).

Scheme Meeting Convening Notice has the meaning given to that term in Appendix 5 (*Notice of Director Nomination Resolution*) of this Explanatory Statement.

Scheme Sanction Hearing means the hearing of the Court for the purpose of sanctioning the Scheme pursuant to the order of the Court under Section 899 of the Companies Act.

Scheme Settlement Condition means the condition described in clause 5 of the Scheme.

Scheme Settlement Condition Testing Date means the latest to occur of:

(a) the Scheme Effective Date; and

(b) the date on which the resolutions proposed at each of the Preference Shareholders Meeting, the 5.5555% Bondholders Meeting and the 13% Bondholders Meeting and the general meeting of the Company referred to in paragraph 1.35(b) of Part B (*Overview of the Scheme*) have been voted and each such meeting has been concluded.

Scheme Settlement Date means the date on which the Scheme Consideration and the Additional New Ordinary Shares are issued as described in the Scheme.

Scheme Website means *http://www.co-operative.coop/Bondholders*.

SDRT has the meaning given to that term in paragraph 3.3 of Part F (*Taxation*) of this Explanatory Statement.

SEC has the meaning given to that term on page 10 (*Important Securities Law Notice)* of this Explanatory Statement.

Second Round Allocations has the meaning given to that term in paragraph 2.30(b) of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Section 19 Power has the meaning given to that term in paragraph 8 of Appendix 7 (*Resolution Analysis*) of this Explanatory Statement.

Securities Act has the meaning given to that term on page 10 of this Explanatory Statement.

Selling Agent means TFS Derivatives Limited and Tradition (UK) Limited.

Senior Bonds has the meaning given to that term in paragraph 8 of Appendix 7 (*Resolution Analysis*) of this Explanatory Statement.

Senior Manager has the meaning given to that term in the Bank T2 Notes Prospectus.

Settlement Condition has the meaning given to that term in paragraph 1.3(b) in Part C (*Overview of the Liability Management Exercise*) of this Explanatory Statement.

Settlement Date has the meaning given to that term in the Offer Memorandum

Sterling-Equivalent means, with respect to any principal amount outstanding and/or amount of accrued but unpaid interest in respect of the 2016 Notes, the amount of such principal amount outstanding and/or amount of accrued but unpaid interest in Euro notionally converted into Sterling at the Scheme FX Rate.

Statement of Separation Principles means the execution version of the statement of separation principles between the Company and Co-operative Group.

Subscriber means a Subscribing Noteholder, a Sub-purchaser or a Modified Scheme Purchaser, as applicable.

Subscribing Noteholder means a Noteholder which elects to participate in the Additional New Ordinary Shares Offer.

Subscription Amount has the meaning given to that term in paragraph 2.29(b) of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Subscription Escrow Bank means BNP Paribas, London branch.

Subscription Escrow Account means the escrow account to be opened with the Subscription Escrow Bank to hold subscription monies for the Additional New Ordinary Shares Offer.

Subscription Price has the meaning given to that term in paragraph 2.27(b) of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Sub-purchase Amount has the meaning given to that term in paragraph 2.42(b)(iii) of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Sub-purchaser means the Noteholders which elect to participate in the Sub-purchasing Offer.

Sub-purchasing Commitment has the meaning given to that term in paragraph 2.38 of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Sub-purchasing Offer has the meaning given to that term in paragraph 2.33 of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Sub-purchaser Premium has the meaning given to that term in paragraph 2.44 of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Sub-purchasing Shares has the meaning given to that term in paragraph 2.41 of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Supplementary Prospectus means the supplementary prospectus relating to the Bank T2 Notes dated 4 December 2013 which is appended to this Explanatory Statement in Appendix 9.

Takeover Panel has the meaning given to that term in page 11 (*Important Securities law* Notice) of this Explanatory Statement.

Target Day means a day on which the Trans European Automated Real-Time Gross Settlement Express Transfer payment system is open for settlement of payments in euro.

Total First Round Allocation has the meaning given to that term in paragraph 2.30(a) of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Total Second Round Allocation has the meaning given to that term in paragraph 2.30(b) of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Total Subscription Amount has the meaning given to that term in paragraph 2.29(c) of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Total Third Round Allocation has the meaning given to that term in paragraph 2.30(c) of Part B (Overview of the Scheme) of this Explanatory Statement.

Treasury Briefing has the meaning given to that term in paragraph 8 of Appendix 7 (*Resolution Analysis*) of this Explanatory Statement.

Trustees means The Law Debenture Trust Corporation p.l.c. in its capacity as trustee for each series of the Dated Notes.

Trust Deeds mean the trust deeds relating to the Dated Notes.

UK has the meaning given to that term in paragraph 4.1 of Part D (*Risk Factors*) of this Explanatory Statement.

Unadmitted Noteholder means a Noteholder on whose behalf a valid Account Holder Letter has not been delivered to and received by the Information Agent before the Voting Instruction Deadline other than any Eligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent between the Voting Instruction Deadline and the Business Day preceding the Scheme Settlement Date and in relation to whom the Company exercises its discretion to issue Scheme Consideration on the Scheme Settlement Date in accordance with the terms of the Scheme.

Unallocated Subscribing Noteholder has the meaning given to that term in paragraph 2.30(a) of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Undertaking to Pay has the meaning given to that term in paragraph 3 of Part A (*Background to and reasons for the Recapitalisation Plan*) of this Explanatory Statement.

Undertaking Transaction Parties means the Trustees, the Common Depositaries, the Holding Period Trustee, the Information Agent, the Selling Agent, the Modified Scheme Purchasers, Co-operative Group and the New Administrative Parties.

Unfilled Subscribing Noteholders has the meaning give to that term in paragraph 2.30 of Part B (*Overview of the Scheme*) of this Explanatory Statement.

Voting Instruction Deadline means 4.30 p.m. (London time) on 13 December 2013.

In this Explanatory Statement:

(a) words denoting the singular number only shall include the plural number also and vice versa;

(b) words denoting one gender only shall include the other genders;

(c) words denoting persons only shall include firms and corporations and vice versa;

(d) references to any statutory provision shall be deemed also to refer to any statutory modification or re-enactment thereof or any statutory instrument, order or regulation made thereunder or under any such re-enactment;

(e) any reference in this Appendix 1 (*Definitions and Interpretation*) to any document whose meaning is stated to be the meaning given to a document as defined in the Bank T2 Notes Prospectus shall be construed as a reference to that document as amended, varied, novated, restated, modified, supplemented or re‑enacted or replaced prior to the date of this Explanatory Statement;

(f) clause, paragraph and schedule headings are for ease of reference only;

(g) a reference to this Explanatory Statement includes a reference to the preliminary sections and appendices of this Explanatory Statement;

(h) references to any person shall include references to his successors, transferees and assigns and any person deriving title under or through him;

(i) references to "Sterling" or to "£" are references to the lawful currency from time to time of the United Kingdom;

(j) references to "Euro" or to "€" are references to the lawful currency from time to time of the member states of the European Community that adopt or have adopted the Euro as their lawful currency under the legislation of the European Community for Economic and Monetary Union; and

(k) references to time shall be to London time (Greenwich Mean Time or British Summer Time, as appropriate).

APPENDIX 2

INSTRUCTIONS AND GUIDANCE FOR SCHEME CREDITORS AND ANY PERSON WITH AN INTEREST IN THE DATED NOTES

THIS APPENDIX SETS OUT INSTRUCTIONS AND GUIDANCE FOR VOTING AT THE SCHEME MEETING AND PARTICIPATING IN THE ADDITIONAL NEW ORDINARY SHARES OFFER AND PROCEDURES TO RECEIVE SCHEME CONSIDERATION IN ACCORDANCE WITH THE TERMS OF THE SCHEME AND CERTAIN ADDITIONAL MATTERS. ALL SCHEME CREDITORS AND ANY PERSON WITH AN INTEREST IN THE DATED NOTES ARE REQUESTED TO READ:

(1) THE GENERAL GUIDANCE IN SECTION 1 OF THIS APPENDIX;

(2) THE GUIDANCE ON VOTING AT THE SCHEME MEETING IN SECTION 2 OF THIS APPENDIX;

(3) THE GUIDANCE ON THE DISTRIBUTION OF SCHEME CONSIDERATION IN SECTION 3 OF THIS APPENDIX;

(4) THE GUIDANCE ON PARTICIPATING IN THE ADDITIONAL NEW ORDINARY SHARES OFFER AND THE SUB-PURCHASING OFFER IN SECTION 4 OF THIS APPENDIX; AND

(5) THE GUIDANCE ON VOTING FOR OR AGAINST THE APPOINTMENT OF ANY NOMINATED DIRECTORS (IF APPLICABLE).

SECTION 1 – GENERAL GUIDANCE

SCHEME MEETING

1. Before the Scheme can become effective and binding on the Company and the Scheme Creditors, a resolution to approve it must be passed by the Scheme Creditors by the requisite majority required by section 899 of the Companies Act 2006. The requisite majority is a majority in number representing at least 75% in value of the Scheme Creditors who, being so entitled, are present in person, by a duly authorised representative if a corporation, or by proxy and vote at the Scheme Meeting. The Scheme Meeting has been ordered by the Court to be summoned to take place on 16 December 2013 at 10 a.m. (London time).

2. Formal notice of the Scheme Meeting is set out in Appendix 4 (*Notice of Scheme Meeting*) of this Explanatory Statement.

3. If the Scheme Creditors do not approve the Scheme at the Scheme Meeting, then the Company will not be able to implement the Scheme and the Liability Management Exercise.

4. The relevant Scheme Creditors for the purposes of voting on the Scheme at the Scheme Meeting are the Noteholders. Each of the Common Depositaries and the Trustees has confirmed that it will not exercise any voting rights to which it may be entitled as a Scheme Creditor at the Scheme Meeting.

DEADLINE FOR VOTING AT THE SCHEME MEETING

5. Voting will take place at the Scheme Meeting by Noteholders appearing in person, by a duly authorised representative or by proxy as explained in more detail in section 2 (*Voting*) below.

VOTING

6. As explained in more detail in section 2 (*Voting*) below, each Noteholder must ensure that its Account Holder completes and submits to the Information Agent a valid Account Holder Letter in order to vote at the Scheme Meeting. **Account Holder Letters for the purpose of voting must be submitted to the Information Agent before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013**.

7. A valid Account Holder Letter for the purposes of voting means an Account Holder Letter which has been signed by an Account Holder duly authorised by a Noteholder and in respect of which Part 2 Section 3 (*Voting*) of the Account Holder Letter has been completed, including all confirmations required to be given by the Account Holder.

8. **Failure to deliver a valid Account Holder Letter on behalf of a Noteholder by the Voting Instruction Deadline will mean that the voting instructions contained in that Account Holder Letter will be disregarded for the purposes of voting at the Scheme Meeting and the relevant Noteholder will not be entitled to vote at the Scheme Meeting.**

9. Notwithstanding any other provision of this Explanatory Statement, the Chairman will be entitled, at the sole discretion of the Chairman, to permit a Noteholder in respect of which a completed Account Holder Letter has not been delivered prior to the Voting Instruction Deadline to vote at the Scheme Meeting if the Chairman considers that the relevant Noteholder has produced sufficient proof that it is a Scheme Creditor.

ASSESSMENT OF SCHEME CLAIMS FOR VOTING PURPOSES

10. The amount of the Scheme Claims of each Noteholder which submits a valid Account Holder Letter in respect of the Dated Notes will be calculated as at the Record Date based on information confidentially provided to the Company by the Information Agent. This information will be used by the Chairman to determine whether the Scheme is approved at the Scheme Meeting. Accordingly, Noteholders do not need to take any action in respect of confirming the amount of their Scheme Claims other than providing the details requested in the Account Holder Letter.

11. As the 2016 Notes are denominated in Euro and the other series of the Dated Notes are denominated in Sterling, the Scheme Claims in respect of the 2016 Notes of each Noteholder which submits a valid Account Holder Letter shall be notionally converted from Euro into Sterling at the Scheme FX Rate for the purposes of calculating the value of those Scheme Claims in connection with voting at the Scheme Meeting.

12. Only those Noteholders which are Scheme Creditors as at the Record Date, being 4.30 p.m. (London time) on 13 December 2013, are entitled to attend and vote, either in person, by a duly authorised representative if a corporation, or by proxy at the Scheme Meeting.

13. The assessment of Scheme Claims for voting purposes shall be carried out by the Chairman. The Chairman may, for voting purposes only, reject a Scheme Claim in whole or in part if he/she considers that it does not constitute a fair and reasonable assessment of the relevant sums owed to the relevant Noteholder by the Company or if the relevant Noteholder has not complied with the voting procedures described in this Explanatory Statement. If a Scheme Claim is unascertained, contingent or disputed (in part) but the Chairman is able to place a minimum value on that Scheme Claim, he/she may admit the Scheme Claim for voting purposes at that value. If a Scheme Claim is disputed in its entirety, or the Chairman is otherwise unable to place a minimum value on it, that Scheme Claim may be valued at £1 for voting purposes.

14. The Chairman will report to the Court, at the Scheme Sanction Hearing (which it is anticipated will take place on 18 December 2013), his/her decision to reject Scheme Claims (if any), with details of those Scheme Claims and the reasons for rejection.

15. The admission and valuation of any Scheme Claim for voting purposes does not (in itself) constitute an admission of the existence or value of the Scheme Claim and will not bind the Company or the Noteholders concerned.

TRANSFERS / ASSIGNMENTS AFTER THE RECORD DATE

16. Under the Scheme, the Company is under no obligation to recognise any assignment or transfer of any Scheme Claim after the Record Date, provided that where the Company has received from the relevant parties in writing notice of such assignment or transfer, the Company may, in its absolute discretion and subject to such evidence as it may reasonably require, agree to recognise such assignment or transfer for the purposes of the Scheme. Any assignee or transferee of a Scheme Claim recognised under the Scheme at the discretion of the Company shall be bound by the terms of the Scheme and be a Scheme Creditor for the purposes of the Scheme.

DISTRIBUTION OF SCHEME CONSIDERATION

17. In order to receive the Scheme Consideration to which it is entitled in accordance with the terms of the Scheme (or, to the extent it is not eligible to receive such Scheme Consideration and does not appoint a Designated Recipient, in order to receive the net proceeds of the sale of such Scheme Consideration in accordance with the terms of the Scheme and the Distribution Agreement), each Noteholder must ensure that its Account Holder completes and delivers to the Information Agent a valid Account Holder Letter.

18. A valid Account Holder Letter for the purposes of confirming eligibility to receive Scheme Consideration means an Account Holder Letter which has been signed by an Account Holder duly authorised by a Noteholder and in respect of which Part 4 (*Scheme Consideration, Eligibility and Delivery of the Additional New Ordinary Shares*) has been completed, including all confirmations required to be given by the Account Holder for and on behalf of the relevant Noteholder.

19. Account Holder Letters for the purpose of confirming eligibility to receive Scheme Consideration must be delivered to the Information Agent so as to be received by the Information Agent before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013, in order for the relevant Noteholder to be entitled (if it is an Eligible Noteholder) to receive Scheme Consideration on the Scheme Settlement Date.

20. If a valid Account Holder Letter for the purposes of confirming eligibility to receive Scheme Consideration is delivered to and received by the Information Agent between the Voting Instruction Deadline and the Business Day preceding the Scheme Settlement Date, provided that the Information Agent can establish to its satisfaction that the Noteholder on whose behalf such Account Holder Letter was submitted was, at the Record Date, the Noteholder in respect of the Dated Notes specified in the relevant Account Holder Letter, the Noteholder (or, if it has appointed a Designated Recipient, its Designated Recipient) may receive the Scheme Consideration to which that Noteholder is entitled at the sole discretion of the Company on the Scheme Settlement Date.

21. **Failure to deliver a valid Account Holder Letter on behalf of a Noteholder before the Voting Instruction Deadline will mean that the Noteholder (irrespective of whether it would otherwise be eligible to receive Scheme Consideration) will not receive any Scheme Consideration to which it would be entitled in accordance with the terms of the Scheme on the Scheme Settlement Date.**

22. If a Noteholder is not entitled to receive Scheme Consideration on the Scheme Settlement Date (for example, because a valid Account Holder Letter has not been delivered to and received by the Information Agent in respect of that Noteholder before the Voting Instruction Deadline and that Noteholder is an Unadmitted Noteholder), the relevant Scheme Consideration will be delivered to the Holding Period Trustee to hold on trust for the Unadmitted Noteholders in accordance with the terms of the Scheme and the Distribution Agreement.

23. The Holding Period Trustee shall hold any such Scheme Consideration on trust for the Unadmitted Noteholders for a period of 36 months following the Scheme Settlement Date in accordance with the terms of the Scheme and the Distribution Agreement. This period of 36 months is referred to in the Scheme as the Holding Period.

24. If, at the end of the Holding Period, the Holding Period Trustee is holding any Scheme Consideration on behalf of any Unadmitted Noteholders, as soon as reasonably practicable thereafter the Selling Agent will sell the relevant Scheme Consideration in accordance with the terms of the Distribution Agreement and the Scheme and the Holding Period Trustee will pay the net proceeds of such sale to the Company.

25. **Failure by a Noteholder which is an Unadmitted Noteholder to deliver a valid Account Holder Letter before the end of the Holding Period will mean that any Scheme Consideration to which it would have been entitled in accordance with the terms of the Scheme will be sold and the net proceeds of such sale will be distributed to the Company and that Noteholder shall have no entitlement to those net proceeds or any rights or claims against the Company, the Holding Period Trustee, the Selling Agent or any other person in respect thereof.**

26. **Any Unadmitted Noteholder in respect of which an Account Holder Letter is being delivered to the Information Agent during the Holding Period, following the occurrence of the Scheme Settlement Date, will also need to instruct its Account Holder to provide all information required by the Information Agent to enable the Information Agent to verify that the Unadmitted Noteholder was a Scheme Creditor as at the Record Date in respect of the Dated Notes referred to in the Account Holder Letter.**

27. Any Unadmitted Noteholder in respect of which:

    (a) a valid Account Holder Letter is completed and delivered by its Account Holder to the Information Agent on or after the Voting Instruction Deadline but before the end of the Holding Period; and

    (b) its Account Holder has confirmed on its behalf in the Account Holder Letter that (a) the Unadmitted Noteholder is an Eligible Person or (b) if the Unadmitted Noteholder has appointed a Designated Recipient, the Designated Recipient is an Eligible Person,

    will be an Eligible Noteholder for the purposes of the Scheme and the Distribution Agreement.

28. Each Eligible Noteholder (or, to the extent applicable, its Designated Recipient) will receive the Scheme Consideration to which it is entitled in accordance with the terms of the Scheme (including any accrued and paid dividends and interest or other payments received by the Holding Period Trustee in respect of such Scheme Consideration, in each case net of any applicable taxes (including, without limitation, any withholding taxes but excluding any stamp duty and/or stamp duty reserve tax which the Company will covenant to pay on behalf of that Eligible Noteholder under the terms of the Distribution Agreement)) as soon as reasonably practicable after the receipt by the Information Agent of a valid Account Holder Letter in respect of that Eligible Noteholder.

ADDITIONAL NEW ORDINARY SHARES OFFER

29. In order to participate in the Additional New Ordinary Shares Offer, a valid Account Holder Letter with the appropriate elections made must be delivered to and received by the Information Agent by no later than the Voting Instruction Deadline.

30. **Failure to deliver a valid Account Holder Letter containing the relevant elections in relation to the Additional New Ordinary Shares Offer and confirming that the relevant Noteholder is an Eligible Person or, if it has appointed a Designated Recipient, that the Designated Recipient is an Eligible Person by the Voting Instruction Deadline will mean that the relevant Noteholder will not be entitled to participate in the Additional New Ordinary Shares Offer.**

31. In order to receive its entitlement to Additional New Ordinary Shares pursuant to the terms of the Additional New Ordinary Shares Offer, a Subscribing Noteholder must ensure that it has deposited in the Subscription Escrow Account in cleared funds an amount equal to the Subscription Price for nominal amount of Additional New Ordinary Shares to which it is entitled in accordance with the terms of the Additional New Ordinary Shares Offer by no later than two Business Days after the date of the Scheme Meeting.

32. **Failure to ensure compliance with the requirements in paragraph 31 above will result in the entitlement of the relevant Subscribing Noteholder lapsing in accordance with the terms of the Additional New Ordinary Shares Offer and that Subscribing Noteholder will not be entitled to any Additional New Ordinary Shares.**

SUB-PURCHASING OFFER

33. In order to participate in the Sub-purchasing Offer, a valid Account Holder Letter with the appropriate elections made must be delivered to the Information Agent so as to be received by the Information Agent by no later than the Voting Instruction Deadline.

34. **Failure to deliver a valid Account Holder Letter containing the relevant elections in relation to the Sub-purchasing Offer and confirming that the relevant Noteholder is an Eligible Person or, if it has appointed a Designated Recipient, that the Designated Recipient is an Eligible Person by the Voting Instruction Deadline will mean that the relevant Noteholder will not be entitled to participate in the Sub-purchasing Offer.**

35. In order to receive the Sub-purchase Premium payable to it in respect of any Sub-purchasing Commitment allocated to it, a Sub-purchaser must ensure that it has deposited in the Subscription Escrow Account in cleared funds an amount equal to the amount of its Sub-purchasing Commitment required to be funded as notified to it by the Company (or an agent acting on behalf of the Company) on the date of the Scheme Meeting by no later than two Business Days after the date of the Scheme Meeting.

36. **Failure to ensure compliance with the requirements in paragraph 35 above will result in the commitment of the relevant Sub-purchaser lapsing and that Sub-purchaser will not be entitled to any Sub-purchaser Premium in accordance with the terms of the Sub-purchasing Offer.**

37. If you hold your interests in the Dated Notes in Crest and are not a Crest participant, contact your Crest participant and the Information Agent as soon as possible in connection with participation in the Scheme (and any part thereof). Crest participants should contact the Information Agent immediately. The form of Account Holder Letter to be used by Noteholders holding their interests in the Dated Notes through Crest is not the form of Account Holder Letter attached at Appendix 3 (*Form of Account Holder Letter*) to this Explanatory Statement. The relevant form of Account Holder Letter will be provided by the Information Agent on request. Notwithstanding the different

form of Account Holder Letter, the instructions and guidance set out in this Appendix 2 (*Instructions and guidance for Scheme Creditors and any persons with an interest in the Dated Notes*) apply to a Noteholder irrespective of the fact they might hold their interests in the Dated Noted in Crest.

SECTION 2: VOTING

GENERAL

38. Each Scheme Creditor that is a Noteholder should immediately contact its Account Holder (through any Intermediaries, if appropriate) to ensure that a valid Account Holder Letter in respect of its Scheme Claim is delivered to and received by the Information Agent.

39. It will be the responsibility of Account Holders to obtain from the Noteholders (through any Intermediaries, if applicable) on whose behalf they are acting in accordance with the procedures established between them, whatever information or instructions they may require to identify in an Account Holder Letter the relevant Noteholder and to provide the information, instructions, confirmations and representations required to be given by the Account Holder Letter for and on behalf of the relevant Noteholder. To assist this process, each Noteholder is strongly encouraged to contact its Account Holder (through any Intermediaries, if appropriate) to enable that Account Holder to complete an Account Holder Letter and deliver such Account Holder Letter to the Information Agent before the Voting Instruction Deadline.

40. Before the Voting Instruction Deadline, each Noteholder that wishes to vote at the Scheme Meeting and in respect of which an Account Holder Letter is completed will be required to ensure that its Account Holder has instructed the relevant Clearing System in which the Dated Notes which are the subject of the Account Holder Letter are held to block those interests in the Dated Notes, by giving Custody Instructions to that effect to the relevant Clearing System. The procedure for doing this is described further below.

41. If a person is in any doubt as to whether or not it is a Noteholder, such person should contact the Information Agent using the contact details in the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*).

42. Noteholders may also wish to refer to the diagrams set out in the section entitled *Are you a Scheme Creditor or a person with an interest in the Dated Notes?* at pages 21 to 27 above to see the relationship between Noteholders, Intermediaries and Account Holders.

Appointment of the Information Agent

43. The Information Agent has been appointed to facilitate communications with Noteholders. The Information Agent's remuneration and expenses, and all costs incurred by it on behalf of the Company, shall be met by the Company.

LOCK-UP UNDERTAKINGS

44. As described in Part B (*Overview of the Scheme*) of this Explanatory Statement, a Noteholder may enter into a Lock-up Arrangement by entering into either a Lock-up Agreement or instructing its Account Holder in the Account Holder Letter to elect to enter into Lock-up Undertakings on its behalf.

45. If a Noteholder wishes to enter into Lock-up Undertakings, it should instruct its Account Holder to confirm to the Company, Co-operative Group and the Information Agent that the Noteholder has authorised the Account Holder to enter into Lock-up Undertakings on its behalf by making the appropriate elections in the Account Holder Letter.

VOTING AT THE SCHEME MEETING

46. In order to vote at the Scheme Meeting, each Noteholder (through any Intermediaries, if applicable) should instruct its Account Holder to complete and sign an Account Holder Letter as described below and deliver the completed and signed Account Holder Letter to the Information Agent on behalf of the Company before the Voting Instruction Deadline.

PROCEDURE FOR BLOCKING NOTES HELD IN A CLEARING SYSTEM

47. Each Account Holder should ensure that Euroclear and/or Clearstream, Luxembourg (as the case may be) has/have received irrevocable instructions (with which it has/they have complied) to block the Dated Notes which are the subject of an Account Holder Letter. Each Noteholder procuring the submission of an Account Holder Letter by its Account Holder should instruct its Account Holder to confirm that (and the Account Holder should ensure that) the Account Holder Letter cross references the relevant Custody Instruction Reference Number. Failure to include a valid Custody Instruction Reference Number in an Account Holder Letter delivered on behalf of a Noteholder to the Information Agent will invalidate that Account Holder Letter and the voting instructions contained in that Account Holder Letter will be disregarded for the purposes of voting at the Scheme Meeting and the relevant Noteholder will not be entitled to vote at the Scheme Meeting.

48. Notes held in Euroclear or Clearstream, Luxembourg should be blocked in accordance with the procedures of the relevant Clearing System and the deadlines required by that Clearing System. It is the responsibility of Account Holders to ensure that they comply with any particular deadlines imposed by the Information Agent and the relevant Clearing System for blocking the Dated Notes.

49. **Custody Instructions in respect of any Dated Notes held in Euroclear which are the subject of an Account Holder Letter should be given to Euroclear in accordance with the deadlines specified by Euroclear and its standard practices.** Euroclear will assign a Custody Instruction Reference Number in respect of each Custody Instruction and, as noted in paragraph 47 above, the Custody Instruction Reference Number must be cross referenced in the Account Holder Letter relating to the Dated Notes in respect of which the Custody Instruction Reference Number has been obtained. An Account Holder Letter will not be valid if it does not contain the relevant Custody Instruction Reference Number(s). This will enable the Information Agent to verify the blocking of the Dated Notes in accordance with paragraph 51 below.

50. **Custody Instructions in respect of any Dated Notes held in Clearstream, Luxembourg which are the subject of an Account Holder Letter should be given to Clearstream, Luxembourg in accordance with the deadlines specified by Clearstream, Luxembourg and its standard practices.** Clearstream, Luxembourg will assign a Custody Instruction Reference Number in respect of each Custody Instruction and, as noted in paragraph 47 above, the Custody Instruction Reference Number must be cross referenced in the Account Holder Letter relating to the Dated Notes in respect of which the Custody Instruction Reference Number has been obtained. An Account Holder Letter will not be valid if it does not contain the relevant Custody Instruction Reference Number(s). This will enable the Information Agent to verify the blocking of the Dated Notes in accordance with paragraph 51 below.

51. The Information Agent will request the Clearing Systems to confirm to its satisfaction that the relevant Dated Notes have been blocked with effect from or before the date of receipt by the Information Agent of an Account Holder Letter. In the event that a Clearing System fails to do so, the Information Agent may reject that Account Holder Letter. In order to give the requested confirmation for the purpose of voting, the Clearing Systems will need to have received the Custody Instructions no later than 5 p.m. (local time in the place of the relevant Clearing System) on 12 December 2013, being the day before the Voting Instruction Deadline.

52. The Information Agent will use all reasonable endeavours to assist Noteholders to complete their Account Holder Letters validly, should it receive any Account Holder Letters which are not valid. However, failure to deliver a valid Account Holder Letter on behalf of a Noteholder to the Information Agent in the manner and within the deadlines referred to above will mean that the voting instructions contained in such Account Holder Letter will be disregarded for the purposes of voting at the Scheme Meeting and the relevant Noteholder will not be entitled to vote at the Scheme Meeting.

53. None of the Company, Co-operative Group, the Information Agent or any other person will be responsible for any loss or liability incurred by a Noteholder as a result of any determination by the Information Agent that an Account Holder Letter contains an error or is incomplete, even if this is subsequently shown not to have been the case.

COMPLETING THE ACCOUNT HOLDER LETTER FOR THE PURPOSES OF VOTING

54. Each Noteholder will need to give its Account Holder information and instructions as to voting and certain other matters.

55. In summary each Noteholder may elect:

    (a) to attend and vote at the Scheme Meeting in person or by a duly authorised representative if a corporation; or

    (b) to instruct the Chairman as its proxy to cast its vote in accordance with the wishes of that Noteholder; or

    (c) to appoint someone else as its proxy to attend and vote at the Scheme Meeting in person on its behalf,

    in each case, by ensuring that such election is recorded in the Account Holder Letter delivered on its behalf and that the voting intention section of the Account Holder Letter is completed.

56. Each Noteholder which has not entered into a Lock-up Agreement prior to the submission of its Account Holder Letter may also elect to enter into Lock-up Undertakings as described in paragraphs 44 and 45 above.

57. Each Noteholder is recommended to appoint a proxy (either the Chairman or someone else of its choice who would be willing to attend the Scheme Meeting) in any event, even if that Noteholder intends to attend and vote in person or by a duly authorised representative, if a corporation, in case such Noteholder is unable to do so for some reason. If a Noteholder appoints a proxy and then decides to attend and vote at the Scheme Meeting in person or by a duly authorised representative, if a corporation, that Noteholder will be entitled to do so.

58. Each Noteholder which submits, delivers or procures the delivery of an Account Holder Letter will be required to make (or authorise its Account Holder to make on its behalf) the representations, warranties and undertakings to the Company, Co-operative Group and the Information Agent set out in paragraph1 of schedule 1 to the Account Holder Letter.

59. Any Noteholder that is unable to give any of the representations, warranties and undertakings referred to in paragraph 58 above should contact the Information Agent directly as soon as possible, as there may be additional procedures involved in respect of that Noteholder's participation in the Scheme. A valid Account Holder Letter for the purposes of confirming eligibility to receive Scheme Consideration means an Account Holder Letter which has been signed by an Account Holder duly authorised by a Noteholder and in respect of which Part 4 (*Scheme Consideration, Eligibility and*

Delivery of the Additional New Ordinary Shares) has been completed, including all confirmations required to be given by the Account Holder.

60. Each Noteholder should also ensure that the following is included in the Account Holder Letter delivered on its behalf:

(a) its identity;

(b) details of the Dated Notes which are the subject of the Account Holder Letter, including the ISIN number(s), the principal amount of the Dated Notes held at the relevant Clearing System(s), the identity of the relevant Clearing System(s), the account number of the Account Holder in the relevant Clearing System(s) and the Custody Instruction Reference Number(s);

(c) the appropriate confirmations to be given by the Account Holder; and

(d) its voting instructions.

DELIVERY OF ACCOUNT HOLDER LETTERS FOR THE PURPOSES OF VOTING

61. Account Holder Letters for the purposes of voting at the Scheme Meeting should be delivered by Account Holders as soon as possible to the Information Agent and, in any event, before the Voting Instruction Deadline, being 4.30 p.m. (London time) on 13 December 2013.

62. Each Noteholder should note that, unless a valid Account Holder Letter is delivered on its behalf to the Information Agent before the Voting Instruction Deadline, the voting instructions contained in that Account Holder Letter will be disregarded for the purposes of voting at the Scheme Meeting and the Noteholder will not be entitled to vote at the Scheme Meeting.

63. Any Account Holder Letter delivered will be irrevocable from and after the Voting Instruction Deadline unless and until the Scheme is not approved by the requisite majorities at the Scheme Meeting or the Scheme is withdrawn.

64. By delivering an Account Holder Letter to the Information Agent, the Account Holder: (i) confirms to the Company, Co-operative Group and the Information Agent that Custody Instructions in respect of the Dated Notes which are the subject of that Account Holder Letter have been issued to the relevant Clearing System with effect from or before the Voting Instruction Deadline in accordance with the normal procedures of such Clearing System and after taking into account the deadlines imposed by such Clearing System; (ii) instructs the relevant Clearing System to transmit to the Information Agent (for onward transmission to the Company and Co-operative Group) the information contained within the Custody Instructions; and (iii) gives the other confirmations required by the Account Holder Letter in favour of the Company, Co-operative Group and the Information Agent.

ATTENDING THE SCHEME MEETING

65. The Scheme Meeting will take place at 10 a.m. on 16 December 2013 at the offices of Allen & Overy LLP, One Bishops Square, London E1 6AD.

66. If a Noteholder wishes to attend the Scheme Meeting, it should produce a duplicate copy of the Account Holder Letter delivered on its behalf, evidence of corporate authority (in the case of a corporation) (for example, a valid power of attorney and/or board minutes) and evidence of personal identity (for example, a passport or other picture identification) at the registration desk no later than one hour before the scheduled time of the Scheme Meeting.

67. Any proxy attending the Scheme Meeting on behalf of a Noteholder should produce a duplicate copy of the Account Holder Letter in which he/she is named as proxy. Where this copy can be matched against one of the copies provided by the relevant Account Holder to the Information Agent on behalf of the Company, that Noteholder's proxy will be admitted to the Scheme Meeting upon providing evidence of his/her personal identity (for example, a passport or other picture identification). Where the Account Holder Letter cannot be produced by the person purporting to have been appointed by a Noteholder as its proxy, that person will need to provide evidence of his/her personal identity (for example, a passport or other picture identification) and, provided that the evidenced identity conforms with the details in the relevant copy of the Account Holder Letter provided by the relevant Account Holder to the Information Agent on behalf of the Company, that person will be admitted to the Scheme Meeting.

68. If a Noteholder appoints the Chairman as its proxy, there is no need for the Chairman to take the Account Holder Letter to the Scheme Meeting.

SECTION 3: DISTRIBUTION OF SCHEME CONSIDERATION

GENERAL

69. Each Scheme Creditor that is a Noteholder should immediately contact its Account Holder (through any Intermediaries, if appropriate) to ensure that a valid Account Holder Letter in respect of its Scheme Claim is delivered to and received by the Information Agent.

70. If a person is in any doubt as to whether or not it is a Noteholder, such person should contact the Information Agent using the contact details in the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*).

71. Noteholders may also wish to refer to the diagrams set out in the section entitled *Are you a Scheme Creditor or a person with an interest in the Dated Notes?* at pages 21 to 27 above to see the relationship between Noteholders, Intermediaries and Account Holders.

72. It will be the responsibility of Account Holders to obtain from the Noteholders (through any Intermediaries, if applicable) on whose behalf they are acting in accordance with the procedures established between them, whatever information or instructions they may require to identify in an Account Holder Letter the relevant Noteholder and to provide the information, instructions and confirmations required by the Account Holder Letter. To assist this process, each Noteholder is strongly encouraged to contact its Account Holder (through any Intermediaries, if appropriate) to enable that Account Holder to complete the relevant sections of an Account Holder Letter and deliver such Account Holder Letter to the Information Agent before the Voting Instruction Deadline.

73. Each Noteholder will be required to ensure that its Account Holder has instructed the relevant Clearing System in which the Dated Notes which are the subject of the Account Holder Letter are held to block those interests in the Dated Notes, by giving Custody Instructions to that effect to the relevant Clearing System. The procedure for doing this is the same as the procedure described in paragraphs 47 to 53 above.

74. The Information Agent will use all reasonable endeavours to assist Noteholders to complete their Account Holder Letters validly, should it receive any Account Holder Letters which are not valid. However, failure to deliver a valid Account Holder Letter on behalf of a Noteholder to the Information Agent in the manner and within the deadlines referred to above will mean that the relevant Noteholder will not be entitled to receive the Scheme Consideration to which the Noteholder is entitled on the Scheme Settlement Date (in respect of an Eligible Noteholder) or the net proceeds of the sale of the Scheme Consideration to which a Noteholder is entitled as soon as reasonably practicable after the Scheme Settlement Date in accordance with the terms of the Scheme (in respect of an Ineligible Noteholder). Any such Noteholder will be required to take the additional steps described in paragraphs 81 to 92 below.

75. None of the Company, Co-operative Group, the Information Agent or any other person will be responsible for any loss or liability incurred by a Noteholder as a result of any determination by the Information Agent that an Account Holder Letter contains an error or is incomplete, even if this is subsequently shown not to have been the case.

COMPLETING THE ACCOUNT HOLDER LETTER FOR THE PURPOSES OF CONFIRMING ELIGIBILITY TO RECEIVE SCHEME CONSIDERATION

76. Each Noteholder will need to give its Account Holder information and instructions as to its eligibility to receive Scheme Consideration under applicable securities and other laws.

77. In summary each Noteholder may elect:

(a) to receive the Scheme Consideration to which it is entitled in accordance with the terms of the Scheme, in which case it must instruct its Account Holder to confirm on its behalf that it is an Eligible Person;

(b) for a Designated Recipient to receive the Scheme Consideration to which that Noteholder is entitled in accordance with the terms of the Scheme, in which case it must instruct its Account Holder to confirm on its behalf that its Designated Recipient is an Eligible Person; or

(c) for the Scheme Consideration to which that Noteholder is entitled to be sold pursuant to the terms of the Distribution Agreement as soon as reasonably practicable and for the net proceeds of the sale of that Scheme Consideration to be paid to that Noteholder, in which case it must instruct its Account Holder to confirm on its behalf that it is not an Eligible Person and it must not appoint a Designated Recipient,

in each case, by ensuring that such election is recorded in the Account Holder Letter delivered on its behalf and that the details of its Designated Recipient, if applicable, are included in the Account Holder Letter.

78. Each Noteholder which submits, delivers or procures the delivery of an Account Holder Letter will be required to make (or authorise its Account Holder to make on its behalf) the representations, warranties and undertakings to the Company, Co-operative Group and the Information Agent set out in paragraph 2 of schedule 1 to the Account Holder Letter.

79. Any Noteholder that is unable to give any of the representations, warranties and undertakings referred to in paragraph 78 above should contact the Information Agent directly as soon as possible, as there may be additional procedures involved in respect of that Noteholder's participation in the Scheme.

80. Each Noteholder should also ensure that the following is included in the Account Holder Letter delivered on its behalf:

(a) its identity;

(b) details of the Dated Notes which are the subject of the Account Holder Letter, including the ISIN number(s), the principal amount of the Dated Notes held at the relevant Clearing System(s), the identity of the relevant Clearing System(s), the account number of the Account Holder in the relevant Clearing System(s) and the Custody Instruction Reference Number(s);

(c) the appropriate confirmations to be given by the Account Holder; and

(d) its elections in respect of the distribution of Scheme Consideration.

DISTRIBUTION OF SCHEME CONSIDERATION

81. In order to receive the Scheme Consideration to which a Noteholder is entitled, a Noteholder must have complied with the procedures set out in this Appendix 2 (*Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes*).

Eligible Noteholders

82. Any Noteholder in respect of which:

(a) a valid Account Holder Letter is completed and delivered by its Account Holder to the Information Agent; and

(b) its Account Holder has confirmed on its behalf in the Account Holder Letter that (a) the Noteholder is an Eligible Person or (b) if the Noteholder has appointed a Designated Recipient, the Designated Recipient is an Eligible Person,

will be an Eligible Noteholder for the purposes of the Scheme.

83. Each Eligible Noteholder (or, to the extent applicable, its Designated Recipient and/or its Alternative Recipient) will receive the Scheme Consideration to which it is entitled in accordance with the terms of the Scheme:

(a) on the Scheme Settlement Date if a valid Account Holder Letter in respect of that Eligible Noteholder is delivered to and received by the Information Agent before the Voting Instruction Deadline;

(b) on the Scheme Settlement Date if a valid Account Holder Letter in respect of that Eligible Noteholder is delivered to and received by the Information Agent between the Voting Instruction Deadline and the Business Day preceding the Scheme Settlement Date and the Company exercises its discretion to issue the relevant Scheme Consideration to that Eligible Noteholder; or

(c) as soon as reasonably practicable after the date on which the Information Agent delivers a Distribution Instruction Certificate relating to that Eligible Noteholder to the Holding Period Trustee (which, in accordance with the terms of the Distribution Agreement must be no later than 10 Business Days following the date on which a valid Account Holder Letter in respect of that Eligible Noteholder has been delivered to and received by the Information Agent (provided that the Information Agent shall be under no obligation to deliver an Instruction Certificate to the Holding Period Trustee prior to the Scheme Settlement Date)), if a valid Account Holder in respect of that Eligible Noteholder is delivered between the Voting Instruction Deadline and the Holding Period (i.e. during the 36 month period from the Scheme Settlement Date).

84. Any Scheme Consideration to which an Eligible Noteholder is entitled to receive on the Scheme Settlement Date under the terms of the Scheme will be delivered on the Scheme Settlement Date to the account of the Account Holder in the Clearing Systems in which the Account Holder holds the Dated Notes on behalf of that Eligible Noteholder (or, if that Eligible Noteholder is an Account Holder, the account of that Eligible Noteholder in the Clearing Systems in which that Eligible Noteholder holds its Dated Notes), irrespective of whether such Scheme Consideration is to be delivered to that Eligible Noteholder or, if applicable, the Designated Recipient appointed by that Eligible Noteholder.

Ineligible Noteholders

85. Any Noteholder in respect of which:

(a) a valid Account Holder Letter is completed and delivered by its Account Holder to the Information Agent; and

(b) its Account Holder has confirmed on its behalf in the Account Holder Letter that the Noteholder is not an Eligible Person and it has not appointed a Designated Recipient,

will be an Ineligible Noteholder for the purposes of the Scheme.

86. An Ineligible Noteholder will not receive the Scheme Consideration to which it would otherwise be entitled to in accordance with the terms of the Scheme if it were an Eligible Noteholder. Instead, such Scheme Consideration held by the Holding Period Trustee on trust for the Ineligible Noteholders shall be sold by the Selling Agent in accordance with the terms of the Distribution Agreement and the Scheme.

87. As described in more detail in paragraphs 3.5 to 3.18 of Part B (*Overview of the Scheme*) of this Explanatory Statement, the Holding Period Trustee shall sell or procure the sale of any such Scheme Consideration and distribute the net proceeds of such sale to the Ineligible Noteholder.

88. If the Holding Period Trustee is holding any Scheme Consideration on behalf of any Ineligible Noteholders which has not been sold by the end of the Holding Period and the Holding Period Trustee (or the Selling Agent on behalf of the Holding Period Trustee) is not able, after having used reasonable efforts and having consulted with the Company, to sell any such Scheme Consideration within three months of the end of the Holding Period, the Holding Period Trustee shall transfer by way of gift on behalf of such Ineligible Noteholders such Scheme Consideration to Carers Trust (registered charity number 1145181) or to any other registered charity selected by the Company in writing for this purpose.

Unadmitted Noteholders

89. Any Noteholder in respect of which a valid Account Holder Letter is not completed and delivered by its Account Holder Letter to the Information Agent before the Voting Instruction Deadline (other than any Eligible Noteholder on whose behalf a valid Account Holder Letter has been delivered to and received by the Information Agent between the Voting Instruction Deadline and the Business Day preceding the Scheme Settlement Date and in relation to whom the Company exercises its discretion to issue Scheme Consideration on the Scheme Settlement Date in accordance with the terms of the Scheme) will be an Unadmitted Noteholder for the purposes of the Scheme.

90. Each Unadmitted Noteholder will not receive the Scheme Consideration to which it is entitled in accordance with the terms of the Scheme on the Scheme Settlement Date. Such Scheme Consideration shall be delivered to the Holding Period Trustee on the Scheme Settlement Date, which will hold such Scheme Consideration on trust for that Unadmitted Noteholder.

91. An Unadmitted Noteholder that subsequently arranges for a valid Account Holder Letter to be delivered to the Information Agent before the end of the Holding Period shall become either an Eligible Noteholder or an Ineligible Noteholder.

92. If, at the end of the Holding Period, the Holding Period Trustee is holding any Scheme Consideration on behalf of any Unadmitted Noteholders, as soon as reasonably practicable after the end of the Holding Period the Holding Period Trustee shall instruct the Selling Agent to sell all such Scheme Consideration and to distribute the net proceeds to the Company in accordance with the terms of the Distribution Agreement, provided that, to the extent that the Holding Period Trustee (or the Selling Agent on behalf of the Holding Period Trustee) is not able, after having used reasonable efforts and having consulted with the Company, to sell any such Scheme Consideration following the expiry end of the Holding Period, the Holding Period Trustee shall transfer by way of gift on behalf of such Unadmitted Noteholders such Scheme Consideration to Carers Trust (registered charity number 1145181) or to any other registered charity selected by the Company in writing for this purpose.

DELIVERY OF ACCOUNT HOLDER LETTERS FOR THE PURPOSES OF CONFIRMING ELIGIBILITY TO RECEIVE SCHEME CONSIDERATION

93. Account Holder Letters for the purposes of confirming eligibility to receive Scheme Consideration should be delivered by Account Holders as soon as possible to the Information Agent and, in any event, before the Voting Instruction Deadline, being 4.30 p.m. on 13 December 2013.

94. **Failure by a Noteholder to deliver a valid Account Holder Letter to the Information Agent before the Voting Instruction Deadline will mean that Noteholder will not be entitled to receive the Scheme Consideration to which it is entitled in accordance with the terms of the Scheme on the Scheme Settlement Date and, if that Noteholder has not complied with the relevant procedures prior to the end of the Holding Period, such Scheme Consideration will be sold and the net proceeds of such sale will be distributed to the Company (or, if the Holding Period Trustee is unable to sell such Scheme Consideration as described in paragraph 3.15 of Part B (*Overview of the Scheme*), a charity selected by the Company) and that Noteholder shall have no entitlement to those net proceeds or any rights or claims against the Company, the Holding Period Trustee, the Selling Agent or any other person in respect thereof.**

95. Any Account Holder Letter delivered will be irrevocable from and after the Voting Instruction Deadline unless and until the Scheme is not sanctioned by the Court at the Scheme Sanction Hearing or the Scheme is withdrawn.

96. By delivering an Account Holder Letter to the Information Agent, the Account Holder: (i) confirms to the Company, Co-operative Group and the Information Agent that Custody Instructions in respect of the Dated Notes which are the subject of that Account Holder Letter have been issued to the relevant Clearing System with effect from or before the Scheme Sanction Hearing in accordance with the normal procedures of such Clearing System and after taking into account the deadlines imposed by such Clearing System (or, in respect of an Account Holder Letter delivered on behalf of an Unadmitted Noteholder during the Holding Period, the Dated Notes which are the subject of that Account Holder Letter were held by that Noteholder as at the Record Date and continued to be so held until the transfer and cancellation of those Dated Notes in accordance with the terms of the Scheme on the Scheme Settlement Date); (ii) instructs the relevant Clearing System to transmit to the Information Agent (for onward transmission to the Company and Co-operative Group) the information contained within the Custody Instructions; and (iii) gives the other confirmations required by the Account Holder Letter in favour of the Company, Co-operative Group and the Information Agent.

SECTION 4: PARTICIPATING IN THE ADDITIONAL NEW ORDINARY SHARES OFFER AND THE SUB-PURCHASING OFFER

GENERAL

97. Each Scheme Creditor that is a Noteholder should immediately contact its Account Holder (through any Intermediaries, if appropriate) to ensure that a valid Account Holder Letter in respect of its Scheme Claim is delivered to and received by the Information Agent.

98. If a person is in any doubt as to whether or not it is a Noteholder, such person should contact the Information Agent using the contact details in the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*).

99. Noteholders may also wish to refer to the diagrams set out in the section entitled *Are you a Scheme Creditor or a person with an interest in the Dated Notes?* at pages 21 to 27 above to see the relationship between Noteholders, Intermediaries and Account Holders.

100. As described in Part B (*Overview of the Scheme*), any Noteholder may participate in the Additional New Ordinary Shares Offer and/or the Sub-purchasing Offer by instructing its Account Holder to make the appropriate elections in its Account Holder Letter and confirming on its behalf that the Noteholder is an Eligible Person or, if it has appointed a Designated Recipient, that the Designated Recipient is an Eligible Person and delivering a valid Account Holder Letter containing those confirmations to the Information Agent before the Voting Instruction Deadline.

COMPLETING THE ACCOUNT HOLDER LETTER FOR THE PURPOSES OF PARTICIPATING IN THE ADDITIONAL NEW ORDINARY SHARES OFFER

101. Each Noteholder may elect:

(a) in respect of the Additional New Ordinary Shares Offer, to subscribe for a minimum number of 26,667 Additional New Ordinary Shares and a maximum number of 33,333,334 Additional New Ordinary Shares; and

(b) in respect of the Sub-purchasing Offer, to nominate a minimum commitment to back-stop the purchase of between 26,667 Additional New Ordinary Shares and 33,333,334 Additional New Ordinary Shares,

in each case, by ensuring that such election is recorded in the Account Holder Letter delivered on its behalf (by completing part 3 (*Additional New Ordinary Shares Offer*)) and, in addition, that part 4 (*Scheme Consideration, Eligibility and Delivery of the Additional New Ordinary Shares*) of the Account Holder Letter is completed.

DELIVERY OF ACCOUNT HOLDER LETTERS FOR PARTICIPATING IN THE ADDITIONAL NEW ORDINARY SHARES OFFER AND/OR THE SUB-PURCHASING OFFER

102. Account Holder Letters for the purposes of electing to subscribe for Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer or electing to nominate a commitment for the Sub-purchasing Offer should be delivered by Account Holders as soon as possible to the Information Agent and, in any event, before the Voting Instruction Deadline, being 4.30 p.m. on 13 December 2013.

103. Each Noteholder should note that, unless a valid Account Holder Letter is delivered on its behalf to the Information Agent containing the requisite elections and confirmations that the Noteholder (or, if

it has appointed a Designated Recipient, its Designated Recipient) is an Eligible Person before the Voting Instruction Deadline, the elections contained in that Account Holder Letter in relation to the Additional New Ordinary Shares Offer and/or the Sub-purchasing Offer (as the case may be) will be disregarded and that Noteholder will not be entitled to participate in the Additional New Ordinary Shares Offer or the Sub-purchasing Offer.

104. Any Account Holder Letter delivered will be irrevocable from and after the Voting Instruction Deadline unless and until the Scheme is not approved by the requisite majorities at the Scheme Meeting or the Scheme is withdrawn.

105. By delivering an Account Holder Letter to the Information Agent, the Account Holder: (i) confirms to the Company, Co-operative Group and the Information Agent that Custody Instructions in respect of the Dated Notes which are the subject of that Account Holder Letter have been issued to the relevant Clearing System with effect from or before the Voting Instruction Deadline in accordance with the normal procedures of such Clearing System and after taking into account the deadlines imposed by such Clearing System; (ii) instructs the relevant Clearing System to transmit to the Information Agent (for onward transmission to the Company and Co-operative Group) the information contained within the Custody Instructions; and (iii) gives the other confirmations required by the Account Holder Letter in favour of the Company, Co-operative Group and the Information Agent.

SECTION 5: VOTING FOR OR AGAINST THE APPOINTMENT OF ANY NOMINATED DIRECTORS (IF APPLICABLE)

GENERAL

106. Each Scheme Creditor that is a Noteholder should immediately contact its Account Holder (through any Intermediaries, if appropriate) to ensure that a valid Account Holder Letter in respect of its Scheme Claim is delivered to and received by the Information Agent.

107. If a person is in any doubt as to whether or not it is a Noteholder, such person should contact the Information Agent using the contact details in the Account Holder Letter set out in Appendix 3 (*Form of Account Holder Letter*).

108. Noteholders may also wish to refer to the diagrams set out in the section entitled *Are you a Scheme Creditor or a Person with an Interest in the Dated Notes?* at pages 21 to 27 above to see the relationship between Noteholders, Intermediaries and Account Holders.

109. As described in paragraph 6 of Part B (*Overview of the Scheme*) of the Explanatory Statement, any Noteholder may vote for or against any Nominated Directors which are nominated by the Purchasers by instructing its Account Holder to make the appropriate elections in its Account Holder Letter and delivering a valid Account Holder Letter containing those confirmations to the Information Agent before the Voting Instruction Deadline.

COMPLETING THE ACCOUNT HOLDER LETTER FOR THE PURPOSES OF VOTING FOR OR AGAINST ANY NOMINATED DIRECTORS (IF APPLICABLE)

110. Each Noteholder may elect to vote for or against the appointment of either or both Nominated Directors at the Scheme Meeting, if any such Nominated Directors are nominated by the Modified Scheme Purchasers, as described in paragraph 6 of Part B (*Overview of the Scheme*) of the Explanatory Statement, in each case, by ensuring that such election is recorded in the Account Holder Letter delivered on its behalf by completing part 5 (*Director Nominations*) of the Account Holder Letter.

DELIVERY OF ACCOUNT HOLDER LETTERS FOR THE PURPOSES OF VOTING FOR OR AGAINST ANY NOMINATED DIRECTORS (IF APPLICABLE)

111. Account Holder Letters for the purposes of voting for or against any Nominated Directors, if any such Nominated Directors are nominated by the Modified Scheme Purchasers, should be delivered by Account Holders as soon as possible to the Information Agent and, in any event, so as to be received before the Voting Instruction Deadline, being 4.30 p.m. on 13 December 2013.

112. Each Noteholder should note that, unless a valid Account Holder Letter is delivered on its behalf to the Information Agent containing the requisite elections and confirmations, the votes of that Noteholder will be disregarded for the purposes of approving any Nominated Directors.

113. Any Account Holder Letter delivered will be irrevocable from and after the Voting Instruction Deadline unless and until the Scheme is not approved by the requisite majorities at the Scheme Meeting or the Scheme is withdrawn.

114. By delivering an Account Holder Letter to the Information Agent, the Account Holder: (i) confirms to the Company, Co-operative Group and the Information Agent that Custody Instructions in respect of the Dated Notes which are the subject of that Account Holder Letter have been issued to the relevant Clearing System with effect from or before the Voting Instruction Deadline in accordance

with the normal procedures of such Clearing System and after taking into account the deadlines imposed by such Clearing System; (ii) instructs the relevant Clearing System to transmit to the Information Agent (for onward transmission to the Company and Co-operative Group) the information contained within the Custody Instructions; and (iii) gives the other confirmations required by the Account Holder Letter in favour of the Company, Co-operative Group and the Information Agent.

APPENDIX 3

FORM OF ACCOUNT HOLDER LETTER

FORM OF ACCOUNT HOLDER LETTER

For use by Account Holders in Euroclear and Clearstream, Luxembourg in respect of

€34,980,000 Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (the **2016 Notes**)

£37,775,000 5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942) (the **2019 Notes**)

£275,000,000 9.25% Subordinated Notes due April 2021 (ISIN: XS0620315902) (the **April 2021 Notes**)

£8,747,000 Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984) (the **November 2021 Notes**)

£235,402,000 7.875% Subordinated Notes due 2022 (ISIN: XS0864253868) (the **2022 Notes**)

£200,000,000 5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183) (the **2024 Notes**)

and

£150,000,000 5.875% Subordinated Notes due 2033 (ISIN: XS0145065602) (the **2033 Notes**)

issued by

THE CO-OPERATIVE BANK P.L.C.
(the **Company**)

in relation to

The Company's scheme of arrangement under
Part 26 of the Companies Act 2006 (the **Scheme**)

The Scheme will, if implemented, materially affect certain creditors of the Company, including the holders of the 2016 Notes, the 2019 Notes, the April 2021 Notes, the November 2021 Notes, the 2022 Notes, the 2024 Notes and the 2033 Notes (together, the **Dated Notes**).

Persons who are account holders with Euroclear and Clearstream, Luxembourg (together, **Account Holders**) must use this Account Holder Letter to register details of their interests in the Dated Notes and to make certain elections in relation to the voting in respect of the Scheme.

DEADLINE FOR RECEIPT OF BLOCKING INSTRUCTIONS AND ACCOUNT HOLDER LETTER

THIS ACCOUNT HOLDER LETTER HAS 6 PARTS.

IN ALL CASES PART 1 OF THIS ACCOUNT HOLDER LETTER MUST BE COMPLETED AND, IN ADDITION:

IN ORDER TO VOTE AND/OR LOCK-UP

Part 2 of this Account Holder Letter: In order to vote and/or lock-up in respect of the Scheme, Part 2 (*Voting and Lock-up*) of this Account Holder Letter must be delivered by post, facsimile or email to the Information Agent using the contact details set out below and must be received by the Information Agent by

no later than 4.30 p.m. (London time) on 13 December 2013 (the **Voting Instruction Deadline**). Account Holder Letters received after the Voting Instruction Deadline will not constitute valid voting instructions for the purposes of the Scheme. The Dated Notes identified in this Account Holder Letter must be blocked by no later than the Business Day preceeding the Voting Instruction Deadline.

IN ORDER TO ELECT TO PARTICIPATE IN THE ADDITIONAL NEW ORDINARY SHARES SUBSCRIPTION AND/OR THE SUB-PURCHASING OFFER

Part 3 of this Account Holder Letter: In order to elect to subscribe for any Additional New Ordinary Shares or participate in the Sub-purchasing Offer in accordance with the Scheme, Part 3 Section 1 (*Election to Subscribe*) (in respect of the Additional New Ordinary Shares Offer) and/or Part 3 Section 2 (*Election to Sub-purchase*) (in respect of the Sub-purchasing Offer in respect of the Additional New Ordinary Shares Offer) of this Account Holder Letter must be delivered by post, facsimile or email to the Information Agent using the contact details set out below and must be received by the Information Agent by no later than the Voting Instruction Deadline. Such delivery will constitute an irrevocable offer by the relevant Noteholder to subscribe for Additional New Ordinary Shares pursuant to the Additional New Ordinary Shares Offer (if Part 3 Section 1 (*Election to Subscribe*) is completed) and/or the Sub-purchasing Offer (if Part 3 Section 2 (*Election to Sub-purchase*) is completed)..

If Part 3 Section 1 (*Election to Subscribe*) and/or Part 3 Section 2 (*Election to Sub-purchase*) are completed, Part 4 (*Scheme Consideration, Eligibility And Delivery Of The Additional New Ordinary Shares*) must also be completed so as to confirm that the Account Holder and Noteholder (or if the Noteholder has appointed a Designated Recipient, its Designated Recipient), are Eligible Persons.

IN ORDER TO RECEIVE SCHEME CONSIDERATION AND ADDITIONAL NEW ORDINARY SHARES

Part 4 of this Account Holder Letter: In order to receive Scheme Consideration and (if applicable) Additional New Ordinary Shares pursuant to the terms of the Scheme on the Scheme Settlement Date, and to participate in the Sub-purchasing Offer, Part 4 (*Scheme Consideration, Eligibility And Delivery Of The Additional New Ordinary Shares*) of this Account Holder Letter must be delivered by post, facsimile or email to the Information Agent using the contact details set out below and must be received by the Information Agent by no later than the Voting Instruction Deadline.

IN ORDER TO VOTE FOR OR AGAINST THE APPOINTMENT OF THE NOMINATED DIRECTORS

Part 5 of this Account Holder Letter: In order to vote for or against the appointment of one or both of the Nominated Directors, Part 5 (*Director Nominations*) must be delivered by post, facsimile or email to the Information Agent by no later than the Voting Instruction Deadline.

IN ALL CASES PART 6 OF THIS ACCOUNT HOLDER LETTER SHOULD BE COMPLETED.

Part 6 of this Account Holder Letter: In order to be valid, this Account Holder Letter must be signed by the Account Holder.

A separate Account Holder Letter must be completed in respect of each separate beneficial holding of/interest in the Dated Notes.

Capitalised terms used in this Account Holder Letter but not defined in it have the same meaning as given to them in the explanatory statement relating to the Scheme dated 18 November 2013 (as amended on 4 December 2013) (the **Explanatory Statement**), subject to any amendments or modifications made by the Court.

You are strongly advised to read the Explanatory Statement and the Scheme and, in particular, Appendix 2 (*Instructions and guidance for Scheme Creditors and any person with an interest in the Dated Notes*) to the Explanatory Statement, before you complete the Account Holder Letter. Appendix 2 (*Instructions and guidance for Scheme Creditors and any person with an interest in the Dated Notes*) to the Explanatory Statement contains detailed information on the various options contained in this Account Holder Letter. All relevant documentation can be found at the Scheme Website www.co-operative.coop/Bondholders.

This Account Holder Letter and any non-contractual obligations arising out of or in relation to this Account Holder Letter shall be governed by, and interpreted in accordance with, English law.

FOR ASSISTANCE CONTACT THE INFORMATION AGENT:

Lucid Issuer Services Limited

Leroy House
436 Essex Road
London
N1 3QP

Attention: Sunjeeve Patel / Yves Theis

Telephone: +44 20 7704 0880
Email: co-op@lucid-is.com
Facsimile: +44 20 7067 9098

PART 1: NOTEHOLDER AND HOLDING DETAILS

SECTION 1: NOTEHOLDER DETAILS

If you are not the Noteholder (that is, the person that is the beneficial owner of and/or the holder of the ultimate economic interest in the relevant Dated Notes, held in global form through the Clearing Systems with a claim in respect of any amount outstanding under the Dated Notes as at the Record Date (being 4.30 p.m. (London time) on 13 December 2013) (unless the Company, in its sole discretion, elects to recognise a transfer of Dated Notes after the Record Date)), please identify the Noteholder on whose behalf you are submitting this Account Holder Letter. If such Noteholder does not wish to provide details of its identity, please identify a person with full legal right and authority to act on behalf of that Noteholder as its representative.

To be completed for all Noteholders:

Full Name of Noteholder _____

Country[1] _____

E-mail Address _____

Telephone Number (with country code) _____

Passport Number[2] _____

To be completed if the Noteholder is an institution:

Jurisdiction of Incorporation of Noteholder _____

Name of Authorised Employee of Noteholder _____

_____

Department _____

Passport Number[3] _____

To be completed if the Noteholder is an investment fund, managed account, discretionary account or similar over which a manager, adviser or general partner has discretionary authority:

Name of Investment Manager / Investment Adviser / General Partner _____

[1] If the Noteholder is an institution, enter the country in which its registered office is located. If the Noteholder is an individual, enter the country in which the individual's home address is located. If a country other than the United Kingdom is entered, the Noteholder should refer to the section(s) entitled "Restrictions" in the Explanatory Statement.

[2] Required if attending the Scheme Meeting in person or by a duly authorised representative, if a corporation.

[3] Required if attending the Scheme Meeting in person by a duly authorised representative.

SECTION 2: HOLDING DETAILS

If this Account Holder Letter is delivered before the Voting Instruction Deadline, the Account Holder on behalf of the relevant Noteholder holds the following Dated Notes to which this Account Holder Letter relates, which have been "blocked" through delivery of Custody Instructions to the relevant Clearing System, the Custody Instruction Reference Number(s) in relation to which is/are identified below.

If this Account Holder Letter is delivered after the Voting Instruction Deadline but before the Scheme Settlement Date, the Account Holder on behalf of the relevant Noteholder held the following Dated Notes to which this Account Holder Letter relates on the Record Date, continues to hold those Dated Notes and those Dated Notes have been "blocked" through delivery of Custody Instructions to the relevant Clearing System, the Custody Instruction Reference Number(s) in relation to which is/are identified below.

If this Account Holder Letter is delivered after the Scheme Settlement Date, the Account Holder on behalf of the relevant Noteholder held the following Notes to which this Account Holder Letter relates, on the Record Date and the relevant Noteholder has not transferred its Dated Notes between the Record Date and the Scheme Settlement Date.

ISIN	**Amount blocked at Clearing System**	**Clearing System**	**Clearing System Account number**	**Custody Instruction Reference Number**[4]

[4] Corresponding to your blocking instruction.

PART 2: VOTING AND LOCK-UP

SECTION 1: ACCOUNT HOLDER CONFIRMATIONS

The Account Holder named below in Part 6 (*Execution of Account Holder Letter by Account Holder*) for itself hereby confirms to the Company, the Co-operative Group and the Information Agent as follows (select "yes" or "no" as appropriate for each item):

A: That all authority conferred or agreed to be conferred pursuant to this Account Holder Letter and every obligation of the Account Holder under this Account Holder Letter (including any elections made in this Account Holder Letter) shall be binding upon the successors and assigns of the Account Holder (in the case of a corporation or institution) or the successors, assigns, heirs, executors, administrators, trustees in bankruptcy and legal representatives of the Account Holder (in the case of a natural person) and shall not be affected by, and shall survive, the insolvency, bankruptcy, dissolution, death or incapacity (as the case may be) of the Account Holder and that all of the information in this Account Holder Letter is complete and accurate.

☐ Yes

☐ No

B. That the Account Holder has irrevocably instructed Euroclear and/or Clearstream, Luxembourg, as the case may be, pursuant to Custody Instructions to block the Dated Notes identified in Part 1 Section 2 (*Holding Details*) of this Account Holder Letter on or before the date that this Account Holder Letter is delivered to the Information Agent and that a Custody Instruction Reference Number for each such Custody Instruction appears in this Account Holder Letter under "Custody Instruction Reference Number" in Part 1 Section 2 (*Holding Details*) of the Account Holder Letter.

☐ Yes

☐ No

C. That, in relation to the Dated Notes identified in Part 1 Section 2 (*Holding Details*) of this Account Holder Letter, the Account Holder has authority to (i) give the voting instructions set out in Part 2 Section 3 (*Voting*) of this Account Holder Letter and to nominate the person named in Part 2 Section 3 (*Voting*) of this Account Holder Letter (if applicable) to attend and speak at the Scheme Meeting, and (ii) make the elections and/or give the confirmations set out in Part 2 Section 2 (*Lock-up*) below on behalf of the Noteholder.

☐ Yes

☐ No

An Account Holder who is unable to confirm "yes" in respect of paragraphs A to C above should contact the Information Agent using the contact details set out in this Account Holder Letter for assistance.

By delivering this Account Holder Letter to the Information Agent, the Account Holder confirms that the Noteholder agrees that both it and the Noteholder shall be deemed to have made the representations, warranties and undertakings set out in paragraph 1 of Schedule 1 (*Representations, Warranties and Undertakings*) to this Account Holder Letter in favour of the Company, the Co-operative Group and the Information Agent as at the date on which this Account Holder Letter is delivered to the Information Agent.

SECTION 2: LOCK-UP

The Account Holder named below in Part 6 (*Execution of Account Holder Letter by Account Holder*) hereby confirms to the Company, the Co-operative Group and the Information Agent that the Noteholder agrees that the Noteholder shall be deemed to have made the representations, warranties and undertakings set out in paragraphs (a) and (b) and the undertakings set out in paragraphs (c), (e) and (f) of this Part 2 Section 2 (*Lock*-up) below (select "yes" or "no" as appropriate):

☐ Yes

☐ No

(a) The Noteholder which submits, delivers or procures the submission and/or delivery of an Account Holder Letter represents and warrants to the Company, the Co-operative Group and the Information Agent that:

(i) it is legally entitled and able to control the exercise and the casting of votes in relation to its Dated Notes in order to comply with the undertakings set out in paragraph (b) below; and

(ii) it has all requisite power, authority and legal capacity to give and carry out the transactions contemplated by, and to perform its obligations under, the undertakings set out in paragraph (b) below.

(b) The Noteholder undertakes in favour of the Company that it will (or, as applicable, will procure that a duly authorised representative, proxy or nominee will):

(i) attend the Scheme Meeting by proxy or in person and exercise and cast all of its votes in respect of its Dated Notes (as set out in Part 1 Section 2 (*Holding Details*) (its **Locked-up Notes**)) in favour of the Scheme and any amendment or modification to the Scheme or adjournment to the Scheme Meeting, provided that they are proposed by the Company and that the terms of the Scheme as amended or modified are and remain consistent in all material respects with the terms of the Scheme without such amendments or modifications and are consistent with and do not include any additional material terms which are likely to adversely affect or conflict with the terms of the Proposed Restructuring or its implementation;

(ii) except where Subclause b(i) applies, exercise and cast all of its votes in respect of its Locked-up Notes against any amendment or modification to the Scheme or any proposal to adjourn the Scheme Meeting;

(iii) not commence or request or instruct that any Trustee or any other person commence proceedings against the Company or take any other action in connection with any Note Event of Default or Potential Note Event of Default arising as a result of an application for or the making of the Scheme or the Proposed Restructuring;

(iv) not commence, take, support or actively assist (or request, instruct or procure that any other person commence, take, support, or actively assist) any judicial, arbitration, regulatory proceedings or any other action inconsistent with the terms of the undertakings set out in this paragraph (b) or the Scheme, that would reasonably be expected to impede, prevent or frustrate the implementation of the Scheme or the Proposed Restructuring;

(v) promptly notify the Company, by sending an additional Account Holder Letter (with Part 2 Section 2 (*Lock-up*) duly completed to provide the undertakings set out in paragraph (b) of

Part 2 Section 2 (*Lock-up*) of that Account Holder Letter) to the Company and/or the Information Agent, of any change (whether an increase or decrease) to the aggregate principal amount of its Dated Notes and upon actual receipt of a request in writing from the Company (or an agent acting on its behalf) provide such other information in relation to any Scheme Claim (to the extent such information cannot be obtained from this Account Holder Letter or any additional Account Holder Letter delivered by or on behalf of the Noteholder) as the Company (or an agent acting on its behalf) may reasonably require in order to enable it to calculate any Scheme Consideration; and

(vi) promptly provide to the Company (or an agent acting on its behalf), upon actual receipt of a request in writing from the Company (or an agent acting on its behalf), written confirmation of the aggregate principal amount of its Locked-up Notes.

(c) From the date of this Account Holder Letter until the date on which the undertakings set out in paragraph (b) above are terminated in accordance with paragraph (d) below, the Account Holder named below hereby confirms to the Company, the Co-operative Group and the Information Agent that the Noteholder undertakes not to sell, transfer, assign or otherwise dispose of its interest in all or any part of its Locked-up Notes to any person unless that person has entered into a Lock-Up Arrangement with the Company.

(d) Subject to paragraph (e) below, the undertakings set out in paragraph (b) above will terminate immediately upon the occurrence of any of the following events:

(i) at a Scheme Meeting at which a vote takes place, the Scheme is not approved by the requisite majorities of the Scheme Creditors specified in section 899(1) of the Companies Act;

(ii) on the earlier of the Scheme Settlement Date and the Longstop Date;

(iii) the Company gives the Noteholder or any other Noteholder written notice of an intention either:

(A) not to proceed with the Scheme; or

(B) to proceed with a proposed scheme of arrangement on terms which are different to the Scheme in any material respect;

(iv) the Noteholder sells, transfers, assigns or otherwise disposes of all of its Locked-up Notes in the manner permitted by paragraph (c) above; and

(v) if:

(A) the 5.5555% Bondholders vote against the proposals (to the extent related to the 5.5555% Bonds) contemplated in the relevant Proposed Restructuring Documents at the 5.5555% Bondholders Meeting;

(B) the 13% Bondholders vote against the proposals (to the extent related to the 13% Bonds) contemplated in the relevant Proposed Restructuring Documents at the 13% Bondholders Meeting; or

(C) the Preference Shareholders vote against the proposals (to the extent related to the Preference Shares) contemplated in the relevant Proposed Restructuring Documents at the Preference Shareholders Meeting.

(e) The Account Holder named below confirms that the Noteholder agrees and acknowledges to the Company that damages are not an adequate remedy for a breach of any of the undertakings set out in paragraph (b) and (c) above by it and specific performance and/or relief to compel performance are appropriate remedies for any such breach and any such remedies shall not be exclusive but shall be cumulative and in addition to any other remedies available to the Company.

(f) No undertaking set out in paragraph (b) above will prevent the Noteholder from buying Dated Notes (including Dated Notes which are not subject to a Lock-Up Arrangement) provided that the Account Holder named below confirms that the Noteholder undertakes to the Company that it will deliver an additional Account Holder Letter which will include the undertakings set out in paragraph (b) above in respect of such Dated Notes unless and to the extent that such Dated Notes are (i) held in custody for a third party; or (ii) (unless and to the extent that the Noteholder agrees otherwise) held or otherwise acquired by one or more of the Noteholder's proprietary trading desks when acting as a market maker.

SECTION 3: VOTING

A. Attendance at the Scheme Meeting

The Noteholder wishes:

Tick only ONE of the boxes below.

☐ to appoint the Chairman as its proxy to attend and vote on its behalf at the Scheme Meeting (*please now only complete paragraph B (Appointment of proxy and voting instructions to proxy) below*).

☐ to appoint a proxy (other than the Chairman) to attend and vote on its behalf at the Scheme Meeting (*please now only complete paragraph B (Appointment of proxy and voting instructions to proxy*) *below*).

☐ to attend and vote at the Scheme Meeting in person or by a duly authorised representative, if a corporation (*please now complete only paragraph C (Indication of voting intention) below*).

Section 3 (*Voting*) is continued on the next page.

B. Appointment of proxy and voting instructions to proxy

The Noteholder wishes to appoint (and the Account Holder is hereby authorised to appoint on its behalf):

Tick only ONE of the boxes below.

☐ Chairman; or (tick box if appropriate)

☐ the following individual (tick box if appropriate and fill in the details immediately below)

(Name):

(Address):

(Passport number):

_____

or failing him:

(Name): ("**Alternate 1**")

(Address):

(Passport number):

_____

or failing Alternate 1:

the Chairman

as its proxy and wishes its proxy to vote:

Tick only ONE of the boxes below.

☐ FOR the Scheme

☐ AGAINST the Scheme

C. Indication of voting intention

The Noteholder wishes to vote (and the Account Holder is hereby authorised to vote on its behalf) at the Scheme Meeting as follows. The Noteholder understands that this expression of intention is not binding and that it may vote as it sees fit at the Scheme Meeting (provided the authorised representative of a Noteholder wishing to attend the Scheme Meeting must bring his or her passport to the Scheme Meeting)

Tick only ONE of the boxes below.

☐ FOR the Scheme

☐ AGAINST the Scheme

PART 3: ADDITIONAL NEW ORDINARY SHARES OFFER

SECTION 1: ELECTION TO SUBSCRIBE

To participate in the Additional New Ordinary Shares Offer, this Part 3 Section 1 (*Election to Subscribe*) must be delivered to the Information Agent no later than the Voting Instruction Deadline. If you do not wish to participate in the Additional New Ordinary Shares Offer, please leave this Part 3 Section 1 (*Election to Subscribe*) blank.

The Account Holder named in Part 6 (*Execution of Account Holder Letter by Account Holder*) for itself hereby confirms to the Company, the Co-operative Group and the Information Agent that, in relation to the Dated Notes identified in Part 1 Section 2 (*Holding Details*) of this Account Holder Letter, the Account Holder has authority to make the elections and/or give the confirmations set out in Part 3 Section 1 (*Election to Subscribe*) below on behalf of the Noteholder. (select "yes" or "no" as appropriate).

Yes ☐

No ☐

Noteholders who wish to elect for Additional New Ordinary Shares pursuant to the Additional New Ordinary Shares Offer (described in Part B paragraphs 2.22 to 2.30 of the Explanatory Statement) and who procure that their Account Holder completes and returns this Part 3 Section 1 (*Election to Subscribe*) of the Account Holder Letter will be allotted Additional New Ordinary Shares in accordance with the terms of the Scheme on the Scheme Settlement Date.

Noteholders wishing to elect to subscribe for all or any of the Additional New Ordinary Shares pursuant to the Additional New Ordinary Shares Offer should ensure that an Account Holder Letter including a duly completed Part 3 Section 1 (*Election to Subscribe*) is received by the Information Agent no later than the Voting Instruction Deadline, after which time any election received will not be valid.

Any allotment of Additional New Ordinary Shares is subject to the eligibility confirmation being provided in Part 4 Section 2 (*Eligibility Confirmation*) in respect of the Noteholder or its Designated Recipient (as applicable) at the same time as this Part 3 (*Additional New Ordinary Shares Offer*) of the Account Holder Letter is delivered to the Information Agent.

Election in respect of Additional New Ordinary Shares

Election of Additional New Ordinary Shares is subject to a minimum number of 26,667 and a maximum number of 33,333,334 Additional New Ordinary Shares. Insert maximum number of Additional New Ordinary Shares elected below.

……Additional New Ordinary Shares with a subscription price of £3.75 each (insert number of New Ordinary Shares)

Irrespective of the number of Additional New Ordinary Shares elected for above, allotment of Additional New Ordinary Shares will be determined in accordance with Part B paragraphs 2.22 to 2.30 of the Explanatory Statement. To the extent that the number of Additional New Ordinary Shares allocated is less than the number elected for above, the consideration payable for the Additional New Ordinary Shares will be adjusted accordingly.

Allocation Payments for Additional New Ordinary Shares

The delivery and receipt of a valid Account Holder Letter with this Part 3 Section 1 (*Election to Subscribe*) duly completed constitutes an irrevocable offer to the Company by the relevant Noteholder to subscribe for

up to the maximum number of Additional New Ordinary Shares indicated above. The acceptance of this offer will be effected and evidenced by notification by the Company to the relevant Noteholder of the relevant Noteholder's allocation of Additional New Ordinary Shares in accordance with the terms of the Scheme.

The allocation of Additional New Ordinary Shares, the amount to be paid in respect of such allocation and instructions as to payments to be made to the Company in respect of any Additional New Ordinary Shares issued to a Noteholder or its Designated Recipient shall be notified to the Noteholder by the Company or the Information Agent on the date of the Scheme Meeting.

If this Part 3 Section 1 (*Election to Subscribe*) had been completed, Part 4 (*Scheme Consideration, Eligibility and Delivery of The Additional New Ordinary Shares*) must also be completed.

SECTION 2: ELECTION TO SUB-PURCHASE

To participate in the Sub-purchasing Offer, this Part 3 Section 2 (*Election to Sub-purchase*) must be received by the Information Agent no later than the Voting Instruction Deadline. If you do not wish to participate in the Sub-purchasing Offer, please leave this Part 3 Section 2 (*Election to Sub-purchase*) blank.

The Account Holder named below in Part 6 for itself hereby confirms to the Company, the Co-operative Group and the Information Agent that, in relation to the Dated Notes identified in Part 1 Section 2 (*Holding Details*) of this Account Holder Letter, the Account Holder has authority to make the elections and/or give the confirmations set out in this Part 3 Section 2 (*Election to Sub-purchase*) below on behalf of the Noteholder (select "yes" or "no" as appropriate for each item).

Yes ☐

No ☐

Noteholders who wish to elect to participate in the Sub-purchasing Offer (described in Part B paragraphs 2.33 to 2.46 of the Explantory Statement) and who procure that their Account Holder completes and returns this Part 3 Section 2 (*Election to Sub-purchase)* of the Account Holder Letter will be allocated a Sub-purchasing Commitment in accordance with the terms of the Scheme.

Noteholders wishing to elect to participate in the Sub-purchasing Offer should ensure that (i) an Account Holder Letter including a duly completed Part 3 Section 2 (*Election to Sub-purchase*) is received by the Information Agent no later than the Voting Instruction Deadline, after which time any election received will not be valid.

Any participation in the Sub-purchasing Offer is subject to the eligibility confirmation being provided in Part 4 Section 2 (*Eligibility Confirmation*) in respect of the Noteholder or its Designated Recipient (as applicable) at the same time this Part 3 Section 2 (*Election to Sub-purchase*) of the Account Holder Letter is delivered to the Information Agent.

Election in respect of the Sub-purchase of the Additional New Ordinary Shares Offer

Election to participate in the Sub-purchase of the Additional New Ordinary Shares Offer is subject to a commitment to purchase a minimum number of 26,667 and a maximum number of 33,333,334 Additional New Ordinary Shares. Insert maximum nominated Sub-purchasing Commitment below.

……..Additional New Ordinary Shares with a subscription price of £3.75 each (insert number of Additional New Ordinary Shares)

Irrespective of the above, allotment of the Sub-purchasing Commitment to purchase Additional New Ordinary Shares in accordance with the Sub-purchasing Offer will be determined as set out in Part B paragraphs 2.33 to 2.46 of the Explanatory Statement. The delivery and receipt of a valid Account Holder Letter with this Part 3 Section 2 (*Election to Sub-purchase*) duly completed constitutes an irrevocable offer to the Company by the relevant Noteholder to subscribe for up to the maximum commitment elected above. The acceptance of this offer will be effected and evidenced by the Company to the relevant Sub-purchaser by notification of the Sub-purchasing Commitment on or around the date of the Scheme Meeting.

Allocation Payments for Sub-purchase of Additional New Ordinary Shares Offer

The Company (or the Information Agent on behalf of the Company) will notify each Sub-purchaser of its Sub-purchasing Commitment and the amount by which the number of Additional New Ordinary Shares

subscribed for by the Noteholders in the Additional New Ordinary Shares Offer is less than 33,333,334 (if any) and the amount of Additional New Ordinary Shares required to be purchased by that Noteholder pursuant to its Sub-purchasing Commitment on the date of the Scheme Meeting.

If this Part 3 Section 2 has been completed, Part 4 must now also be completed.

PART 4: SCHEME CONSIDERATION, ELIGIBILITY AND DELIVERY OF THE ADDITIONAL NEW ORDINARY SHARES

IN ORDER TO RECEIVE SCHEME CONSIDERATION AND ADDITIONAL NEW ORDINARY SHARES IN ACCORDANCE WITH THE TERMS OF THE SCHEME ON THE SCHEME SETTLEMENT DATE AND IN ORDER TO PARTICIPATE IN THE SUB-PURCHASING OFFER THIS PART OF THE ACCOUNT HOLDER LETTER MUST BE DELIVERED BY POST, FACSIMILE OR EMAIL TO THE INFORMATION AGENT USING THE CONTACT DETAILS SET OUT ABOVE AND MUST BE RECEIVED BY THE INFORMATION AGENT BY NO LATER THAN THE VOTING INSTRUCTION DEADLINE.

SECTION 1: ELIGIBILITY AND DESIGNATED RECIPIENT

Requirement to complete Part 4 Section 2 (*Eligibility Confirmation*)

To be eligible to receive the Scheme Consideration, any Additional New Ordinary Shares pursuant to the Scheme, and to be eligible to participate in the Sub-purchasing Offer the Account Holder for itself and on behalf of the Noteholder (or, if the Noteholder has appointed a Designated Recipient, its Designated Recipient) must provide confirmation to the Company, the Co-operative Group, the Information Agent and the Holding Period Trustee that it and the Noteholder (or, if the Noteholder has appointed a Designated Recipient, its Designated Recipient) is an Eligible Person by confirming that it and the Noteholder (or, if the Noteholder has appointed a Designated Recipient, its Designated Recipient) is an "Eligible Person" in Part 4 Section 2 (*Eligibility Confirmation*) below.

Option to appoint Designated Recipient

If the Noteholder is unable to provide the confirmation in Part 4 Section 2 (*Eligibility Confirmation*) referred to above itself it may nominate a Designated Recipient that is an Eligible Person in order that the Scheme Consideration and/or the Additional New Ordinary Shares can be distributed to that Designated Recipient on behalf of the Noteholder **provided that** the account number of the Account Holder in respect of both the Noteholder **and** the Designated Recipient must be the same as that specified by the Account Holder in Part 6 (*Execution of Account Holder Letter by Account Holder*) below. The details of the Designated Recipient, if applicable, must be completed below.

Is the Noteholder unable to provide the confirmation in Part 4 Section 2 (*Eligibility Confirmation*) below and does it wish to nominate a Designated Recipient?

☐ No (Please now only complete Section 2)

☐ Yes (Please provide details below)

DESIGNATED RECIPIENT

Designated Recipient's Name

_____

Jurisdiction of incorporation _____

Address of Designated Recipient

_____

City _____

State _____

Postal Code_____

Country_____

Contact Name: _____

Telephone no. of Designated Recipient

_____

(with country code)

E-mail of Designated Recipient

_____

SECTION 2: ELIGIBILITY CONFIRMATION

This Part 4 Section 2 (*Eligibility Confirmation*) of this Account Holder Letter should be completed in all cases. If the Account Holder fails to tick one of the boxes below the Noteholder will be deemed an Unadmitted Noteholder and will not receive Scheme Consideration or any Additional New Ordinary Shares to which it would otherwise be entitled under the terms of the Scheme on the Scheme Settlement Date or participate in the Sub-purchasing Offer. For more details please see paragraphs 2.17, 2.24 and 2.36 of Part B (*Overview of the Scheme*) of the Explanatory Statement.

The Account Holder for itself confirms to the Company, Co-operative Group , the Information Agent and the Holding Period Trustee as follows (select "yes" or "no" as appropriate for each item):

A. That all authority conferred or agreed to be conferred pursuant to this part of the Account Holder Letter and every obligation of the Account Holder under this part of the Account Holder Letter shall be binding upon the successors and assigns of the Account Holder (in the case of a corporation or institution) or the successors, assigns, heirs, executors, administrators, trustees in bankruptcy and legal representatives of the Account Holder (in the case of a natural person) and shall not be affected by, and shall survive, the insolvency, bankruptcy, dissolution, death or incapacity (as the case may be) of the Account Holder and that all of the information in this part of the Account Holder Letter is complete and accurate.

☐ Yes

☐ No

B. That it has authority to (i) give the confirmation set out in this Part 4 Section 2 (*Eligibility Confirmation*) for itself and for the Noteholder (or, if the Noteholder has appointed a Designated Recipient, its Designated Recipient), (ii) identify the person who is to be the Designated Recipient of the Scheme Consideration and the Additional New Ordinary Shares (if applicable) and (iii) give, on behalf of the Noteholder or its Designated Recipient (as applicable), the confirmation and request set out in Part 4 Section 3 (*Delivery of Bank T2 Notes, New Ordinary Shares and The Additional New Ordinary Shares*).

☐ Yes

☐ No

An Account Holder who is unable to confirm "yes" in respect of paragraphs A and B above should contact the Information Agent or the Holding Period Trustee (as appropriate) using the contact details set out in this Account Holder Letter for assistance.

By ticking the box below marked "Yes", the Account Holder confirms that it and the Noteholder (or, if the Noteholder has appointed a Designated Recipient, its Designated Recipient) confirm, agree and represent or are deemed to have confirmed, agreed or represented the statements set out in paragraph 2 of Schedule 1 (*Representations, Warranties and Undertakings*) to this Account Holder Letter with or in favour of the Company, the Co-operative Group, the Information Agent and the Holding Period Trustee as at the date on

which this Account Holder Letter is received by the Information Agent or the Holding Period Trustee (as applicable), on the Voting Instruction Deadline (to the extent not already passed), on the Scheme Settlement Date (to the extent not already passed) and, to the extent the Scheme Settlement Date has already occurred, the date on which the Holding Period Trustee transfers the relevant Scheme Consideration to the Noteholder.

If the Account Holder is unable to give the confirmation referred to in the paragraph above, it may only tick the box below marked "No" below and should contact the Information Agent or the Holding Period Trustee using the contact details set out in this Account Holder Letter for assistance.

Eligible Person

☐ Yes

☐ No

SECTION 3: DELIVERY OF BANK T2 NOTES, NEW ORDINARY SHARES AND ADDITIONAL NEW ORDINARY SHARES

The Account Holder named below in Part 6 (*Execution of Account Holder Letter by Account Holder*) of this Account Holder Letter confirms, acknowledges and agrees to the Company, Information Agent and Holding Period Trustee that, subject to the eligibility confirmation set out in Part 4 Section 2 (*Eligibility Confirmation*) above having been provided, any Bank T2 Notes, New Ordinary Shares and Additional New Ordinary Shares to be delivered to the Account Holder (on behalf of the Noteholder or its Designated Recipient) as Scheme Consideration or in connection with the Additional New Ordinary Shares Offer or any Sub-purchase Commitment and any Sub-purchaser Premium payable to the Noteholder in connection with the Sub-purchasing Offer shall be delivered to the clearing system account referred to in Part 6 (*Execution of Account Holder Letter by Account Holder*) of this Account Holder Letter.

PART 5: DIRECTOR NOMINATIONS

The Account Holder named in Part 6 (*Execution of Account Holder Letter by Account Holder*) below for itself hereby confirms to the Company, the Co-operative Group and the Information Agent that, in relation to the Dated Notes identified in Part 1 Section 2 (*Holding Details*) of this Account Holder Letter, the Account Holder has authority to make the elections and/or give the confirmations set out in this Part 5 (*Director Nominations)* below on behalf of the Noteholder. (select "yes" or "no" as appropriate for each item).

Yes ☐

No ☐

As described in Part B paragraph 6 of the Explanatory Statement, the Company may publish a notice no later than 5 Business Days before the Scheme Meeting setting out details of two directors nominated by the Modified Scheme Purchasers (the **Nominated Directors**). The appointment of such Nominated Directors is subject to Noteholder approval as described in paragraph 6.3 of Part B of the Explanatory Statement. Noteholders who wish to vote for or against the appointment of one or both of the Nominated Directors should procure that their Account Holder completes and returns this Part 5 (*Director Nominations)* of the Account Holder Letter before the Voting Instruction Deadline. Alternatively, Noteholders may attend the Scheme Meeting to vote for or against the nomination of one or both of the Nominated Directors.

A. Attendance at the Director Appointment Meeting

The Noteholder wishes:

Tick only ONE of the boxes below.

☐ to appoint the Chairman as its proxy to attend and vote on its behalf on the appointment of the Nominated Directors at the Scheme Meeting (*please now only complete paragraph B (Appointment of proxy and voting instructions to proxy) below*).

☐ to appoint a proxy (other than the Chairman) to attend and vote on its behalf on the appointment of the Nominated Directors at the Scheme Meeting (*please now only complete paragraph B (Appointment of proxy and voting instructions to proxy*) *below*).

☐ to attend and vote on the appointment of the Nominated Directors at the Scheme Meeting in person or by a duly authorised representative, if a corporation (*please now complete only paragraph C (Indication of voting intention) below*).

B. Appointment of proxy and voting instructions to proxy

The Noteholder wishes to appoint (and the Account Holder is hereby authorised to appoint on its behalf):

Tick only ONE of the boxes below.

☐ Chairman; or (tick box if appropriate)

☐ the following individual (tick box if appropriate and fill in the details immediately below)

(Name):

(Address):

(Passport number):

_____

or failing him:

(Name): ("**Alternate 1**")

(Address):

(Passport number):

_____

or failing Alternate 1:

the Chairman

as its proxy and wishes its proxy to vote:

Nominee Director 1

Tick only ONE of the boxes below.

☐ FOR the appointment of Nominee Director 1

☐ AGAINST the appointment of Nominee Director 1

Nominee Director 2

Tick only ONE of the boxes below.

☐ FOR the appointment of Nominee Director 2

☐ AGAINST the appointment of Nominee Director 2

C. Indication of voting intention

The Noteholder wishes to vote as follows. The Noteholder understands that this expression of intention is not binding and that it may vote as it sees fit at the Scheme Meeting.

Nominee Director 1

Tick only ONE of the boxes below.

☐ FOR the appointment of Nominee Director 1

☐ AGAINST the appointment of Nominee Director 1

Nominee Director 2

Tick only ONE of the boxes below.

☐ FOR the appointment of Nominee Director 2

☐ AGAINST the appointment of Nominee Director 2

Please note: If you do not tick any box you will be deemed not to have attended the Scheme Meeting for the purposes of voting on the appointment of the Nominated Directors.

PART 6: EXECUTION OF ACCOUNT HOLDER LETTER BY ACCOUNT HOLDER

Full name of Euroclear or Clearstream Account Holder _____

_____

Account Number of Account Holder or Participant at Clearing System _____

Authorised Employee of Account Holder _____
(print name)

Department _____

Telephone no. of Authorised Employee (with country code) _____

E-mail of Authorised Employee _____

Authorised Employee Signature _____
(sign)

Date _____

Before returning this Account Holder Letter, please make certain that you have provided all the information requested.

By signing above, the Account Holder confirms that it has obtained all necessary consents, authorisations, approvals and/or permissions required to be obtained by it under the laws and regulations applicable to it in any jurisdiction in order to sign this Account Holder Letter on behalf of the Noteholder.

Before returning this Account Holder Letter or either part of this Account Holder Letter, please make certain that you have provided all the information requested.

Acceptance of Part 2 (*Voting and Lock-up*) of this Account Holder Letter by the Information Agent is subject to receipt by the Information Agent by no later than the Voting Instruction Deadline of valid Custody Instruction Reference Numbers in respect of the Dated Notes which are the subject of this Account Holder Letter. Custody Instructions must be delivered to Euroclear or Clearstream, Luxembourg, as the case may be, in respect of the Dated Notes identified in Part 1 Section 2 (*Holding Details*) of this Account Holder Letter as being held in one of those Clearing Systems prior to the Custody Instruction Deadline. Information in this Account Holder Letter must be consistent with such Custody Instructions and in the event of any ambiguity, the Custody Instructions shall take precedence.

Acceptance of Part 4 (*Scheme Consideration, Eligibility And Delivery Of The Additional New Ordinary Shares*) of this Account Holder Letter by the Information Agent or the Holding Period Trustee (as applicable) is subject to receipt by the Information Agent or the Holding Period Trustee (as applicable) of evidence satisfactory to it that the Noteholder held the Dated Notes to which Part 4 (*Scheme Consideration, Eligibility And Delivery Of The Additional New Ordinary Shares*) of this Account Holder Letter relates on the Record Date and that the Noteholder did not transfer the Dated Notes between the Record Date and the Scheme Settlement Date unless the Company, in its sole discretion, elected to recognise a transfer of Dated Notes after the Record Date.[5]

The Account Holder may complete and submit this Account Holder Letter or either part of this Account Holder Letter on behalf of the Noteholder if the Account Holder has authority to do so.

Facsimile or pdf copies of this Account Holder Letter will be accepted and originals are not required.

[5] For the purposes of determining priorities in the First Round Exception, if a valid Account Holder Letter is delivered to and received by the Information Agent in respect of a Noteholder (which has validly elected to participate in the Additional New Ordinary Shares Offer and/or the Sub-purchasing Offer) on whose behalf an Old Account Holder Letter has, prior to the delivery of that Account Holder Letter, been delivered to and received by the Information Agent (and not revoked), that Account Holder Letter will be deemed to have been received by the Information Agent on the date and at the time that the Old Account Holder Letter was received by the Information Agent.

SCHEDULE 1

REPRESENTATIONS, WARRANTIES AND UNDERTAKINGS

1. Voting Representations, Warranties and Undertakings

Each Noteholder which submits, delivers or procures the delivery of an Account Holder Letter represents, warrants and undertakes to the Company, the Co-operative Group and the Information Agent that:

(a) it is lawful to seek voting instructions from that Noteholder in respect of the Scheme;

(b) it is assuming all of the risks inherent in that Noteholder participating in the Scheme and has undertaken all the appropriate analysis of the implications of participating in the Scheme for that Noteholder without relying on the Company, the Co-operative Group, the Dealer Managers or the Information Agent (other than any representations or warranties given in favour of that Noteholder by the Company or the Co-operative Group (as the case may be) under any of the Bank T2 Notes Prospectus and Group Notes Prospectus and the Explanatory Statement and, if applicable, a Lock-up Agreement to which that Noteholder is a party);

(c) the Dated Notes which are the subject of the Account Holder Letter are, at the time of delivery of such Account Holder Letter held by it (directly or indirectly) or on its behalf at Euroclear or Clearstream, Luxembourg (and that Noteholder will use all reasonable endeavours to ensure that those Dated Notes will continue to be so held up to and including the Scheme Settlement Date (prior to their transfer in accordance with the terms of the Scheme);

(d) by instructing the relevant Clearing System, it will be deemed to have authorised the relevant Clearing System to provide details concerning its identity, the Dated Notes which are the subject of the Account Holder Letter delivered on its behalf and its applicable account details to the Company and the Information Agent and their respective legal and financial advisers at the time the Account Holder Letter is submitted;

(e) neither the Information Agent nor the Dealer Managers nor any of their Affiliates, directors, officers or employees has made any recommendation to that Noteholder as to whether, or how, to vote in relation to the Scheme, and that it has made its own decision with regard to voting based on any legal, tax or financial advice that it has deemed necessary to seek;

(f) all authority conferred or agreed to be conferred pursuant to these representations, warranties and undertakings shall be binding on the successors and assigns of that Noteholder (in the case of a corporation or institution) or the successors, assigns, heirs, executors, trustees in bankruptcy and legal representatives of that Noteholder (in the case of a natural person) and shall not be affected by, and shall survive, the insolvency, bankruptcy, dissolution, death or incapacity (as the case may be) of that Noteholder; and

(g) no information has been provided to it by the Company, the Co-operative Group, the Dealer Managers, the Information Agent or any of their respective Affiliates, directors, officers, advisers or employees with regard to the tax consequences to that Noteholder arising from voting in favour of the Scheme, and that it is solely liable for any taxes or similar payments imposed on it under the laws of any applicable jurisdiction as a result of voting in favour of the Scheme, and that it will not and does not have any right of recourse (whether by way of reimbursement, indemnity or otherwise) against the Company, the Co-operative Group, the Dealer Managers, the Information Agent or any of their Affiliates, directors, officers, advisers or employees in respect of such taxes or similar payments.

2. Eligibility

(a) The Account Holder and Noteholder (or, if the Noteholder has appointed a Designated Recipient, its Designated Recipient) each confirm, agree and represent with or in favour of the Company, the Co-operative Group, the Information Agent and the Holding Period Trustee that the offer to, issue to or subscription by it in respect of any New Ordinary Shares, Bank T2 Notes (and, if applicable, Additional New Ordinary Shares):

(i) would not be unlawful or prohibited under the laws or regulations of any applicable jurisdiction; and

(ii) would not, or would not be likely to result in the Company being required to comply with any filing, registration, disclosure or other onerous requirement in any jurisdiction where that person is a citizen or subject to the laws of or in which that person is domiciled or resident.

APPENDIX 4

NOTICE OF SCHEME MEETING

IN THE HIGH COURT OF JUSTICE **No. 7830 of 2013**
CHANCERY DIVISION
COMPANIES COURT

IN THE MATTER OF THE CO-OPERATIVE BANK P.L.C.

and

IN THE MATTER OF THE COMPANIES ACT 2006

€34,980,000 Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998)

£37,775,000 5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942)

£275,000,000 9.25% Subordinated Notes due April 2021 (ISIN: XS0620315902)

£8,747,000 Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984)

£235,402,000 7.875% Subordinated Notes due 2022 (ISIN: XS0864253868)

£200,000,000 5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183)

and

£150,000,000 5.875% Subordinated Notes due 2033 (ISIN: XS0145065602)

issued by the Company (together, the **Dated Notes**)

NOTICE IS HEREBY GIVEN that, by an order dated 4 December 2013 (varying an order made 18 November 2013) made in the above matter, the High Court of England and Wales (the **Court**) has directed that a meeting (the **Scheme Meeting**) be convened of the Scheme Creditors (as such term is defined in the scheme of arrangement hereinafter referred to) of The Co-operative Bank p.l.c. (the **Company**) for the purposes of considering and, if thought fit, approving (with or without modification, addition or condition approved or imposed by the Court and/or agreed by the Company) a scheme of arrangement proposed to be made between the Company and the Scheme Creditors (as amended on 4 December 2013, the **Scheme**).

The Scheme Meeting will be held at the offices of Allen & Overy LLP, One Bishops Square, London E1 6AD on 16 December 2013 commencing at 10 a.m. (London time). All Scheme Creditors are requested to attend at such place and time either in person, by a duly authorised representative if a corporation, or by proxy.

A copy of the Scheme and a copy of the statement required to be furnished pursuant to section 897 of the Companies Act 2006 (as amended on 4 December 2013, the **Explanatory Statement**) are incorporated in the document of which this notice forms part.

Scheme Creditors may vote in person or by a duly authorised representative if a corporation, at the Scheme Meeting or they may appoint another person, whether a Scheme Creditor or not, as their proxy to attend and vote in their place. Scheme Creditors may appoint proxies to vote at the Scheme Meeting by filling out section 3 (*Voting*) of the Account Holder Letter (as defined in the Explanatory Statement). If a Scheme

Creditor is a corporation, it must appoint an authorised representative or proxy to vote on its behalf at the Scheme Meeting by filling out section 3 (*Voting*) of the Account Holder Letter in order to be entitled to vote at the Scheme Meeting.

To avoid double counting, each of the trustees and the common depositaries for the Dated Notes has confirmed in writing that it will not exercise any voting rights to which it may be entitled as a Scheme Creditor.

Each Scheme Creditor or its proxy will be required to register its attendance at the Scheme Meeting prior to the commencement of the Scheme Meeting. Registration will commence at 8.00 a.m. (London time) on the date of the Scheme Meeting and each Scheme Creditor and proxy must be registered no later than one hour prior to the commencement of the meeting. Each Scheme Creditor that is not a proxy must bring to the Scheme Meeting a copy of the relevant Account Holder Letter, evidence of corporate authority (in the case of a corporation) (for example, a valid power of attorney and/or board minutes) and evidence of personal identity (for example, a passport or other picture identification). Each proxy must bring to the Scheme Meeting a copy of the Account Holder Letter authorising him or her to act as proxy on behalf of the Scheme Creditor and evidence of personal identity (for example, a passport or other picture identification).

In order to vote on the Scheme and attend the Scheme Meeting (in person, by a duly authorised representative if a corporation, or by proxy), Scheme Creditors must ensure that an Account Holder Letter is completed, delivered to and received by the Information Agent (as defined in the Explanatory Statement) (marked for the attention of Sunjeeve Patel / Yves Theis) in accordance with the instructions set out in the Account Holder Letter before 4.30 p.m. (London time) on 13 December 2013. A copy of the form of Account Holder Letter may be downloaded from *http://www.co-operative.coop/Bondholders* (the **Scheme Website**).

The Scheme, the Explanatory Statement and the Account Holder Letter will be available to download from the Scheme Website during the course of the afternoon on 4 December 2013 and thereafter. A letter from the Company dated 4 December 2013 explaining the amendments to the Scheme, the Explanatory Statement and the Account Holder Letter from the versions uploaded to the Scheme Website on or around 18 November 2013 (the **Amendment Letter**) is being sent to Scheme Creditors via the Clearing Systems (as defined in the Explanatory Statement) on the date of this notice and is also available to download from the Scheme Website. If a hard copy is required, please send your request to the Information Agent (marked for the attention of Sunjeeve Patel / Yves Theis). By the order referred to above, the Court has appointed Niall Booker or, failing him, Alistair Asher or, failing him, Mark Sterling or another partner of Allen & Overy LLP to act as chairman of the Scheme Meeting and has directed the chairman to report the result of the Scheme Meeting to the Court.

Any Scheme Creditor on whose behalf a valid account holder letter for the purposes of the version of the Explanatory Statement which was uploaded to the Scheme Website on or around 18 November 2013 which includes a valid election to participate in the Additional New Ordinary Shares Offer and/or the Sub-purchasing Offer (as each such term was defined in that version of this Explanatory Statement) (any such account holder letter, an **Old Account Holder Letter**) has been delivered to and received by the Information Agent on or before the date of this notice should read carefully the changes to the Additional New Ordinary Shares Offer (as defined in the Explanatory Statement) described in the Amendment Letter (including the blackline of changed pages to the Explanatory Statement from the version uploaded to the Scheme Website on or around 18 November 2013).

Any Old Account Holder Letter delivered to the Information Agent will have no effect. However, if a valid Account Holder Letter is delivered to and received by the Information Agent before 4.30 pm (London time) on 13 December 2013 in respect of a Scheme Creditor on whose behalf an Old Account Holder Letter has, prior to the delivery of that Account Holder Letter, been delivered to and received by the Information Agent (and not revoked), that Account Holder Letter will be deemed to have been received by the Information Agent on the date and at the time that the Old Account Holder Letter was received by the Information Agent.

The Scheme will be subject to the subsequent approval of the Court.

For further information in this regard, please contact the Information Agent using the following contact details:

Lucid Issuer Services Limited
Leroy House
436 Essex Road
London
N1 3QP
Attention: Sunjeeve Patel / Yves Theis
Telephone: +44 20 7704 0880
Email: co-op@lucid-is.com
Facsimile: +44 20 7067 9098

Dated 4 December 2013

The Co-operative Bank p.l.c.

APPENDIX 5

NOTICE OF DIRECTOR NOMINATION RESOLUTION

THE CO-OPERATIVE BANK P.L.C. (REGISTERED NUMBER 990937)

€34,980,000 Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998)

£37,775,000 5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942)

£275,000,000 9.25% Subordinated Notes due April 2021 (ISIN: XS0620315902)

£8,747,000 Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984)

£235,402,000 7.875% Subordinated Notes due 2022 (ISIN: XS0864253868)

£200,000,000 5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183) and

£150,000,000 5.875% Subordinated Notes due 2033 (ISIN: XS0145065602)

issued by The Co-operative Bank p.l.c. (the **Company**)

Reference is made to the notice dated 4 December 2013 (the **Scheme Meeting Convening Notice**) of the convening of a meeting of a single class of Scheme Creditors that has been ordered by the Court for the purposes of considering and, if thought fit, approving the scheme of arrangement proposed to be made between the Company and the Scheme Creditors referred to in the Scheme Meeting Convening Notice (the **Scheme**). Capitalised terms used in this notice have the meanings given to those terms in the Explanatory Statement (as defined in the Scheme Meeting Convening Notice).

NOTICE IS HEREBY GIVEN THAT, at the Scheme Meeting, although not a term of the Scheme, the Scheme Creditors may be asked to consider and, if thought fit, approve the nomination for appointment to the board of up to two persons (the **Nominated Directors**). In the event that the Modified Scheme Purchasers notify the Company of a person or persons to be designated as the Nominated Directors at least 7 Business Days prior to the Scheme Meeting the Company will notify the Noteholders of the Nominated Directors no later than 5 Business Days prior to the Scheme Meeting by the issue of an announcement to each Noteholder through the relevant Clearing System and on the Scheme Website at *http://www.cooperative.coop/Bondholders*.

The Company has agreed to procure the appointment of each Nominated Director, if its appointment is approved by a separate resolution of the Noteholders. A majority in number representing at least 75 per cent. in value of the Noteholders present and voting in person or by proxy will be required to approve the appointment of each Nominated Director. If a Nominated Director or Nominated Directors are notified in accordance with the preceding paragraph the vote on these separate resolutions will take place at the Scheme Meeting following and independently of the vote in respect of the Scheme.

Noteholders are requested to refer to pages 62 to 63 of the Explanatory Statement for more information and instructions on how to vote on the resolutions or to contact the Information Agent on the contact details in the Scheme Meeting Convening Notice.

The Scheme may be approved by the requisite majorities of Scheme Creditors at the Scheme Meeting and be sanctioned by the Court at the Scheme Sanction Hearing and become effective in accordance with its terms, irrespective of whether either resolution to appoint the Nominated Directors is passed.

Dated 4 December 2013

The Co-operative Bank p.l.c.

APPENDIX 6

ILLUSTRATIVE ADDITIONAL NEW ORDINARY SHARES ALLOCATION MODEL

The information set out in this Appendix is illustrative only and is being provided by way of an example to assist Noteholders when reviewing the descriptions of the calculation methodology to be used to allocate the Additional New Ordinary Shares to Subscribing Noteholders as set out in paragraph 2.30 of Part B of this Explanatory Statement.

The illustrative allocation model set out below has been prepared on the basis of the following assumptions:

(a) Seven (7) Noteholders wish to participate in the Additional New Ordinary Shares Offer i.e there are seven (7) Subscribing Noteholders.

(b) Two (2) Subscribing Noteholders (Subscribing Noteholders #2 and #4) have made the Minimum Election (26,667 Additional New Ordinary Shares).

(c) The Subscription Amounts for the remaining five (5) Subscribing Noteholders range from 4,250,000 (Subscribing Noteholder #6) to 11,500,000 Additional New Ordinary Shares (Subscribing Noteholder #5).

(d) The Total Subscription Amount is 33,678,334 Additional New Ordinary Shares i.e. the Additional New Ordinary Shares Offer is oversubscribed.

(e) The Scheme Consideration Calculation Amounts of the Subscribing Noteholders range from £2,002,520.55 (Subscribing Noteholder #4) to £75,279,696.13 (Subscribing Noteholder #3).

(f) The aggregate Scheme Consideration Calculation Amounts of all Subscribing Noteholders is £210,892,266.36.

Additional New Ordinary Shares	33,333,334							
Subscribing Noteholder	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**Total**
Nominal								
Face Value	€10,000,000	£5,000,000	£75,000,000	£2,000,000	£5,000,000	£50,000,000	£60,000,000	
Face Value (£)	£8,564,400	£5,000,000	£75,000,000	£2,000,000	£5,000,000	£50,000,000	£60,000,000	**£205,564,400**
Scheme Consideration Calculation Amount	£8,569,618.10	£5,202,808.22	£75,279,696.13	£2,002,520.55	£5,286,369.86	£53,840,410.96	£60,710,842.54	**£210,892,266.36**
Subscription for Shares								
Subscription Amount	4,250,000	26,667	7,500,000	26,667	11,500,000	4,250,000	6,125,000	**33,678,334**
Round #1 Allocation								
Min. Election?	NO	YES	NO	YES	NO	NO	NO	
Total First Round Allocation	0	26,667	0	26,667	0	0	0	**53,334**
Unallocated Subscription Amount	4,250,000	0	7,500,000	0	11,500,000	4,250,000	6,125,000	**33,625,000**
Remaining Additional New Ordinary Shares								**33,280,000** NEXT ROUND
Round #2 Allocation								
Remaining Subscription Amount	4,250,000	0	7,500,000	0	11,500,000	4,250,000	6,125,000	**33,625,000**
Scheme Consideration Calculation Amount	£8,569,618.10	£0.00	£75,279,696.13	£0.00	£5,286,369.86	£53,840,410.96	£60,710,842.54	**£203,686,937.59**
Allocation Ratio	0.042	0.000	0.370	0.000	0.026	0.264	0.298	
Multiple Lowest Bidders?	1	0	0	0	0	1	0	**YES**
Total Second Round Allocation	16,078,433	16,078,433	16,078,433	16,078,433	16,078,433	16,078,433	16,078,433	
Pro-forma Share Allocation	676,459	0	5,942,352	0	417,290	4,250,000	4,792,330	**16,078,431**
Shares Allocated	676,459	0	5,942,352	0	417,290	4,250,000	4,792,330	**16,078,431**
Excess to Pro-forma Share Allocation	0	0	0	0	0	0	0	**0**
Unallocated Subscription Amount	3,573,541	0	1,557,648	0	11,082,710	0	1,332,670	**17,546,569**
Remaining Additional New Ordinary Shares								**17,201,569** NEXT ROUND
Round #3 Allocation								
Remaining Subscription Amount	3,573,541	0	1,557,648	0	11,082,710	0	1,332,670	**17,546,569**
Scheme Consideration Calculation Amount	£8,569,618.10	£0.00	£75,279,696.13	£0.00	£5,286,369.86	£0.00	£60,710,842.54	**£149,846,526.63**
Allocation Ratio	0.057	0.000	0.502	0.000	0.035	0.000	0.405	
Multiple Lowest Bidders?	0	0	0	0	0	0	1	**NO**
Total Third Round Allocation	3,289,296	3,289,296	3,289,296	3,289,296	3,289,296	3,289,296	3,289,296	
Pro-forma Share Allocation	188,112	0	1,652,472	0	116,041	0	1,332,670	**3,289,295**
Shares Allocated	188,112	0	1,557,648	0	116,041	0	1,332,670	**3,194,471**
Excess to Pro-forma Share Allocation	0	0	94,824	0	0	0	0	**94,824**
Unallocated Subscription Amount	3,385,429	0	0	0	10,966,669	0	0	**14,352,098**
Remaining Additional New Ordinary Shares								**14,007,098** NEXT ROUND
Round #4 Allocation								
Remaining Subscription Amount	3,385,429	0	0	0	10,966,669	0	0	**14,352,098**
Scheme Consideration Calculation Amount	£8,569,618.10	£0.00	£0.00	£0.00	£5,286,369.86	£0.00	£0.00	**£13,855,987.96**
Allocation Ratio	0.618	0.000	0.000	0.000	0.382	0.000	0.000	
Multiple Lowest Bidders?	1	0	0	0	0	0	0	**NO**
Total Fourth Round Allocation	5,473,810	5,473,810	5,473,810	5,473,810	5,473,810	5,473,810	5,473,810	
Pro-forma Share Allocation	3,385,429	0	0	0	2,088,381	0	0	**5,473,810**
Shares Allocated	3,385,429	0	0	0	2,088,381	0	0	**5,473,810**
Excess to Pro-forma Share Allocation	0	0	0	0	0	0	0	**0**
Unallocated Subscription Amount	0	0	0	0	8,878,288	0	0	**8,878,288**
Remaining Additional New Ordinary Shares								**8,533,288** NEXT ROUND
Round #5 Allocation								
Remaining Subscription Amount	0	0	0	0	8,878,288	0	0	**8,878,288**
Scheme Consideration Calculation Amount	£0.00	£0.00	£0.00	£0.00	£5,286,369.86	£0.00	£0.00	**£5,286,369.86**
Allocation Ratio	0.000	0.000	0.000	0.000	1.000	0.000	0.000	
Multiple Lowest Bidders?	0	0	0	0	1	0	0	**NO**
Total Fifth Round Allocation	8,533,288	8,533,288	8,533,288	8,533,288	8,533,288	8,533,288	8,533,288	
Pro-forma Share Allocation	0	0	0	0	8,533,288	0	0	**8,533,288**
Shares Allocated	0	0	0	0	8,533,288	0	0	**8,533,288**
Excess to Pro-forma Share Allocation	0	0	0	0	0	0	0	**0**
Unallocated Subscription Amount	0	0	0	0	345,000	0	0	**345,000**
Remaining Additional New Ordinary Shares								**0** STOP
Total Additional New Ordinary Shares Issued								
Total Allocation Amount	4,250,000	26,667	7,500,000	26,667	11,155,000	4,250,000	6,125,000	**33,333,334**
Subscription Price	£15,937,500.00	£100,001.25	£28,125,000.00	£100,001.25	£41,831,250.00	£15,937,500.00	£22,968,750.00	**£125,000,002.50**

APPENDIX 7

RESOLUTION ANALYSIS

1. Purpose of this resolution analysis

The purpose of the resolution analysis contained in this Appendix 7 (*Resolution Analysis*) is to assist Noteholders in determining whether or not to vote in favour of the Scheme or otherwise participate in the Liability Management Exercise. The resolution analysis compares the position which Noteholders would be likely to face if the Company were resolved on 31 December 2013 with the position for Noteholders if the Liability Management Exercise is successfully implemented, to assist Noteholders in deciding whether or not to vote in favour of the Scheme or otherwise to participate in the Liability Management Exercise.

The Bank of England and HM Treasury (the **Resolution Authorities**) have wide discretionary powers as to how to effect a resolution of the Company. Analysing the position of Noteholders following resolution of the Company is therefore subject to a number of uncertainties and Noteholders should take careful note of the significant limitations and uncertainties set out in section 5 below.

2. Why participate in the Liability Management Exercise?

The Company believes that if the Liability Management Exercise were to fail this would result in the Company being subject to a resolution procedure under the Banking Act. If, following resolution, the Company goes into an insolvency proceeding, the Company believes, on the basis of the hypothetical analysis described in section 5 (*The Insolvency Analysis*) below, that Noteholders would receive no dividend at all in that insolvency proceeding and no compensation, whether directly or indirectly, as a result of the resolution. The Company also believes that there is fundamental uncertainty as to whether the Company could be resolved a going concern without the active support of Co-operative Group and a substantial amount of additional capital, as described in section 8 (*Could the Company be resolved as a going concern?*) below.

If the Liability Management Exercise is successfully completed the Noteholders will be entitled to receive the Bank T2 Notes and the New Ordinary Shares (together with the opportunity to participate in the Additional New Ordinary Shares Offer), the 5.5555% Bondholders will receive the Exchange Offer Bank T2 Notes (together with a cash amount equal to the accrued and unpaid interest on the 5.5555% Bonds) and the 13% Bondholders and the Preference Shareholders will have the choice to receive either Final Repayment Notes or cash consideration payable in instalments (represented by Instalment Repayment Notes (together with a cash amount equal to the accrued and unpaid dividends on the Preference Shares or interest on the 13% Bonds (as the case may be)) (in each case subject to compliance with the relevant procedures described in this Explanatory Statement, in the case of the Noteholders, and the Offer Memorandum, in the case of the Preference Shareholders, 5.5555% Bondholders and 13% Bondholders and depending on the extent of their participation in the Liability Management Exercise) (the **Restructuring Consideration**).

3. What happens if the Liability Management Exercise is successfully completed?

If the Liability Management Exercise is successfully completed each Noteholder, Preference Shareholder, 5.5555% Bondholder and 13% Bondholder will be entitled to receive, for each £1,000 nominal of Existing Securities which it holds, the amount of Restructuring Consideration described in the relevant table set out in paragraph 2 "Summary Offering Tables" of Part C (*Overview of the Liability Management Exercise*) of this Explanatory Statement.

New debt securities

For details of the terms of the Bank T2 Notes see the description in paragraph 2.10 of Part B (*Scheme Consideration*) of this Explanatory Statement (including the sections of the Bank T2 Notes Prospectus referred to therein) and for a summary of the associated risk factors relating to these securities see Part D (*Risk Factors*) of this Explanatory Statement (including the sections of the Bank T2 Notes Prospectus referred to therein).

The value of the Bank T2 Notes (and the Final Repayment Notes and Instalment Repayment Notes) are shown in the tables referred to above at nominal (face) value for illustrative purposes and should not be taken as a guide to the market value of these securities following the successful implementation of the Liability Management Exercises.

New Ordinary Shares in the Company

There is currently no public trading market for the New Ordinary Shares and the Additional New Ordinary Shares and there can be no certainty as to the development or liquidity of any market for the New Ordinary Shares and the Additional New Ordinary Shares. Noteholders should therefore determine for themselves, based on the information set out in the Explanatory Statement (including the sections of the Bank T2 Notes Prospectus referred to therein), the value to be ascribed by them to the New Ordinary Shares and the Additional New Ordinary Shares.

4. What is the likely outcome for Noteholders if the Liability Management Exercise is not successfully completed?

Stabilisation powers of Bank of England and HM Treasury

As a preliminary point, regulatory policy (see, for example, Bank of England and FSA joint paper entitled "A review of requirements for firms entering into or expanding in the banking sector", March 2013 at pages 5, 9 and 13) is that if a bank is no longer able to survive as a going concern, the bank should be allowed to fail. That is to say, while both the payments system and insured depositors will be protected, there should be no bail out of a bank. In other words, public funds will not be made available in order to resolve a bank.

The stabilisation powers in relation to the Company available to the Bank of England and HM Treasury, once the relevant conditions are satisfied are as follows:

(a) to sell all or part of the business of the Company to a commercial purchaser;

(b) to transfer all or part of the business of the Company to a company which is wholly owned by the Bank of England; or

(c) to take the Company into temporary public ownership.

HM Treasury may only exercise the Temporary Public Ownership power if the exercise for that power is necessary:

(i) to resolve or reduce a serious threat to the stability of the financial systems of the United Kingdom; or

(ii) to protect the public interest, where HM Treasury have provided financial assistance in respect of the Company for the purpose of resolving or reducing a serious threat to the stability of the financial systems of the United Kingdom. HM Treasury have not provided any such financial assistance so this would not be applicable.

If the Resolution Authorities exercise a stabilisation power, HM Treasury must make an order which establishes a regime for compensation in respect of the resolution although there is nothing to prevent the application of the valuation principles in such an order establishing a scheme for compensation from resulting in no compensation being payable.[7] A compensation scheme order will provide for a transferor to be paid compensation or provide for a scheme to determine whether a transferor should be paid compensation and will establish a scheme for paying any such compensation. A compensation scheme order may provide for the amount of any compensation payable to be determined by an independent valuer appointed in accordance with the order and may specify principles to be applied in determining the amount of compensation.

A resolution fund order is an order establishing a scheme under which transferors become entitled to the proceeds of the disposal of things transferred in specified circumstances and to a specified extent.

A third party compensation order provides for compensation to be paid to persons other than transferors. A third party compensation order must provide that the independent valuer must assess the treatment (the **Insolvency Treatment**) which pre-transfer creditors would have received had the Company entered into insolvency immediately prior to the time at which it was resolved. The independent valuer must assess the treatment (the **Actual Treatment**) which pre-transfer creditors have received, are receiving or are likely to receive if no compensation is paid. If the independent valuer considers that, in relation to any pre-transfer creditor, the Actual Treatment is less favourable than the Insolvency Treatment, the independent valuer must determine that compensation is paid to that pre-transfer creditor. The amount of compensation must be determined by reference to the difference in treatment and on the basis of the fair and equitable value of that difference in treatment.

The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities are exchanged or sold pursuant to the Liability Management Exercise.

As stated in the June Announcement, Co-operative Group and the Company believe that the Recapitalisation Plan, of which the Liability Management Exercise forms an integral part, is in the long-term interests of their respective stakeholders and of the Company itself.

Absent the support of sufficient Noteholders, to approve the proposals being made in the Scheme, the Scheme and therefore the Liability Management Exercise will fail.

The uncertainty around the implementation of the Recapitalisation Plan constitutes a material uncertainty which casts significant doubt on the Company's ability to continue as a going concern. The Company's Interim Financial Information, therefore, included an emphasis of matter as to the Company's ability to continue as a going concern (see note 2 to the Interim Financial Information for further details of the going concern position of the Company contained in part B in section 16 (*Financial Information*) at page 289 of the Bank T2 Notes Prospectus.

Given the discretionary nature of the powers available to the Resolution Authorities under the Banking Act, the Company is unable to predict with certainty the precise outcome for Noteholders if the Scheme and the Liability Management Exercise are not successfully implemented during 2013. However, the Company has no other source available to it to raise the required additional capital. As stated in the Company's Interim Financial Information, if the Liability Management Exercise is not successfully implemented, the Company will cease to be a going concern and, as a result, the Company is likely to fail to satisfy its threshold conditions for authorisation (within the meaning of Section 55B of FSMA) and the relevant Resolution Authority may then exercise a stabilisation power under the Banking Act. These threshold conditions include a requirement that the PRA is

[7] Valuation principles under a compensation scheme order may require or permit an independent valuer to make assumptions such as, for example, that the Company has had its regulatory permissions varied or cancelled, is unable to continue as a going concern, is in administration or is being wound up.

satisfied that the Company, in particular, has appropriate financial and non-financial resources, including that the Company has made appropriate provision for its liabilities. In addition, the Resolution Authorities may also exercise their powers to resolve the Company even if it remains a going concern.

If the Liability Management Exercise is not successfully implemented on or before 31 December 2013, the Company therefore considers that the PRA would have a basis for determining that the Company is failing, or is likely to fail, to satisfy its threshold conditions; that the power of the Resolution Authorities to exercise stabilisation powers under the Banking Act had arisen; and the Company believes it would be subject to a resolution procedure under the Banking Act. The Company therefore believes that there are only two realistic outcomes for the Company, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Company ceasing to be a going concern and, as such, the Company considers it likely that the Company would be subject to a resolution procedure under the Banking Act.

For further details of the risks of the Liability Management Exercise, see Part D (*Risk Factors*) of this Explanatory Statement (including the sections of the Bank T2 Notes Prospectus referred to therein).

5. The insolvency analysis

In order to form a view as to whether it is likely, if the Company went into a hypothetical insolvency process following its resolution, that there would be any return to Noteholders as a result of that process, the Company has prepared an insolvency analysis.

The insolvency analysis represents an illustrative estimate of insolvency values and recovery percentages based upon hypothetical insolvency proceedings for the Company commenced on 31 December 2013. The insolvency analysis is based on the balance sheet contained in the Interim Financial Information.

Insofar as insolvency might be an event that occurs in the future, the ultimate returns to Noteholders will be determined by a series of complex circumstances relevant at the time of the insolvency. There may be unforeseen events, changes in economic conditions and many other potential variables that could impact on and change the actual outcome of an insolvency process.

The Company has prepared the insolvency analysis on the basis of assumptions which the Directors believe are reasonable in the circumstances. However, the assumptions are subject to significant uncertainties which are beyond anyone's control, and unanticipated events and circumstances might materially affect the anticipated results.

Neither the assumptions nor the numbers generated in the insolvency analysis have been audited. While the insolvency values are presented with some specificity (albeit within a range), the actual results achieved would in all likelihood vary, and could vary in ways that may be material. Accordingly, there can be no assurance that the assumptions employed in determining the insolvency value of the assets will result in accurate estimations of such insolvency values.

None of the Company, its Directors or advisers makes any representation or warranty that the actual results for Noteholders upon an insolvency of the Company would or would not approximate to the financial outcomes described below.

Nothing in this Appendix 7 (*Resolution Analysis*) constitutes a valuation. Where present values for different scenarios are shown they are provided for illustrative purposes only and are subject to assumptions set out in this Appendix 7 (*Resolution Analysis*).

Estimated outcomes

Subject to the caveats and assumptions set out in this Appendix 7 (*Resolution Analysis*), the Company believes that the return to the Company's senior unsecured creditors from a bank insolvency procedure or administration of the Company would be in the range of 91.5% and that Noteholders would receive no recovery at all in such an administration or bank insolvency procedure because their claims are subordinated to the claims of the senior unsecured creditors of the Company.

The insolvency analysis indicates that there would be approximately £32.4 billion of estimated net recoveries (after secured creditor claims and costs) and approximately £37.3 billion of total senior unsecured creditors. Realisations in the insolvency procedure would therefore need to increase by over £3.1 billion in order for senior unsecured creditors to recover the full principal amount of their claims.

Key insolvency analysis assumptions

(a) Insolvency procedures available for the Company include a bank insolvency procedure, a bank administration procedure (both provided for under the Banking Act), a liquidation or an administration (both provided for under the Insolvency Act 1986). Under an administration pursuant to the Insolvency Act 1986, an administrator has powers to make distributions to creditors (a distributing administration). For the purposes of the insolvency analysis the Company has assumed that the relevant insolvency procedure is either a bank insolvency procedure or a distributing administration. The Company considers that the likely strategy of the insolvency office holder and the likely outcome for creditors would be similar under either procedure.

(b) Any surplus realisations remaining after payment of the debts proved by senior unsecured creditors would be applied in the insolvency procedure in payment of the debts proved by subordinated creditors in respect of the Dated Notes before being applied in payment of interest, whether on the debts proved by the senior unsecured creditors or on the debts proved by the Noteholders.

(c) Under a bank insolvency procedure the liquidator has two statutory objectives:

  (i) to work with the FSCS so as to ensure that as soon as reasonably practicable each eligible depositor has the relevant account transferred to another institution or it receives payment from the FSCS; and

  (ii) to wind up the affairs of the bank so as to achieve the best result for the bank's creditors as a whole.

In relation to the second statutory objective, the Company considers that the best results for its creditors as a whole would not be achieved through a fire sale on day 1 of the process which would flood the market and drive down pricing. At the opposite end of the scale, a very long term run-off may result in higher nominal recoveries but it is likely to result in significant cost inefficiencies and not achieve the best result for creditors as a whole taking into account the cost of funding of the creditors. The Company considers that the best result will lie somewhere in between and in practice would anticipate the insolvency office holder's strategy to be a combination of medium term run-off combined with regular portfolio sales. In particular, a bank liquidator would be influenced as to strategy by his creditors committee which would include the FSCS who would be the majority creditor (following its pay out to eligible depositors), Hence, maximising return for the Company's creditors as a whole would need to take account of the FSCS's cost of funding relating to the

depositor payments it has made. The Company understands that this is likely to be "market rate" funding cost.

The result in an administration would be similar. An administrator must submit his proposals to a creditors' meeting which may approve them without modification or approve them with modifications to which the administrator consents. An administrator has a responsibility to have regard to the views of the creditors and is entitled to give considerable weight to the views of a substantial majority of creditors about how to proceed.

The Company has therefore assumed for the purposes of the insolvency analysis a five year run off and a sale of the rump at the end of year five. The Company considers that this five year period is appropriate by reference to loan repayment profiles and economic factors and that it does not appear inconsistent with relevant precedents.

6. Would Noteholders be entitled to compensation as a result of a resolution of the Company?

Noteholders would, except in the circumstances referred to in section 8 below, be third parties for the purposes of the compensation regime which must be established by HM Treasury pursuant to the Banking Act. The independent valuer appointed pursuant to any third party compensation order must apply the principles set out in section 4 above. Applying these principles to the insolvency analysis set out in section 5, under the Insolvency Treatment, no Noteholder would be entitled to any recovery at all in the hypothetical insolvency process for the Company and the Actual Treatment cannot therefore be less favourable than the Insolvency Treatment in this case. There is therefore no basis on which Noteholders would be entitled to compensation under an order made pursuant to the Banking Act as a result of a resolution of the Company.

7. Could the Company be entitled to compensation as a result of its resolution?

If a resolution of the Company involves a transfer of all or part of its assets or liabilities, the Company will be entitled to claim compensation as a transferor under the compensation regime which must be established by HM Treasury. The Company believes that the most likely circumstances in which compensation may be payable to it as a transferor would be either if all or part of its assets were transferred at an undervalue (in which case it would be entitled to claim under a scheme compensation order) or if the assets which were transferred were subsequently realised (in which case it may be able to claim under a resolution fund order).

Although the Resolution Authorities have wide discretionary powers and although the Company is not waiving or abrogating any right to claim compensation as a transferor in the event of its resolution, the Company is not aware of any circumstances which would lead it to believe that it would be able to recover compensation following its resolution either at all or of an amount which would result in an indirect return to Noteholders.

8. Could the Company be resolved as a going concern?

Under Section 19 of the Banking Act, the Resolution Authorities have a power (the **Section 19 Power**), in connection with an order for the resolution of the Company, to make an order converting securities from one class to another. The extent of the Section 19 Power has not been tested, but the Company believes that this power may permit the Resolution Authorities to order that the Existing Securities are converted into New Ordinary Shares of the Company in connection with its resolution.

Even if the Section 19 Power were capable of being exercised in this manner, the Company considers that there is material uncertainty whether the Company would be capable of continuing as a going concern following the exercise of the Section 19 Power in this manner. The Recapitalisation Plan for the Company requires the Company to hold additional Common Equity Tier 1 Capital of at

least £1.5 billion by the end of 2014. If the Section 19 Power were exercised, the conversion of the Existing Securities into ordinary shares of the Company would produce Common Equity Tier 1 Capital of approximately £1.23 billion for the Company, which is less than the £1.5 billion minimum requirement imposed by the PRA by the end of 2014. The Company also considers it likely that, if the Section 19 Power were to be used, the PRA would determine that a larger amount of capital would be required to be held by the Company in order to ensure market confidence and reduce the risks of a second resolution.

It is possible, although the extent of this power is also untested, that the PRA may have power under section 192(C) of FSMA to direct CBGL, as a qualifying parent undertaking, to contribute all or any of its shares in CIS General Insurance, the proceeds of sale of CIS General Insurance and/or the deferred consideration payable to CBGL for the sale of its shares in Co-operative Life Insurance and Asset Management, for the purpose of increasing the capital of the Company. However, even if the PRA were, successfully, to exercise its power under section 192(C) of FSMA in this way, both the timing for receipt of the proceeds of sale of CIS General Insurance and Co-operative Life Insurance and Asset Management and the quantum of the proceeds are uncertain. Furthermore, the trustees of Pace have a guarantee from CIS General Insurance for the liabilities of that scheme, which would need to be released as part of the sale process. It is therefore uncertain how much, if any, proceeds will be generated by CBGL from disposal of CIS General Insurance as a result of this requirement. It is therefore uncertain whether the capital generated from the exercise of the Section 19 Power together with the capital generated from the exercise of this power would produce total Common Equity Tier 1 Capital for the Company of £1.5 billion by the end of 2014, or that this would generate sufficient total capital for the Company to continue to operate as a going concern with the total capital required by the PRA.

Further, there is no certainty that if the Company were to be recapitalised in this manner, without the agreement of Co-operative Group, that it would continue to enjoy the support of Co-operative Group. See the risk factors titled "*The Bank will continue to rely on Co-operative Group and the Co-operative brand. Co-operative Group will also continue to exert substantial influence over the Bank*", "*The Bank's operations are highly dependent on the proper functioning of IT and communication systems. Any significant delay in or failure of the Bank to re-engineer its existing IT platform to meet the requirements of its business strategy may adversely affect the future operational and financial performance of the business*", "*The Bank relies on the provision of a number of services (including certain critical functions) by Co-operative Group, including IT*" and "*The Bank is dependent on third party providers of services, IT, software, data and other assets*" in section 2 (*Risk Factors*) at pages 76 to 80 of the Bank T2 Notes Prospectus.

As an alternative, it is possible that the powers of the Resolution Authorities extend to an ability to convert all or part of the £892 million outstanding amount of senior unsecured bonds issued by the Company (**Senior Bonds**) into another class of securities. If the Resolution Authorities concluded that they could exercise their power in this manner it would be possible for sufficient capital to be generated to enable the Company to be resolved as a going concern by converting sufficient Senior Bonds to make up the deficit between the amount of Common Equity Tier 1 Capital generated by converting the Existing Securities and the amount of total capital which the Company requires. However, the Company is not aware whether or not the Resolution Authorities are contemplating the exercise of this power in this manner.

The Company therefore considers that there are material uncertainties as to whether the Company could be successfully resolved under the current terms of the Banking Act such that the Company itself remained a going concern.

In October 2013 HM Treasury published a briefing (the **Treasury Briefing**) on proposed treasury amendments to the Banking Act to introduce a bail in power (the **Proposed Bail in Power**). The Company understands that the Proposed Bail in Power is due to become law in the first quarter of

2014. The Treasury Briefing contains detailed drafting amendments to the Banking Act which would be needed in order to implement the Proposed Bail in Power. It would, in principle, be open to HM Government to introduce the Proposed Bail in Power as emergency legislation so that it was available to resolve the Company should this become necessary. The Proposed Bail in Power includes the power to make an order which contains a provision for cancelling, modifying or changing the form of a liability owed by the Company, which includes the power to convert a debt security into an equity security. The Treasury Briefing notes that exercise of powers in the course of a bail in should in general respect the creditor hierarchy and the principle of equal treatment of equally ranking creditors and that regulations will be made making clear that a no creditor worse off safeguard is to apply in relation to resolutions using the Proposed Bail in Power. The Company is not aware whether or not HM Government are contemplating the introduction of the Proposed Bail in Power ahead of its scheduled enactment if it proves necessary for the Company to be resolved. The Company considers that there are material uncertainties as to whether such emergency legislation would be introduced, how the Company would be resolved pursuant to any such legislation and what, if any, recovery Noteholders might receive as a result of such a resolution.

9. Conclusion

For the reasons set out in this Appendix 7 (*Resolution Analysis*), the Company believes that implementation of the Scheme and the Liability Management Exercise is substantially more beneficial to Noteholders than resolution of the Company.

APPENDIX 8

FINANCIAL STATEMENTS

PART (A)

AUDITED FINANCIAL STATEMENTS OF THE COMPANY FOR THE FINANCIAL YEAR ENDING 31 DECEMBER 2012

The Co-operative Bank plc
Financial Statements 2012

The **co-operative**

Here for you for life

Part of The **co-operative** banking group

Contents

	Directors' report
1	About us: a guide to the Co-operative Bank
3	Chair's statement
4	Chief Executive's overview
6	Business and financial review
10	Social goals
12	The Board
13	Corporate governance
20	Remuneration report
29	Statutory disclosures information
32	Independent auditor's report
33	Consolidated income statement
34	Consolidated statement of comprehensive income
35	Consolidated balance sheet
36	Bank balance sheet
37	Consolidated statement of cash flows
38	Bank statement of cash flows
39	Consolidated and Bank statements of changes in equity
40	Basis of preparation and accounting policies
51	Critical judgments and estimates
54	Risk management
80	Capital management
83	Notes to the financial statements
133	Responsibility statement
134	Notice of Annual General Meeting 2013
135	Glossary

This is the **Directors' report** for The Co-operative Bank plc (Bank). It explains in detail how the Bank has performed during 2012 and sets out a fair review of the business, a balanced and comprehensive analysis of performance, the use of financial and non-financial key performance indicators to explain the progress made, a description of the principal risks and uncertainties faced by the business and an indication of likely future developments.

In preparing the report, the Bank has had regard to the guidance issued by the Financial Reporting Council (formerly the Accounting Standards Board) in its Reporting Statement on narrative reporting. It is intended to provide Shareholders of the Bank and members of the Co-operative Group with a greater understanding of the Bank, its position in the market and its prospects.

In setting out the Bank's main risks and uncertainties, and likely future developments, this report and accounts contains statements which, by their nature, cannot be considered indications of likelihood or certainty. The statements are based on the knowledge and information available at the date of preparation of the Directors' report, and what are believed to be reasonable judgments, and these statements should not be construed as a profit forecast.

About us: a guide to the Co-operative Bank

Who we are

The Co-operative Bank plc is part of the Co-operative Banking Group, providing a **range of financial products and services** to personal and business banking customers across the UK.

The Co-operative Bank plc currently operates under its own brand as well as those of **smile, Platform** and **Britannia**. We offer our services through **339 branches** and **22 corporate banking centres** and via telephone, online and mobile banking.

We are a **leader in the field of ethical investment** and corporate social responsibility. Our customer driven ethical strategy was the first of its kind in our industry and we pursue an active strategy of community involvement.

How do we measure our performance?

The Bank measures its performance over four key areas: **financial**, **customer**, **people** and **process**. This approach reflects our co-operative difference and helps to ensure that a broad range of stakeholder interests and implications are considered in decision making.

The Board reviews performance evidence against the key performance indicators and our risk appetite.

The following table summarises our performance in 2012 against these key indicators:

Financial

Financial measures focus on profitability and underlying financial strength:

Profit before tax
This is a key measure of our performance and is discussed in the business and financial review.

Loan:deposit ratio
A measure which shows the strength of our liquidity through the ratio of customer assets to customer liabilities.

Core Tier 1 ratio
A key industry measure of financial strength.

Profit before tax

2012	2011
£(673.7)m	£54.2m

Loan:deposit ratio

2012	2011
92%	94%

Core Tier 1 ratio

2012	2011
8.8%	9.6%

Customer

Customer measures address the key relationships through which we sustain and grow our business:

Customer advocacy
We aimed to be 8.5% above the level of advocacy achieved by our competitors. We use an external survey to monitor advocacy of customers across the Retail businesses, relative to appropriate peer groups.

Number of primary current account customers
A primary current account customer is defined as one who holds one of our standard current accounts and credits their account with an average of at least £800 per month.

Customer advocacy

2012	2011
+ 9.7%	+10.3%

Primary current account customers

2012	2011
637,000	589,000

People

People measures reflect the importance of internal engagement:

Colleague engagement
In 2012 we adopted the same survey, timing and methodology for measuring colleague engagement as currently adopted across the other Group businesses. 'Talkback' is now the group-wide colleague engagement measurement tool used to effectively capture and analyse colleague perceptions.

Colleague engagement

2012	2011
68%	n/a

Process

Process measures focus on the efficiency of our business in delivering services to our customers:

Cost:income ratio
This is an efficiency measure reflecting costs in the business in relation to its income.

Cost:income ratio

2012	2011
73.7%	66.2%

Chair's statement

Overview

Like many financial organisations, we are still adjusting to the 'new normal' of protracted low interest rates, anaemic economic recovery and the complex challenges facing the banking and wider financial sector in general.

I opened last year's Chair's statement for the financial accounts by writing about how eventful the past 12 months had been. This has remained the case during 2012. Government action on regulation and governance for the industry and a growing sense of frustration from the public about lack of trust in their banks has meant that this year has been one of the busiest and most challenging we have ever encountered in our history.

I should start by saying that we recognise our reported loss in 2012 is disappointing. There are a number of exceptional factors in the form of corporate impairment losses and PPI costs, but we are also undergoing transformational restructuring as part of the outcome of our strategic review which is focused on enhancing the strength of our core bank. However, as the business moves through this change and we concentrate on leveraging the strength of our brand in relationship banking services for both retail and business customers, I am confident that our continued focus on what is right for our customers and members will provide a strong platform for future growth.

This is reflected in the financials of our core business. Although the issue of trust remained a key theme for the industry in 2012, we have seen the strength of our co-operative model become the catalyst for another jump in new business activity with over 100,000 customers joining us in the summer alone and switching their primary banking relationship to us. This steady growth in our customer base continues, our core business remains profitable and our balance sheet remains robust with good capital ratios, which we will take measures to continue to strengthen, and high levels of liquidity.

With the economic backdrop still fragile, there are no doubt more challenges ahead. However, our commitment to deliver customers and members the right products through industry leading customer service and underpinned by our ethical policy provide us with a strong platform for the future.

Customers

During these continued difficult times we have remained focused on our customers and members; we have never forgotten who we work for or why we are here as a co-operative bank. This year, we were the first bank to remove sales related bonuses, replacing them with customer centric service incentives. I am delighted that other banks saw fit to follow suit.

Our customer advocacy levels remain at rates to which other high street banks can only aspire. The advocacy of our 8,000 plus colleagues also remains at high levels, with our 'Talkback' colleague engagement survey results reaffirming our commitment to our compelling model of operation.

Performance

Although recent 'flight to trust' headlines and statements have allowed us to show more people who we are and what makes us different, we have not been immune from the economic conditions and the impact on our financial performance can be seen in this report. Our financial performance is unsatisfactory compared to previous years and we do not take reporting an operating loss lightly, but our focus on providing the best service to our customers has not altered, and we are confident that our co-operative business model and our strategic focus on growing our core business will see us through the tough times in the UK economy that show no sign of ending anytime soon.

Our strategy to strengthen our retail and business banking operations is backed up by our reported core operating profit of £96.8m (2011: £137.3m)

Growing our business

During 2012, we announced a heads of terms agreement with Lloyds Banking Group for the purchase of 632 branches and associated assets (Verde). We have talked before about the significance of this deal for the Bank and the wider Co-operative Group and we remain committed towards reaching an agreement.

Business changes

As we prepare for the next phase of the Verde transaction, we are also experiencing changes across our Bank in the form of transformation projects that will see the strengthening of our structures and governance. Our risk management framework has undergone a significant review with a new model now in place that will improve all elements of risk management related to our operations. We have made a number of new appointments in the past 12 months and I am delighted to welcome Richard Coates to the Board, as our new Chair of the Audit Committee in 2013. Peter Harvey, who has been with us since the Britannia merger, has become Deputy Chair, replacing Rodney Baker-Bates who retired in July. Paul Hewitt also leaves us after nine years on the Board. I wish Rodney and Paul well and thank them for all the work they have done during their tenure. We will also shortly be welcoming Graeme Hardie to the Bank Board and are in the process of strengthening the management team.

Our way of doing business

In my role as Chair I am responsible for ensuring that the Board operates in an effective way that is right for our members and those with a stake in our business. This involves putting a robust framework in place which supports the decision making process of Board members while at the same time ensuring we adhere to our governance structure. You will find details of the governance structure and arrangements on page 13.

Our continuing commitment to ethical banking, supporting our communities and 'doing the right thing' has never been more pertinent than today. In 2012 we launched the 'Lend with Care' scheme which has, within its first year, seen millions of pounds in social loans awarded to co-operatives and small businesses in the developing world. I am proud to chair an organisation that has done so much to help those who need it most. At Co-operative Group level our community fund continues to benefit local areas across the UK, with 2,709 groups benefiting during 2012.

Towards the end of 2012, we announced a new model for our membership which will see a much clearer structure for Co-operative members who trade with Banking Group businesses. The process in food stores has always been a straightforward one, and now our millions of bank customers will benefit from an equally straightforward system that rewards their commitment to trading with the Group.

Looking forward

We fully acknowledge our financial performance is disappointing despite the best efforts of all those who work for and with us. On a broader note prospects for the sector are unlikely to improve in the near future and our Bank faces further challenges around cost reduction and controlling impairment risk as we look to build on the sustainability of our core banking operations. However, we have much to look forward to as we strengthen our profitable core business, enhance our retail offer and simplify our high street presence under one Co-operative brand.

During 2012 we saw a steady stream of new customers come to us looking for a different level of service from a name they can trust. We believe this will continue, as people see there is an alternative to the big high street names.

Paul Flowers, Chair

Chief Executive's overview

The banking environment

It is no exaggeration to say that the past 12 months have been some of the most turbulent in British banking. While we have not been involved in some of the more high profile issues affecting the industry, we have not been immune to many of the challenges facing it as we strive to become the compelling co-operative alternative on the high street.

Our overall financial performance, whilst undoubtedly disappointing, reflects this challenge. The outcome of an ongoing strategic review designed to build on where our co-operative approach has a competitive edge in the market has seen us, in line with the banking sector in general, segment some activities as non-core business and concentrate on managing them for value and targeted for run-down or exit. Our focus is therefore on building on the strength of our brand as a relationship bank in both the retail and business space whilst at the same time de-risking the non-core assets to further strengthen the balance sheet. These non-core activities, particularly the non-prime residential mortgages and commercial real estate assets originating predominately from the non-member Britannia business acquired in 2009, contain the majority of the impairment risk for the Bank and substantial increases in provision have been made for these corporate impairments for the second half of 2012 in light of the continued and persistent weakness in the economy.

However, below these overall results sits a more positive financial picture for the core business. Our core business delivered a solid result characterised by industry leading levels of customer service, a high degree of current account switching from other banks, low levels of impairment and the Co-operative's unique customer led ethical policy. Our core business remains profitable, while our balance sheet is robust. However, we are not complacent about our financial strength and our strategic focus for the medium term is directed at implementing measures to enhance the strength of our capital ratios. In addition to a risk mitigation transaction executed since the year end, these include strengthening the management team and engaging a major investment bank to support on a range of balance sheet deleverage options. Further to the signing of the sale and purchase agreement for the sale of the Co-operative Banking Group's life insurance business which, subject to regulatory approval, is expected to generate a significant release of capital, the strategic review will encompass a review of the scale and composition of the financial services group. Such measures recognise the ongoing uncertain economic environment and the steps required to bolster the balance sheet for the benefits of our customers and members.

There is no doubt that the economy in this country remains fragile. We have seen a double dip recession this year and the fallout from the banking crisis continues. Against this, we remain a resilient, member owned and customer centred organisation which continues to enjoy excellent levels of customer advocacy, employee engagement and a growing primary current account base. As such, we believe we have a solid platform to broaden our reach and appeal in the UK banking sector, either through acquisition of the Lloyd's Verde assets or through continued organic growth.

Performance

Although we have protected ourselves from a number of potential banking pitfalls, and our exposure to peripheral European debt remains low, this has been a challenging year for the business. Whilst our core business delivered a solid result, the overall results reflect a number of charges relating to corporate impairment, further PPI provision and our own transformation programme which have significantly impacted profits across our business.

We are reporting an overall operating loss of £280.5m (2011: profit of £141.1m) and a loss before tax of £673.7m (2011 profit of £54.2m). In addition to further PPI provision and re-visiting the value ascribed to investments made to date in our transformation plan, we have increased the level of provisioning for impaired loans in light of weak economic recovery prospects relating primarily to commercial real estate assets originating from the Britannia book of business. As a result, these factors led to a significant increase in overall provisions which will inevitably impact on the overall short term profitability of the business. Against this, our core business reported a £96.8m operating profit, which although down on 2011 is a creditable performance in difficult economic circumstances and provides a strong platform for future growth.

These results are disappointing, but are framed by the outcome of a recent strategic review designed to build on the strength of the Bank's core retail and business operations and at the same time increase our focus on de-risking the non-core assets in order to further strengthen the balance sheet. This review, supported by a strengthened management team and premier league advisory partners, will deliver capital benefits from a range of initiatives including a review of the composition of our wider Banking Group and the deleveraging of our balance sheet. The Bank's underlying financial strength remains intact and we will continue our strategy for growth in areas where we can evidence a compelling co-operative solution, supporting retail and business customers and offering them products and services that are right for them.

Our customers

We remain unwavering in our commitment to our customers, offering them products and services that are right for them. In addition to removing our sales related performance bonuses this year, we also put in place a range of initiatives during 2012 that really demonstrate our commitment to great customer service. This included removing overdraft fees for the first three months of 2012 and giving first time buyers a helping hand with our flexible mortgage products. We have also stepped up our digital access to customer accounts with the launch of our mobile banking application on iPhone, BlackBerry and Android handsets. Customers can access their account information and locate branches and ATMs. Development of this product will continue in 2013.

In 2012 we provided £2bn of direct new retail lending, with 55% relating to house purchase and just under a third going to first time buyers. We have also seen record numbers of customers switch to our current accounts, with over 100,000 new customers joining us over the summer and an 8.2% increase in new primary account customers in the year. To support customers with switching, our £1,000 overdraft buffer has helped take the pain out of the process.

Our service and product credentials were reaffirmed when we won a Which? Customer Service Award, and 'Best Current Account' at the Moneysupermarket awards. As well as external plaudits we have continued to see high levels of customer advocacy with a 9.7% advantage over our top five competitors.

Project Verde

We believe the ethos of our business provides a solid platform to broaden our reach and appeal in the UK banking sector, whether that is through the Lloyd's deal (referred to as Project Verde) or through continued organic growth. Project Verde would see the equivalent of ten years' growth in one business deal and the transaction would see us take a 7% market share of UK personal current accounts, with around 1,000 branches UK wide. We remain in active discussions with Lloyds Banking Group regarding the sale of its Verde business and both parties remain committed towards reaching an agreement. We have always been clear that any deal of this nature is complex and must satisfy the exacting interests of our customers and members.

Sustainability

We are more than just a bank; we are a co-operative and run our business for our members. This year our sustainability credentials were recognised through the accolade of Europe's Most Sustainable Bank for a third consecutive year. Alongside the Community and Environmental Responsibility award in Management Today's Most Admired Companies Survey 2012, we have much to be proud of. The way we approach every opportunity allows us to rightly boast about our sustainability credentials. Each year we turn away millions of pounds of business from countries and organisations that do not fit our ethical operating framework.

Outlook

There is little doubt that the economic climate will continue to cause concern in the year ahead and, like our customers and the banking industry in general, we will face further challenges as we navigate this. However, we remain a resilient organisation driven by developing deep relationships with our customers over the long term. We believe this customer relationship model provides us with a strong platform moving forward and will enable us to continue to broaden our appeal in 2013 and beyond.

Barry Tootell, Chief Executive

Business and financial review

Overview

	2012 £m	2011 £m	Change £m
Core	**96.8**	137.3	(45.0)
Non-core	**(377.3)**	3.8	(381.1)
Operating result	**(280.5)**	141.1	(421.6)
(Loss)/profit before taxation	**(673.7)**	54.2	(727.9)

During the last six months, forecasts for the UK economic outlook have been revised with significant recovery now not expected until 2018. This prolonged economic downturn (the longest in a century) has been a major factor in 2012 being an extremely challenging year for the Co-operative Bank ('the Bank'), reflected in its statutory loss of £673.7m (2011: profit of £54.2m). The outcome of an ongoing strategic review has seen the Bank, in line with the banking sector in general, segment some activities as non-core business and concentrate on managing them for value and targeted for run down or exit. The strategy is designed to both build on the strength of the Bank's core retail and business banking operations, where it can evidence a compelling co-operative alternative to its peer group, whilst at the same time de-risking the non-core assets in order to further strengthen the balance sheet.

The core business, reflecting the current strategy and risk appetite of the Bank, delivered an operating profit of £96.8m (2011: £137.3m), which, while lower than 2011, provides a solid platform for future growth. The non-core business, those activities not congruent with the current strategy, which are managed for value and targeted for run down or exit, generated an operating loss of £377.3m (2011: profit of £3.8m). As a result, the combined operating loss was £280.5m (2011: profit of £141.1m).

As a result of the financial performance noted above, the Core Tier 1 ratio has reduced to 8.8% (2011: 9.6%). Since the year end, the Bank has completed a securitisation transaction to reduce risk on the balance sheet, which has improved the Core Tier 1 ratio by 0.4%, and which would increase the year end ratio to 9.2% on a pro forma basis. This transaction is one of a range of actions targeted, as part of a strategic review, at improving our capital strength. The completion in 2013 of the sale of the Life and Savings business owned by the Co-operative Banking Group should, subject to regulatory approval, further strengthen the capital position.

Going forward, as the Bank deleverages the balance sheet (facilitated by the additional impairment charges taken in 2012), we will build upon the strength of the core business through a simplification agenda, conservative credit risk appetite and long term growth strategy focused on our core relationship banking franchises in the retail and business banking space. This includes the review of the branch network, to ensure that it meets the needs of our customers and is operating in the most efficient and cost-effective way, together with the unification of the network under one single Co-operative brand. These measures, combined with the potential acquisition of Lloyds Banking Group branches ('Project Verde'), will ensure that we make solid progress towards our clear strategic goal of becoming the compelling co-operative alternative.

The deterioration in the result for the year was principally driven by the following factors:

- Credit impairment on non-core assets: in light of the continued and persistent weakness in the economy, the directors have reassessed the carrying value of the customer loan portfolios of the Bank. This has resulted in an impairment charge of £351.1m during the year (2011: £23.1m), principally relating to the non-core Corporate business. The non-core business contains the majority of the impairment risk for the Bank. It includes non-prime residential mortgages and commercial real estate assets, which originated from the non-member Britannia business prior to merger;
- Intangible asset impairment: the directors have re-evaluated the carrying value of the investment made to date in developing our new banking platform, and have concluded that a write down of £150.0m is required. The impact of the continuing and prolonged economic downturn on the future value stream from the new banking platform now indicates that the carrying value should be reduced;
- PPI: in line with the rest of the banking industry, the Bank saw a continued increase in the volume of PPI complaints in 2012. As a result, the charge of £40.0m reported at the half year has been increased by a further £109.7m, to cover the anticipated cost of customer redress. This increases the total estimated cost of redress to £244.0m;
- Continued economic downturn: the reduction in operating profit within the core business from £137.3m in 2011 to £96.8m in 2012 was broadly attributable to the continued economic downturn. Margins remain under pressure as the result of prolonged low interest rates.

Liquidity remains strong. The loan to deposit ratio was 92% at the year end (2011: 94%), illustrating that lending remains more than sufficiently funded by deposits.

Financial performance

	2012 £m	2011 £m	Change £m
Income	**771.2**	817.6	(46.4)
Operating costs – steady state	**(568.2)**	(548.2)	(20.0)
Operating costs – strategic initiatives	**(14.8)**	(13.4)	(1.4)
Impairment losses	**(468.7)**	(114.9)	(353.8)
Operating result	**(280.5)**	141.1	(421.6)
Significant items	**(85.1)**	(53.3)	(31.8)
Intangible asset impairment	**(150.0)**	–	(150.0)
PPI provision	**(149.7)**	(90.0)	(59.7)
Share of post tax profits from joint ventures	**1.2**	0.2	1.0
Financial Services Compensation Scheme levies	**(24.8)**	(14.5)	(10.3)
Fair value amortisation	**15.2**	86.3	(71.1)
(Loss)/profit before taxation and distributions	**(673.7)**	69.8	(743.5)
Membership dividend	**–**	(15.6)	15.6
(Loss)/profit before taxation	**(673.7)**	54.2	(727.9)

The overall operating result fell to a loss of £280.5m in 2012 from a profit of £141.1m in 2011. The core business delivered an operating profit of £96.8m (2011: £137.3m), which, while lower than 2011, provides a solid platform for future growth. The non-core business generated an operating loss of £377.3m (2011: profit of £3.8m). The loss before taxation was £673.7m (2011: profit of £54.2m).

2012 income (excluding fair value amortisation) fell by £46.4m, reflecting the cost of retained and incremental funding raised during the year in the continuing challenging market conditions. The reduction in income arose principally in the non-core business, with income levels in the core business £11.9m higher than 2011. Total income included gains on a number of Treasury transactions of £43.0m (2011: £37.2m). 2011 income also included a non-recurring benefit of £20.0m, relating to a reduction in the total credit risk expected over the life of the Optimum book.

Operating costs (excluding fair value amortisation and strategic investment costs) of £568.2m were £20.0m higher than 2011. Excluding the impact of inflation this is an increase of less than 1%. In part due to depressed income levels, we recognise that our cost to income ratio remains above industry benchmarks. Cost management is a key area of focus, and a number of initiatives continue. We have already announced plans to merge branches where we have multiple sites within close proximity. However, as a mutual, with a strong customer service ethic, we may not pursue the lowest costs at the expense of poor customer service.

As reported at the half year, impairment losses continue to reflect the strains on our customers' ability to service their loans and these challenges have intensified in the second half of the year, particularly in the corporate sector. As previously noted, in light of the current strategic review, with meaningful economic recovery now not expected until 2018, the directors have reconsidered the carrying value of the Bank's loans, which has led to a substantial impairment charge of £468.7m in the year, principally relating to the non-core Corporate business.

The loss before taxation of £673.7m (2011: profit of £54.2m) was after a recharge for intangible asset impairment of £150.0m (2011: £nil). As reported at the half year, while the Bank has been pursuing Project Verde, progress on the transformation plan has been restrained and spend reduced in those areas where Project Verde could impact the plans of the Bank, to minimise the risk of redundant investment. The Bank has revisited the value ascribed to the investments made in developing the new banking systems, and has written down the carrying value of the asset by £150.0m. In the event of concluding the sale and purchase agreement with Lloyds, the Bank will revisit the value ascribed to the investments made in the transformation plan to date. Should the deal with Lloyds not conclude successfully, the intention is to reinvigorate the project, with further investment made to complete the development of the systems that will then be used to drive the business forwards.

Significant items of £47.0m (2011: £53.3m) were incurred during the year, primarily associated with the investment in the Bank's transformation and integration programmes. In addition, a further £38.1m of transaction costs were incurred in relation to Project Verde.

A provision for PPI claims of £149.7m was made during the year (2011: £90.0m). As previously noted, during 2012 there has been an increase in the volume of complaints received, and as a result the provision held has been increased to cover the anticipated customer redress and associated costs. This increases the total estimated cost to £244.0m.

The Financial Services Compensation Scheme levy increased from £14.5m in 2011 to £24.8m in 2012. This was principally because the scheme has now started to charge the banking industry for the capital losses incurred in supporting failed institutions. Previously the scheme only charged the sector for the interest on its support.

The loss before taxation of £673.7m was after a benefit of £15.2m (2011: £86.3m) arising on fair value amortisation. Since the merger with Britannia Building Society, the profile of these net releases to the income statement has gradually fallen, in line with expectations, and the reduction during the year reflects this trend.

Balance sheet

Despite the year's profit performance and difficult external conditions, the underlying core business remains strong. The balance sheet has been actively managed to ensure a balance between margin, capital and liquidity. Total assets increased slightly compared with December 2011. The Bank has maintained its focus on supporting its customers: £2.6bn has been lent to Retail mortgage customers (2011: £1.4bn) while loans to businesses totalled £1.3bn (2011: £1.2bn).

Retail asset balances remained stable, at £17.7bn (2011: £17.7bn), while Corporate core assets increased marginally from £5.2bn at the end of 2011 to £5.4bn at the end of 2012, reflecting the new lending undertaken in the year. The non-core asset portfolios reduced as planned during the year, with net non-core Corporate balances falling from £3.3bn to £2.8bn, and the Optimum portfolio reducing from £8.0bn to £7.6bn. Retail and Corporate deposits remained relatively stable when compared to the prior year.

The year end loan to deposit ratio was strong, at 92% (2011: 94%).

The Bank has continued to access the capital markets, as part of its diversified funding sources. Early in the third quarter of 2012, £650m was raised via its third 'Silk Road' prime mortgage securitisation since the merger with Britannia Building Society in 2009, and the Bank raised an additional €500m of senior unsecured debt in the final quarter. The exposure of the Bank to peripheral eurozone debt is low and has had little direct impact on its business.

The capital position has been impacted by the statutory loss for the year, with a Core Tier 1 ratio of 8.8% (2011: 9.6%). The total capital ratio was 14.4% (2011: 14.7%), with a Tier 1 ratio of 9.4% (2011: 10.1%). Further detail on the capital position of the Bank can be found in the capital management section on page 80. As noted above, since the year end, the Bank has completed a securitisation transaction to reduce risk on the balance sheet, which would improve the year end Core Tier 1 ratio to 9.2% on a pro forma basis.

Our businesses

	2012 £m	2011 £m	Change £m
Retail	**50.1**	92.1	(42.0)
Corporate and Business Banking – core	**3.7**	12.5	(8.8)
Treasury/other	**43.0**	32.7	10.3
Core operating result	**96.8**	137.3	(40.5)
Non-core	**(377.3)**	3.8	(381.1)
Operating result	**(280.5)**	141.1	(421.6)

The Bank is managed through two distinct divisions.

The 'Core' business represents activity consistent with the strategy and risk appetite for the Bank. This includes the Retail, core Corporate and Business Banking, and Treasury/other segments.

The Retail Banking business (trading as the Co-operative Bank, Britannia and **smile**) offers a range of financial products and services to individuals and households throughout the UK. Retail also includes Platform (the intermediary mortgage business).

Core Corporate and Business Banking comprises corporate banking, business banking, and business services, and effectively consists of all the key business to business elements of the Bank.

Included in the Treasury/other segment are the results of the treasury activities of the business and the results of Unity Trust Bank.

'Non-Core' business lines include activities not congruent with the current strategy of the Bank, which are managed for value and targeted for run down or exit. These non-core lines contain the majority of the impairment risk for the Bank, and predominantly include the Corporate non-core, Optimum (the closed book of intermediary and acquired loan book assets) and Illius (the residential property company) businesses which originated from the non-member Britannia business prior to merger.

Business and financial review continued

Retail

	2012 £m	2011 £m	Change £m
Net interest income	**399.9**	400.5	(0.6)
Non-interest income	**135.8**	149.5	(13.7)
Net income	**535.7**	550.0	(14.3)
Operating costs – steady state	**(434.6)**	(414.0)	(20.6)
Operating costs – strategic initiatives	**(9.6)**	(9.5)	(0.1)
Impairment losses	**(41.4)**	(34.4)	(7.0)
Operating result	**50.1**	92.1	(42.0)

The Retail operating result for 2012 of £50.1m was £42.0m lower than 2011.

Interest income decreased by £0.6m compared to 2011, as improving asset margins were offset by increased costs of retail deposits in a highly competitive market.

Non-interest income fell by £13.7m year on year as a result of reduced revenue from legacy insurance products, merchant interchange fees and cash advances on credit cards. We no longer sell third party general insurance products through our branches, only co-operative products. All new business insurance income is now included within the Bank's fellow subsidiary general insurance business.

Underlying credit performance on secured retail lending continued to improve, reflecting a conservative approach to risk. Despite the ongoing difficulties within the UK economy, asset quality has been maintained with levels of late residential mortgage arrears (>2.5% of balance) unchanged at 0.3%. The Bank remains focused on delivering high quality mortgage assets, with 61.0% loan to value ratio on new lending and 44.3% across the portfolio. However, in the context of the prolonged economic environment further impairment provisions have been required, principally against unsecured balances.

Asset balances remained stable, with the Bank's increased share of new lending offsetting limited demand for credit in the market. 55% of the £2bn of direct new lending in 2012 related to house purchases, of which just under a third was provided to first time buyers. Liquidity remains very strong, with a loan to deposit ratio in line with the previous year.

Corporate and Business Banking – core

	2012 £m	2011 £m	Change £m
Net interest income	**108.4**	101.7	6.7
Non-interest income	**55.2**	51.5	3.7
Net income	**163.6**	153.2	10.4
Operating costs – steady state	**(77.3)**	(77.1)	(0.2)
Operating costs – strategic initiatives	**(2.7)**	(2.1)	(0.6)
Impairment losses	**(79.9)**	(61.5)	(18.4)
Operating result	**3.7**	12.5	(8.8)

Our core Corporate and Business Banking operation delivered an operating profit of £3.7m during 2012, £8.8m lower than 2011 (2011: £12.5m) reflecting higher impairment charges, which have been partly offset by a £10.4m growth in income.

Net interest income, at £108.4m, increased by £6.7m mainly as a result of improved asset margins partially offset by increased costs of fixed term deposits. Other income increased by £3.7m driven by higher core business activity levels.

As a result of continued weak growth and an uncertain economic environment, the impairment charges rose from £61.5m in 2011 to £79.9m in 2012, mainly due to a strengthening of collective provisions.

The business has continued to lend, supporting existing customers and winning selective, high quality new business. We also saw a marked increase in new business banking account applications as testament to the strength of our relationship banking proposition.

Treasury/other businesses

The main component of the Treasury/other business segment, the Treasury operation, has continued to deliver on its core responsibilities of ensuring a strong liquidity base, providing diverse sources of wholesale funding to the Bank, managing market risk and delivering an appropriate return on the investment portfolio.

Net interest income was negatively impacted by increased investment in highly liquid, low risk assets in line with our cautious risk appetite. In addition, net interest income reflects the impact of additional term funding, which included a covered bond issuance towards the end of 2011, the 'Silk Road' prime mortgage securitisation and a senior unsecured debt issuance in the second half of 2012.

Non-interest income was favourably impacted by a restructuring of certain Lower Tier 2 securities in December 2012, generating a benefit of £18.0m. The Treasury result further benefited from gains on the sale of Treasury assets of £25.0m (2011: £37.2m) as part of reshaping the investment portfolio.

Non-core business

	2012 £m	2011 £m	Change £m
Net interest income	**(13.0)**	46.2	(59.2)
Non-interest income	**18.1**	17.2	0.9
Net income	**5.1**	63.4	(58.3)
Operating costs – steady state	**(30.5)**	(35.4)	4.9
Operating costs – strategic initiatives	**(0.8)**	(1.1)	0.3
Impairment losses	**(351.1)**	(23.1)	(328.0)
Operating result	**(377.3)**	3.8	(381.1)

The non-core operating result for 2012 was a loss of £377.3m (2011: profit of £3.8m). This comprised a loss of £372.2m (2011: loss of £50.0m) for the non-core Corporate portfolio, a £3.2m loss (2011: profit of £56.9m) for Optimum and a £1.9m loss (2011: loss of £3.1m) for Illius. As previously noted, in light of any real economic recovery now not expected till 2018, the impact of difficult trading conditions for some of our customers and to reflect the risks associated with higher loan to value assets, the directors have reconsidered the carrying value of the Bank's loans, which has led to the significant additional impairment charges principally relating to the non-core Corporate business.

Non-core Corporate
The non-core Corporate business delivered an operating loss of £372.2m (2011: loss of £50.0m) in 2012. The significant increase in operating loss predominantly reflected the additional impairment charges noted above, which are concentrated in commercial real estate exposures. Approximately £200m of the increase in impairments arose in a relatively small number of major loans in the second half of the year. The remainder of the increase was mainly due to the impact of the prolonged poor economic outlook on our provisioning estimates. Income has reduced reflecting the higher funding costs borne by this portfolio with little opportunity to increase asset margins to offset this.

We are developing the strategy for the management of this portfolio to optimise its capital consumption and profitability through a variety of deleverage, risk transfer and asset sale options.

Optimum
In 2012, the Optimum portfolio, a closed book of intermediary and acquired mortgage book assets, reduced in size, as planned, from £8.0bn to £7.6bn, and delivered a loss of £3.2m (2011: profit of £56.9m). The fall in profitability this year was due to the increase in the cost of funding of this book of assets, partly associated with the relatively long expected lives of much of this book, and also to a lesser extent reflected the additional impairment charges noted above. The 2011 result also included a non-recurring benefit of £20.0m.

Despite the ongoing difficulties within the UK economy, asset quality has improved modestly with levels of late residential mortgage arrears (>2.5% of balance) reducing from 3.59% in 2011 to 2.72% at the end of 2012.

Support for customers

Recent media attention on a number of issues for the industry has led to a further increase in customers turning to the Bank. The number of customers who consider the Co-operative Bank their main bank, key to the continued overall growth of the business, has increased further, with the number of primary current accounts increasing by 8.2% during 2012.

During these difficult times, the Bank has maintained its focus on supporting its customers. £2.8bn was lent to Retail mortgage customers during the year (2011: £1.6bn), while £1.3bn (2011: £1.2bn) was lent to businesses. The Bank has provided additional support for first time buyers at the end of the stamp duty holiday by removing upfront fees on a range of mortgage products and offering a 90% LTV mortgage. The Co-operative Bank was the first major bank to focus its targets for the branch network staff on customer service, rather than sales.

It is our intention to participate in the funding for lending scheme in 2013 in line with our core relationship banking strategy.

Since the launch of the Bank's mobile banking service this summer, take up has exceeded expectations and this now has over 100,000 users, with each customer accessing the application four times a week on average.

The potential mis-selling of derivatives to corporate and business banking customers has been much publicised during 2012. The Bank voluntarily joined the FSA review of these sales and will be carrying out further work in the next stage of the FSA review. The Bank sold only small numbers of simple products to its customers to help them manage interest rate risk. While the review is still in course, the directors believe that should any sales be found to be inappropriate, redress payments would not be material.

The Bank continues to focus on building a relationship banking business where the customer is at the heart of everything. Customer advocacy levels remain strong, testifying to the high degree of trust placed in the Bank by its customers. As at December 2012, advocacy levels for the Co-operative Banking Group were 9.7% higher than the average of the top five competitors for the business. Which? members have rated the customer service provided by the Bank better than any of the major high street banks and building societies, and the Bank won a number of awards at the Moneywise Customer Service Awards in 2012.

The Bank's commitment to sustainability has again been recognised. For the third year running the Bank has been named 'Europe's most sustainable Bank' by the Financial Times. The Bank was also recognised as the leader in Management Today's Most Admired Companies survey 2012 for Community and Environmental Responsibility.

Outlook

Prospects for the sector are unlikely to improve in the near future, and the Bank faces formidable challenges. Recent indications are that any meaningful economic recovery will be delayed for a number of years, offering little scope to improve margins and requiring a reduction in costs as well as control of impairment risk. The Bank remains committed to a strategy for growth as well as de-risking the non-core assets. We are working to strengthen our profitable core business, enhance our retail offer and simplify our high street presence under one Co-operative brand. In the short term, while market conditions remain difficult, we will re-double our focus on cost management, improving our capital strength, deleveraging the balance sheet and controlling impairment risk by actively managing our non-core business for value.

In the meantime, as part of broadening our reach and appeal in the UK banking sector, the Bank continues to pursue the opportunity to acquire the Verde business from Lloyds Banking Group. The Bank remains confident in its long term strategy to deliver a compelling co-operative alternative on the high street founded on strong relationships with its customers, the unified brand and the transformation of the branch network, which provide a solid platform for future growth in its core relationship banking operations.

Social goals

Social goals have been firmly embedded in our approach to business since our inception and, amid increasing calls for more responsible business, continue to earn consumer trust. As part of the Co-operative Group, our members expect that not only do ethics remain at our core but that we continue to deliver a world-class social goals programme.

In 2012, the UN International Year of Co-operatives, our co-operative and ethics-led approach continued to stand us apart. We were recognised with a raft of awards and commendations, not least the Financial Times Award for the Most Sustainable Bank in Europe – for the third year running, a Queens Award for Enterprise in Sustainable Development, and a top rank in Business in the Community's Corporate Responsibility Index.

Our principles in practice

We have always had a purpose beyond profit. As part of the Co-operative Group, we are distinct from other major UK businesses in that we are owned by our members, and are held accountable to them through our democratic structure.

The Group's Ethical Plan sets out its commitments to social responsibility and sustainability, with targets across eight priority areas. We review these annually with our democratically elected members through the Group Values and Principles Committee to ensure that we continue to show the way forward for corporate sustainable development in the UK.

For over 15 years we've produced an annual Sustainability Report. Our reporting is renowned for its openness and honesty, and accolades in 2012 place us amongst the most respected reporters worldwide.

Performance overview

Responsible banking

We recognise that responsible banking is crucial for sustainable development and we are the only UK bank to operate a customer-led Ethical Policy.

Since the launch of the policy in 1992, we have declined over £1.2bn of lending to business activities which our customers deem unethical. At the same time, we're dedicated to supporting progressive social and environmental projects. In particular, by the end of 2012, we had committed £827.6m of our £1bn fund for renewable energy and energy efficiency schemes.

The home and motor insurance products we sell, wherein the underlying investments are screened against the Bank's Ethical Policy, continue to set the bar for ethical insurance in the UK. And through our range of charity credit cards our customers donated £1.25m to charity in 2012.

Our commitment to social inclusion extends through our range of products and services, from accounts for prisoners to our support for small businesses in deprived areas. We continue to be the only bank in the UK to offer a current account for credit union members, in partnership with the Association of British Credit Unions Ltd and provide facilities to 60% of the credit union sector.

In 2012, our reputation for responsible banking led to recognition from the general public as both the UK's most trusted bank[1] and as the leader amongst financial services businesses for social responsibility[2].

Keeping communities thriving

Together with members and colleagues, in 2012, the Co-operative supported over 10,000 initiatives in our communities; that's the equivalent of one initiative every hour of every day, all year long.

The Co-operative Membership Community Fund supports local groups and voluntary organisations throughout the UK, by awarding small grants. In 2012, we saw a significant increase in both the number of awards made and the amount donated, with 2,709 groups benefitting.

In 2012, over 46,000 Co-operative Group colleagues and members voted for The Carer's Trust to be our Charity of the Year partner. Throughout 2013, colleagues and members will be working with us to raise money to help 20,000 young adult carers across the UK.

Supporting co-operatives

At the end of 2012, over 1,000 co-operative businesses had benefited from the services of The Co-operative Enterprise Hub. The Hub, which delivers a unique professional business advisory and training service for co-operatives, expanded its remit in 2012 to enable renewable energy co-operatives to access specialist support. Also in 2012 the Hub launched The Co-operative Community Shares Fund, to help communities raise finance through community share offers.

In 2012, we also launched an inspiring street gallery, graphic novel and film to take the message of co-operation to new audiences.

1 YouGov SixthSense, 'Trust in Financial Services', April 2012. 2,060 representative UK adults (aged 18+).

2 Research is conducted on behalf of the Co-operative Group on a quarterly basis and is based on unprompted responses from a nationally representative sample of approximately 6,000 members of the general public (aged 18+).

Inspiring young people

The Co-operative's Inspiring Young People programme aims to benefit one million young people by 2014, and we are helping to bring about a cultural shift in the way that young people are viewed and treated in the UK.

Within the programme, Skills4Schools promotes two education initiatives, Number Partners and Fit4finance, to improve numeracy and financial literacy among primary and secondary school pupils.

Green Schools Revolution brings inspiring and engaging activities on key sustainability themes to school classrooms. With over 5,200 schools registered, we are well on our way to achieve our target to engage 6,000 schools by 2014.

The Co-operative Group is also working to progress its Co-operative Academies, delivering an innovative curriculum, with a values-led ethos. This forms part of wider work supporting Co-operative Schools, of which there are 388.

Protecting the environment

In line with customer expectations our Ethical Policy establishes that we will not lend to businesses or projects that do not meet our environmental standards, and we have declined £76m of finance to such projects in 2012. At the same time, within our £1bn commitment to fund energy efficiency and renewables, we have set a target to dedicate £100m to small scale community renewable opportunities.

Our Clean Energy Revolution campaign seeks to end the use of unconventional fuels and inspire community energy growth, where communities own, control and benefit from their own renewable energy projects.

2012 was particularly noteworthy for the Government announcement that mandatory greenhouse gas reporting would become a reality for UK quoted companies in 2013. The Co-operative has long campaigned for the introduction of such regulation and will continue to lobby for such mandation to apply to all large businesses.

The Group is on track to achieve its target of 50% reduction in direct greenhouse gas emissions by 2020, as reported in the Co-operative Group Annual Report and Accounts. Further, construction of the Group's new flagship office building in Manchester was completed in 2012, setting new standards in sustainable design, construction and operation.

In 2012, The Co-operative Bank re-achieved certification to the ISO 14001 standard and we are still the only financial services organisation in the world to achieve this leading standard across all business activities and products.

Tackling global poverty

We continue to strive for a fairer world, where basic human needs are met and rights respected. We support microfinance institutions in 28 countries across the globe with a £25m fund to provide small loans to people in some of the world's poorest countries. Our charity credit cards have enabled customers to raise a staggering £718,206 in 2012 for organisations tackling global poverty and human rights issues, such as Oxfam and Amnesty International. And in line with our customer-led Ethical Policy, we declined £27m of finance for business activities which conflicted with our statements on human rights and labour standards in 2012.

In partnership with CARE International UK, the Co-operative Group supports lendwithcare.org, which allows people in the UK to lend directly to entrepreneurs in the developing world, helping them work their way out of poverty. As at the end of 2012 £1.6m had been lent, and our aim is to facilitate over 100,000 loans by the end of 2013. And through The Global Development Co-operative, we're increasing funding to support co-operatives in the developing world, providing low cost loans for capital and infrastructure projects.

The Board

Non-Executive Directors:

Paul Flowers (BA (Hons), Cd'EO (Geneva), FRSA, FCIBS, FRGS)
Age 62. Joined the Board in 2009 and appointed Chair in 2010. Deputy Chair of Co-operative Group Limited. Superintendent Methodist Minister. Member of the Co-operative Group North Regional Board. Chair of Co-operative Banking Group Limited.

Duncan Bowdler (BSc (Hons) Biochemistry)
Age 54. Joined the Board in 2009. Trade and Legislation Manager. Member of the Co-operative Group North West and North Midlands Regional Board. Non-Executive Director of Co-operative Group Limited and Co-operative Banking Group Limited.

Richard Coates (BSc (Econ), FCA)
Age 61. Joined the Board in 2013. Non-Executive Director of Police Mutual Assurance Society. Non-Executive Director of Co-operative Banking Group Limited.

David Davies (BSc (Econ), FIA)
Age 65. Joined the Board in 2003, appointed Deputy Chair in 2010 and together with the other Deputy Chair, Peter Harvey, fulfils the role of Senior Independent Director. Qualified actuary. Chair of Pace Pension Scheme and Nortel Networks Pension Scheme in the UK. Non-Executive Director of Interglobal Insurance Company Limited. Non-Executive Director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Anne Gunther (BSc (Hons), MBA, ACIB, FCIBS)
Age 58. Joined the Board in 2011. A career retail banker, most recently as Chief Executive of Standard Life Bank and then Chief Executive of Norwich and Peterborough Building Society to secure its merger with the Yorkshire Building Society. Chair of Warwick Business School. Non-Executive Director MBNA Limited and Non-Executive Director of (NEW) Devon NHS Clinical Commissioning Group. Non-Executive Director of Co-operative Banking Group Limited.

Peter Harvey (ACIB, Dip FS)
Age 57. Joined the Board in 2009 appointed Deputy Chair in 2012 and together with the other Deputy Chair, David Davies, fulfils the role of Senior Independent Director. Non-Executive Director of Marshalls Holdings Limited. Non-Executive Director of Co-operative Banking Group Limited.

Merlyn Lowther (BSc (Hons), MBA, FCIB)
Age 59. Joined the Board in 2011. Chief Cashier of the Bank of England from 1999 to 2004. Non-Executive Director of Schroders plc. Trustee of the Winston Churchill Memorial Trust and The Henry Smith Charity. Non-Executive Director of Co-operative Banking Group Limited.

Peter Marks CBE
Age 63. Joined the Board in 2009. Group Chief Executive of Co-operative Group Limited. Named Orange Leader of the Year 2009 in the National Business Awards. Entire working life spent within the Co-operative Movement. Instrumental in bringing about a number of major co-operative mergers over the past decade, as well as the Group's acquisition of the Somerfield supermarket chain. Non-Executive Director of Thomas Cook Group plc. Non-Executive Director of Co-operative Banking Group Limited.

Bob Newton (BSc, FIA, CDir)
Age 63. Joined the Board in 2007. Over 40 years' experience in the financial services industry. Chair of Silentair Group Limited. Non-Executive Director of UIA (Insurance) Limited and Reclaim Fund Limited. Non-Executive Director of Co-operative Banking Group Limited. Chair of Co-operative Insurance Society Limited and CIS General Insurance Limited.

Ben Reid OBE (FCCA)
Age 58. Joined the Board in 2009. Chief Executive of The Midcounties Co-operative and also Chair of Walsall Healthcare NHS Trust. Non-Executive Director of Co-operative Group Limited and Co-operative Banking Group Limited.

Len Wardle (BA)
Age 68. Joined the Board in 2002. Chair of Co-operative Group Limited and member of the South East Regional Board. Held management positions in local government and latterly was a Fellow at the University of Surrey in the School of Management. Director of Communicate Mutuality Limited. Non-Executive Director of Co-operative Banking Group Limited.

Martyn Wates (ACA, ATII, BA (Hons))
Age 46. Joined the Board in 2007. Has held various senior finance positions within the Co-operative Movement. Chief Executive of the Co-operative Group's Specialist Businesses Group and Deputy Chief Executive Officer of the Co-operative Group. Director of various internal subsidiaries and Non-Executive Director of Co-operative Banking Group Limited.

Executive Director:

Barry Tootell (BA (Hons), FCA)
Age 51. Joined the Board in 2008. Chief Executive Officer. Qualified accountant with over 20 years of banking experience and was previously Chief Financial Officer. Executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Corporate governance

Introduction from the Chair

In order to meet its vision of becoming the compelling co-operative alternative and differentiate itself within the banking market the Board believes corporate governance now, more than ever, to be key to the effectiveness of the Bank.

During 2012 the Board has continued to provide leadership, challenge, guidance and support to the Executive and management. The Board focused on a number of things including:

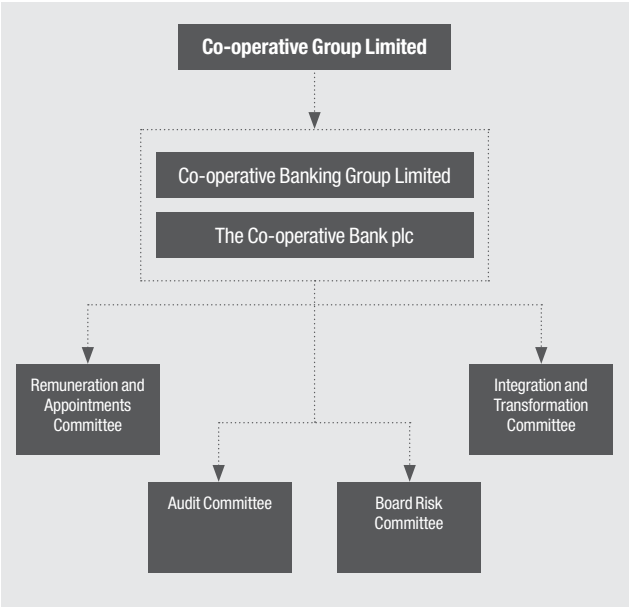
- the implications for the Bank of the potential acquisition of 632 branches from Lloyds Banking Group (Verde);
- the risk management framework;
- the Internal Capital Adequacy Assessment Process (ICAAP);
- Recovery and Resolution Planning (RRP);
- Payment Protection Insurance (PPI);
- packaged accounts; and
- capital markets funding.

A number of steps have been taken to improve corporate governance within the Bank including a review of the composition of the Board of directors, and, as a result of the work undertaken on the Bank's risk management framework, a review of the Board committees' terms of reference. A revised schedule of matters reserved for the Board will be implemented in 2013 alongside revised financial delegated authorities. This will assist the delivery of good governance not only in the boardroom but across the entire business.

Paul Flowers, Chair

Governance structures

The Bank is a subsidiary of the Co-operative Banking Group Limited (the Banking Group) and its ultimate parent organisation is the Co-operative Group Limited (Co-operative Group) which is an Industrial and Provident Society that is jointly owned and democratically controlled by its members.



Relations with members

The Bank has two equity shareholders. The majority of the shares are held by the Banking Group, which is a wholly owned subsidiary of the Co-operative Group. The remainder of the shares are held directly by The Co-operative Group.

The Bank has approximately 2,500 preference shareholders. The preference shares are fixed-interest shares and are non-cumulative and irredeemable. The preference shareholders are entitled to attend the AGM, but the shares only hold speaking or voting rights if and when the dividend has been in arrears for six months or more, or if a resolution is to be proposed at a general meeting abrogating or varying any of their respective rights or privileges, or for the winding up of the Bank or other return of capital and then only on such resolution.

Compliance with the UK Corporate Governance Code

The Board believes that during the year, with the exception of the composition of the Board and the Audit Committee (as explained below), it has fully complied with the principles and provisions of the UK Corporate Governance Code (the Code) appropriate to the democratic structures of the Bank and its parent organisations; the Banking Group and Co-operative Group. The Audit Committee composition now fulfils the requirements of the Code and steps are being taken to recruit additional Non-Executive Directors to the Bank Board to ensure ongoing compliance with the Code.

Leadership

Role and responsibilities of the Board

The Board is responsible for the long term success of the Bank within a framework of controls which enables risk to be assessed and managed. It is responsible for setting strategy, maintaining the policy and decision making framework within which this strategy is implemented which ensures that the necessary financial and human resources are in place to meet strategic aims, monitoring performance against key financial and non-financial indicators, overseeing the system of risk management and for setting values and standards in governance matters.

The responsibility of the Board is to direct the business of the Bank and in particular to:

- ensure that the Bank's affairs are conducted and managed in accordance with its articles of association, the best interests of its stakeholders and co-operative values and principles;
- establish arrangements to ensure the information presented in the annual report and accounts is fair, balanced and understandable;
- agree objectives, policies and strategies, and monitor the performance of executive management;
- approve the annual budget and business plan;
- approve the annual report, financial statements and dividends;
- monitor, utilising various committees, the key significant risks facing the Bank;
- establish Board committees and agree their terms of reference; and
- approve the delegated financial authorities.

Corporate governance continued

Appointment and re-appointment of directors

The directors that serve on the Banking Group Board also sit on the Bank Board to provide common leadership of the financial services business. Whilst appointments to the Board are formally made by the Co-operative Group Board, for the recruitment of independent Non-Executive Directors, external recruitment consultants, Warren Partners, are retained and an interview panel comprising Bank Non-Executive Directors, recommend appointments to the Co-operative Group Board.

All Non-Executive Directors are eligible for reappointment at the end of each term of office. The Co-operative Group Board, being party to agreements with the independent professional Non-Executive Directors for services to the Banking Group and its subsidiaries, including the Bank, may resolve to re-appoint at or before the date their contracts expire for a further three year term. It is the normal policy of the Board not to allow an independent professional Non-Executive Director to serve for more than nine years in aggregate.

Two directors left the Bank Board during the year; Rodney Baker-Bates, who had joined the Bank following the merger with Britannia Building Society, retired on 31 July, and after nine years service, Paul Hewitt left on 21 September. David Davies, who was appointed to the Bank Board in 2003, announced that he will be retiring in 2013. Upon his retirement as Chief Executive of the Co-operative Group, Peter Marks will step down from the Bank Board on 18 May 2013.

Under the articles of association, one third of the Board is required to retire by rotation at the conclusion of the Annual General Meeting (AGM). In accordance with the articles of association, therefore, three directors will retire by rotation in 2013, Duncan Bowdler, Peter Harvey and Bob Newton and all offer themselves for re-election at the 2013 AGM.

Richard Coates has been appointed to the Board since the conclusion of the last AGM on 15 May 2012, which makes him eligible for re-appointment at the 2013 AGM.

The notice of the AGM can be found on page 134. All directors due for re-election continue to demonstrate commitment to their roles. (See schedule of attendance on page 15.)

Board composition

The names of the members of the Board, their biographies and details of length of service are set out on page 12. They were in office for the full period unless otherwise stated.

During the year the composition of the Bank Board was reviewed to strengthen the balance of independent representation and to ensure the appropriate skills and experience were in place to support the long term strategy. Following the review, it was agreed that in future the Board of the Bank would comprise 14 directors being the Chief Executive Officer, the Chief Financial Officer, four representatives from the Co-operative Group and eight independent Non-Executive Directors.

Of the 12 directors sitting on the Bank's Board of directors at the end of 2012 there were 11 Non-Executive Directors and one executive director. Of the 11 Non-Executive Directors four are elected members of the Co-operative Group Board, two are Co-operative Group Executives and five are independent and recruited for their specific financial services experience and expertise. In addition to the appointment of Richard Coates as an independent Non-Executive Director a search is being undertaken for three additional independent Non-Executive Directors. In February 2013 the Bank announced that Graeme Hardie would be joining the Board as an independent Non-Executive Director with an expected joining date of May 2013.

Following signature of heads of terms for the acquisition of the Verde business, it is recognised that the executive appointments to the Board will be reviewed in due course. Barry Tootell is the Chief Executive of the Bank and is appointed to the Board as a director. The existing Chief Financial Officer, James Mack, has announced his resignation and will be leaving the business in 2013. He is not a director therefore there is an executive director vacancy on the Board.

Independence

The Code requires at least half of the Board, excluding the Chair, to be independent Non-Executive Directors. Although not currently compliant with this requirement the Board is taking steps to recruit three additional new independent Non-Executive Directors, as referred to above, to improve the Board's independence and ensure compliance with the Code.

At the end of the year five independent Non-Executive Directors (excluding the Chair) sat on the Board: David Davies, Peter Harvey, Bob Newton, Anne Gunther and Merlyn Lowther. Rodney Baker-Bates was an independent professional Non-Executive Director until his retirement.

All the independent non-executives have considerable experience and make valuable contributions to the operation of the Bank. The independent Non-Executive Directors constructively challenge and help develop proposals on strategy and bring strong, independent judgment, knowledge and experience to the Board's deliberations. The independent Non-Executive Directors are of sufficient calibre and number that their views carry significant weight in the Board's decision making.

The role of the Chair

The Chair is a Non-Executive Director and leads the Board in the determination of its strategy and in the achievement of its objectives. The Chair takes personal responsibility for organising the business of the Board, ensuring its effectiveness and setting its agenda. The Chair has no involvement in the running of the day to day business of the Bank. The Chair facilitates the effective contribution of directors, constructive relations between the executive and Non-Executive Directors, ensures directors receive accurate, timely and clear information and ensures that there is effective communication with members.

The division of responsibilities between the Chair and the Chief Executive is clearly defined and has been approved by the Board.

The current Chair is Paul Flowers who is an elected member of the Co-operative Group Board. The two Deputy Chairs are David Davies and Peter Harvey (who replaced Rodney Baker-Bates), both of whom are independent Non-Executive Directors. The Deputy Chairs together fill the role of Senior Independent Director. The Deputy Chair vacancy which will arise on the departure of David Davies in 2013 will be filled by Merlyn Lowther who is also an independent Non-Executive Director. Details of the Chair's and Deputy Chairs' professional commitments are included in the biographies on page 12. The Board is satisfied that these responsibilities do not interfere with the performance of the Chair or Deputy Chairs' duties for the Bank.

The role of the Chief Executive and the Executive

The Chief Executive has direct charge of the Bank on a day to day basis and is accountable to the Board for the financial and operational performance of the Bank.

It is the responsibility of the Executive to achieve the business objectives as agreed by the Board. The Executive, under the leadership of the Chief Executive, are responsible for the management of the Bank.

The secretary to the Board

The secretary is professionally qualified and is responsible for advising the Board through the Chair on all governance matters. The directors have access to the advice and services of the secretary. The articles of association and the schedule of matters reserved to the Board for decision provide that the appointment and removal of the secretary is a matter for the Board.

How the Board operates

Meetings

The Board meets on a monthly basis and it met 15 times in 2012 including three meetings held specifically to consider the acquisition of the Verde business. The Board is scheduled to meet for 12 Board meetings and to hold two strategy meetings in 2013. The strategy meetings will be attended by senior executives and will consider performance and longer term planning. If necessary, the Board also holds private sessions in the absence of executive directors. Members of the Executive and senior management are invited to Board meetings for specific items. This assists key messages from the boardroom to be articulated to the business and vice versa. In addition members of the Executive seek advice from Non-Executive Directors on a one to one basis at times.

Details of attendance at Board meetings are noted below.

Information to Directors

Recognising the need for a more secure, cost effective alternative to paper Board packs and in line with the Bank's strong stance on environmental ethics, an electronic Board paper solution was trialled with directors and key meeting attendees at the beginning of the year. Following a positive response from directors, the distribution of hard copy Board packs was phased out completely by June 2012.

Directors and key attendees of all Boards and committees now use electronic tablets as their primary method of receipt of papers and this is being further developed to include areas such as supporting material, training and calendar management.

Board and committee papers are now available for directors to access ordinarily eight days before each meeting. This provides the opportunity for directors to prepare fully for meetings. The minutes of all meetings are available to all directors via their electronic tablets.

Attendance

The following table sets out the frequency of, and attendance at, the Board and Board committee meetings for 2012 by directors:

Directors	Bank Board	Audit Committee	Board Risk Committee	Exposures Committee	Integration and Transformation Committee	Remuneration and Appointments Committee
Number of meetings held	15	11	13	8	9	8
Paul Flowers	15 (15)				8 (9)	8 (8)
Duncan Bowdler	15 (15)	10 (11)		8 (8)		
David Davies	15 (15)		11 (13)			7 (8)
Anne Gunther	15 (15)		13 (13)	8 (8)	1 (1)	1 (1)
Peter Harvey	15 (15)	9 (11)	1 (1)	8 (8)		
Merlyn Lowther	15 (15)		13 (13)		4 (5)	
Peter Marks	12 (15)					6 (8)
Bob Newton	14 (15)	10 (11)	9 (13)		8 (9)	
Ben Reid	12 (15)	9 (11)				
Barry Tootell	15 (15)					
Len Wardle	12 (15)			6 (8)		8 (8)
Martyn Wates	14 (15)					
Former directors						
Rodney Baker-Bates	9 (9)					4 (4)
Paul Hewitt	11 (12)	7 (7)	7 (9)		7 (7)	

The number in brackets indicates the total number of meetings the director was eligible to attend during the year. In the case of a director being unable to attend a meeting, the Chair has received a satisfactory reason for their absence.

Board committees

With the agreement of the Financial Services Authority (FSA), the Board has delegated certain responsibilities to a number of committees, all of which have written terms of reference covering the authority delegated to it by the Board. Each of these committees has a role in ensuring the effectiveness of the Bank and its subsidiaries. In accordance with the Code, the terms of reference for all the committees can be found at http://www.co-operativebankinggroup.co.uk.

During 2012, work continued on the Banking Group risk governance framework policy which sets out how the Banking Group and its subsidiaries, including the Bank, manage risk in pursuit of their business objectives. As part of the work undertaken there was a review of the governance committees operating within the Banking Group, both at Board committee level and below, and as a result of the review, the terms of reference for the Audit Committee, Board Risk Committee and Remuneration and Appointments Committee were revised.

Audit Committee

Information on the Audit Committee is found on page 18.

Remuneration and Appointments Committee

Information on the Remuneration and Appointments Committee is found on page 20.

Corporate governance continued

Board Risk Committee

The Board Risk Committee comprises four members and the Chair is Merlyn Lowther. During the year the committee comprised:

Merlyn Lowther	Chair (appointed Chair on 18 January 2012)
David Davies	
Bob Newton	
Anne Gunther	(appointed 18 January 2012)
Peter Harvey	(resigned 22 February 2012)
Paul Hewitt	(resigned 21 September 2012)

Paul Hewitt stood down from the committee following his resignation as a Board member. Peter Harvey was appointed as the interim Chair on 8 September 2011 and on 18 January 2012 Merlyn Lowther formally took on the role of Chair. Peter Harvey resigned from the committee on 22 February 2012. The make up of the committee will again be reviewed following the appointment of additional independent Non-Executive Directors to the Board. The committee met 13 times during the financial year.

The main responsibilities of the committee are set out in its terms of reference and include consideration of the management and control of all significant risks, including technical, operational, business model and external risks. The committee's terms of reference were revised and approved on 18 April 2012 in line with the evolving risk management framework policy.

In accordance with its terms of reference during 2012 the committee reviewed the development and embedding of the risk management framework and the work on risk culture and sought assurance that an appropriate risk culture prevailed in the organisation. The committee also reviewed, challenged and recommended to the Board approval of risk appetite, limits and tolerances. A number of key prudential regulatory requirements for the Bank were reviewed including the Internal Capital Adequacy Assessment Process (ICAAP) and Individual Liquidity Adequacy Assessment (ILAA). The committee reviewed reverse stress testing including the methodology and the results. The committee has discussed and reviewed the development of the Recovery and Resolution Plan (RRP).

During 2012, the committee met regularly to review and assess the risks associated with the two major projects that are underway within the Co-operative Banking Group in respect of the sale of the life business and the acquisition of the Verde business from Lloyds Banking Group. Due to the heavy schedule, additional meetings were arranged so that the committee could fully consider and discuss these transactions and provide appropriate focus.

During the year the committee has reviewed its own effectiveness. The results of the review will be used to assist in the development of the effectiveness of the committee under its revised terms of reference.

Exposures Committee

During the year the committee comprised four members and the Chair was Peter Harvey:

Peter Harvey	Chair
Anne Gunther	
Duncan Bowdler	
Len Wardle	

The committee met eight times during the financial year and its main responsibilities, as set out in its terms of reference were to sanction large counterparty transactions, manage large exposure positions and consider risk management of exposures.

During the year, pursuant to the implementation of the new risk management framework, the role of the Exposures Committee was reviewed. Its responsibilities, as set out in its terms of reference, were reallocated to other Board and executive committees and therefore the Exposures Committee ceased meeting in September 2012.

Integration and Transformation Committee

The committee comprises four members and the Chair is Bob Newton. During the year the committee comprised:

Bob Newton	Chair
Paul Flowers	
Anne Gunther	(appointed 10 October 2012)
Merlyn Lowther	(appointed 18 April 2012)
Paul Hewitt	(resigned 21 September 2012)

The main responsibilities of the committee are set out in its terms of reference. The committee considers integration issues across the Bank and Banking Group and met nine times in 2012.

Following the commencement of negotiations to acquire Verde the committee's terms of reference were reviewed to broaden its scope and the name was changed from the Transformation Committee. The committee has reviewed its effectiveness during the year. This review recognised that the terms of reference will require amendment in 2013 to refine the scope of the committee and reflect the position at that time.

Board effectiveness

Board statement on diversity

The Board takes the issue of diversity seriously and actively promotes policies and practices of equality of opportunity, regardless of age, disability, ethnicity, gender, religion or belief or sexual orientation.

The Bank Board recognises that having members from different backgrounds and with different skills is key to being a challenging and effective Board and believes that by having a diverse Board it will:

- help the Board represent the views of the wider co-operative membership;
- bring a broad range of skills and knowledge to the Board;
- support good governance through challenge and discussion from a diverse range of viewpoints;
- uphold the co-operative values and principles of honesty, openness, equality and equity; and
- gain a leadership position in the UK with regards to good governance and Board composition.

The Board policy includes all aspects of diversity, and in particular, responds to the revised UK Corporate Governance Code published in September 2012, which addresses the recommendations by Lord Davies in his 'Women on Boards' report published in February 2011. The policy aims to address the representation of women on the Board by setting interim targets for the percentage of female directors serving on the Board which are agreed and will be regularly reviewed by the Board. The policy also aims for a Board composition to reflect the diverse composition of the UK population based on the most recent UK Census results.

Currently, interim targets have been set for the Bank Board to comprise of a minimum of 33% of females by 2016, and to comprise of a minimum of 40% of females by 2018. Of the 12 directors appointed to the Bank Board at the end of 2012, two of these were women. Anne Gunther and Merlyn Lowther were appointed to its Board in 2011 and at the end of 2012 women represented 17% of the Board. All recruitment to the Bank Board will take into consideration the Board's policy on diversity.

Performance evaluation

The Code requires the Board to undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

The Board last underwent an external evaluation exercise of its effectiveness at the end of 2010, the only significant recommendation (in respect of the size and composition of the Board) has been addressed during 2011/2012. The next external review is planned for 2013.

An internal self assessment of Board effectiveness took place during the year. The outcome was considered in a separate session of the Board to give time for appropriate discussion of the results of the self assessment. Key issues included the provision of competitor information and the adequacy of succession planning. These areas continue to be under review.

Each year, the Board committees undergo internal self assessment of their effectiveness. In 2012, all the key Board committees including both Audit and Board Risk Committees carried out self assessment exercises.

Each year, one third of the Board directors are subject to a peer evaluation selected on length of service from first appointment to the Board, subject to having served at least one year on the Board as at 30 June. Such an exercise took place in 2012. The responses to the peer evaluation questionnaires provided the basis of one to one discussions with the Chair of the Board.

Induction and continuing professional development

In line with recommendations of the Code, the Bank has reviewed the induction programme for new directors and all newly elected directors are required to undertake a structured induction programme. This is designed to include key corporate governance and business information, including briefing sessions with the Executive on the strategy and performance of key business areas.

A Board learning and development policy is in place to support all Non-Executive Directors. Following discussion at Board to prioritise collective training and development, thematic learning and development sessions for the whole Board have taken place.

Specific training has been organised for Board committees including the Remuneration and Appointments Committee, the Audit Committee, the Exposures Committee and the Board Risk Committee. In addition, one to one support has been provided to a number of directors.

Directors receive information on the operation of the Board's Committees, including the powers delegated to the committees, corporate governance practices and procedures and the powers reserved to the Executive together with the latest financial information. This is supplemented by meetings with key senior executives where appropriate, together with in depth training and round table sessions on specific areas.

An electronic 'reading room' is available as a resource bank to enable directors to access, revisit and review copies of presentations and materials from the more formal development sessions.

Individual learning and development records are issued to all Non-Executive Directors summarising activity through the year and individual learning plans have been put in place in order to construct the framework for individual and collective learning and development.

The Chair addresses the development needs of the Board as a whole, with a view to developing its effectiveness. He ensures that the directors' professional development needs are identified and that they are adequately informed about the Group and their responsibilities as directors.

Succession planning

As part of its annual performance evaluation the Board considers its composition and the balance of skills in the boardroom. When vacancies arise on the Board, directors are consulted prior to commencement of a search to fill a vacancy to ensure the skills and experience being sought from any new appointee enhance the Board composition.

Conflicts of interests

The Board has a conflicts of interests policy. The policy outlines how conflicts will be dealt with and the process for directors to follow when notifying the Bank of an actual or potential conflict. When deciding whether to authorise a conflict or a potential conflict of interest, only those that have no interest in the matter under consideration are able to take part in the decision.

The Board has considered the current external appointments of all directors which may give rise to a situational conflict and has authorised potential conflicts where appropriate.

Directors and their interests

No director had a material interest at any time during the year in any contract of significance, other than a service contract, with the Bank or any of its subsidiary undertakings.

No director had a beneficial interest in any ordinary shares in the Bank or the Banking Group or in Co-operative Group Limited, which is the ultimate holding organisation, or in any other entity controlled by the Co-operative Group. As disclosed in his biography on page 12, Bob Newton is a Non-Executive Director of UIA (Insurance) Limited. UIA (Insurance) Limited holds 200,000 preference shares in the Bank.

Insurance and indemnities

The Bank maintains appropriate directors' and officers' liability insurance cover through the ultimate parent organisation, in respect of legal action against its directors and officers. This constitutes a 'qualifying third party indemnity provision' for the purposes of s236 of the Companies Act 2006 and applied to all of the Bank's directors serving during the financial year. The insurance cover was reviewed and renewed in 2012.

The directors, the secretary and any of the Group's approved persons under the Financial Services and Markets Act 2000 from time to time have entered into a contract of indemnity with the Group in respect of certain liabilities they may incur whilst discharging their functions.

Professional advice and Board support

A number of external consultants provide professional advice to the Board. There is an agreed procedure by which directors may take independent professional advice at the Bank's expense in furtherance of their duties.

Corporate governance continued

Audit

Audit Committee

Composition

The committee is appointed by the Board, comprises four members and, for the majority of 2012, was chaired by Paul Hewitt. Peter Harvey was appointed interim Chair on 22 September 2012 and will be replaced in 2013 by Richard Coates. During the year the committee comprised:

Paul Hewitt	Chair (resigned 21 September 2012)
Peter Harvey	(appointed Chair on 22 September 2012)
Duncan Bowdler	
Ben Reid	
Bob Newton	

In compliance with the terms of reference, Paul Hewitt and Ben Reid brought recent and relevant financial experience and in addition Ben Reid chaired the Co-operative Group's Audit and Risk Committee until 4 November 2012. Duncan Bowdler is a member of the Co-operative Group's Audit and Risk Committee and Bob Newton is also a member of the Co-operative Banking Group's Board Risk Committee. The committee's terms of reference were reviewed and approved on 11 July 2012.

Bob Newton and Peter Harvey are considered to be independent members of the committee. Paul Hewitt stood down from the committee when he ceased to be a director and consequently, for the period until Richard Coates was appointed in 2013, a majority of the committee members were not considered independent as required by the UK Corporate Governance Code. The composition of the committee will again be reviewed following the appointment of additional independent Non-Executive Directors to the Board.

In accordance with the terms of reference members of the executive and management regularly attend meetings of the committee.

Role of the committee

The main responsibilities of the committee are set out in its terms of reference which are available on our website http://www.co-operativebankinggroup.co.uk and include to:

- review and discuss with management and auditors the preliminary results, interim information and annual financial statements of the Bank before submission to the Board;
- review, prior to its consideration by the Board, the external auditor's reports to the directors and management's response;
- consider any necessary disclosure implications from the process that has been applied by the Board to deal with material internal control aspects of any significant problems disclosed in the financial statements;
- obtain assurance that the Bank is compliant with relevant regulation; and
- review and approve the scope of the annual regulatory monitoring plan, taking into account the regulatory risks identified from time to time.

Committee focus during 2012

The committee met 11 times during the financial year. During 2012 the committee focused on:

- the appropriateness of the accounting judgments in the 2012 annual report and the 2012 interim report. The key judgments for the Bank were:
  1. value in use calculations on the replacement of the core banking system. This asset is held on the balance sheet of CFSMS and recharged to the Bank. The committee considered the estimated costs and benefits of the system and discussed the implementation plan with members of the Executive. The debate centered around robustness of plans and sensitivity of the numbers to highly judgmental issues such as implementation date, discount rate and costs to complete.
  2. PPI provision. The committee reviewed a detailed paper and discussed with the Director of Retail Banking the level of the provision and the judgments made in calculating the provision. These judgments, including uphold rates, average payouts and past business review cohorts were benchmarked against actual data and peer group statistics.
  3. credit impairment, particularly in the corporate area. Levels of credit impairment in the bank in 2012 were significant. The committee received detailed calculations of impairment across all areas of the bank. For corporate impairment, members of the committee reviewed and challenged in detail, following review by management from finance, risk, the credit teams, internal and external audit (in line with the three lines of defence model described in the risk management section), all items on the watchlist, all items with attached forbearance and all items considered high risk (ie due to loan to value or interest cover ratios). This represented over 30% of the portfolio. The committee considered the level of exposure to BPIIGS countries and does not consider this to be material. The committee will review impairment on a quarterly basis and is satisfied that current lending is in line with a conservative risk appetite.
  4. going concern. The Audit Committee took particular care to review the going concern status of the organisation in depth. Profit, capital and liquidity forecasting were debated along with the proposed actions to improve the position.
- the control environment, particularly in IT, Finance and Treasury;
- areas receiving a red graded audit report, where the executive responsible was required to attend the meeting to answer the committee's questions. The committee monitored the action plans associated with these audit reports;
- in the run up to and following the signing of heads of terms for the Verde acquisition, the committee held four meetings specifically to discuss the transaction, focusing on the scope and findings of the due diligence and independent assurance work;
- reviewing the arrangements in place to ensure that the internal audit team working on the Banking Group, including the Bank, continued to operate in accordance with best practice.

Additionally the committee received regular reports from KPMG and representatives from KPMG were consulted throughout the debates in each meeting. The committee also met with internal audit four times and KPMG five times. Two of the meetings with the external auditors took place without the presence of internal audit.

Annual review of effectiveness

Following the committee effectiveness review in 2012 it was decided to increase the frequency of meetings from four to six to allow sufficient time to deal with the very full agendas, particularly at half-year and year-end. Given the busy schedule, the committee members recognised the need to retain focus on the Audit Committee training plan and accordingly a programme of activity for 2012 and 2013 has been agreed and adhered to.

Training for committee members

The committee received formal presentations as part of the committee members' learning and development programme which covered forthcoming changes to accounting standards and assurance frameworks.

Members of the committee undertook a visit to the Treasury dealing room at the London office and members were also invited to attend training on corporate governance and risk management responsibilities.

In addition committee members have access to the Audit Committee Institute for background information and guidance on the role and responsibilities of Audit Committee members. New committee members are also provided with an induction.

External audit

The current auditor is KPMG Audit Plc. In line with good corporate governance, a tender process took place during 2011 to consider the appointment of the external auditors to the Co-operative Group, including the Banking Group and the Bank and KPMG Audit Plc was selected and approved at the AGM.

In accordance with Section 489 of the Companies Act 2006, a resolution for the appointment and remuneration of the auditors are proposed at the next AGM and set out on page 134.

Independence, objectivity and fees

The Audit Committee has put in place safeguards to ensure that the independence of the audit is not compromised including a policy on the conduct of non-audit services from the external auditors. The external auditors are permitted to provide some non-audit services that are not, and are not perceived to be, in conflict with their independence. The Audit Committee receives at each meeting a report providing details of assignments (and related financial fees) carried out by the external auditors of the Bank in addition to their statutory audit work. The pre-approval of the committee is required for services above certain thresholds determined by the committee.

In addition, the following assignments are prohibited from being performed by the external auditors:

- bookkeeping or other services related to the accounting records or financial statements;
- financial information systems design and implementation;
- actuarial services;
- Internal Audit outsourcing services;
- management functions or human resources; and
- any other services that the Audit Committee may determine.

Details of fees paid to the auditor for audit services, audit related services and other non-audit services is provided in note 2 to the accounts which includes an analysis of the nature of non-audit spend.

Performance

The committee undertakes a formal annual assessment of the performance of the external auditor, through questionnaires completed by senior managers and directors.

Internal Audit

The Internal Audit function is an independent function which reports to the Audit Committee. Its primary role is to provide assurance over the adequacy and effectiveness of the internal control framework including risk management practices.

Internal Audit seeks to discharge the responsibilities set down in its charter by completing a risk based internal audit plan, reviewing the processes which ensure that the key business risks are effectively managed by key controls.

Internal Audit also acts as a source of constructive advice and best practice on control, working with senior management to deliver its responsibility to improve the processes by which business risks are identified and managed.

Internal Audit reports are submitted to, and significant issues discussed at, the Audit Committee.

Risk management

The Board and executive management have primary responsibility for identifying the key business risks facing the Bank and for approving the Bank's risk strategy and level of acceptable risk which is articulated through its statement of risk appetite. The risk management framework, which is approved and reviewed by the Bank Board, outlines the approach taken to ensure a robust risk management process is in place throughout the Bank.

During 2012 the Banking Group undertook a wide ranging review of its risk management framework which resulted in significant change in its organisational design. The work on the risk management framework to date has included a redesign of the way the Bank classifies the risks it faces, the way risk appetite is established and the structure and application of the authority delegated by the Board to manage the risk within the agreed appetite.

The Board accepts that there are risks which could impact on the achievement of the Bank's business objectives, but endeavours through positive risk management strategies as outlined in the risk management framework, to manage these in a manner that optimises returns within the confines of the business' risk appetite, whilst protecting members' interests and reserves.

Further information on the Bank's approach to risk management is given on page 54 and details of KPIs are on page 2.

Internal control

Internal controls are the activities undertaken by management, the Board and other parties to enhance risk management and increase the probability that established objectives and goals will be achieved. The Board has overall responsibility for the Bank's system of internal controls which aim to ensure effective and efficient operations, quality of internal and external reporting, safeguarding of the Bank's assets and compliance with laws and regulations. The Bank operates a three lines of defence governance model to ensure appropriate responsibility and accountability are maintained whilst recognising that the system is designed to manage rather than eliminate risk of failure to achieve business objectives, it can only provide reasonable and not absolute assurance against material misstatement or loss.

The Bank's internal control framework is designed to create an attitude of taking acceptable business risk within clearly defined limits which includes:

- an organisational governance structure with clear lines of responsibility, delegation of authority and reporting requirements;
- checks and balances to ensure that business processes operate efficiently reducing the risk posed to the organisation whilst adhering to organisational values;
- comprehensive systems of financial reporting. The annual budget and long term plan of the Bank and of each division are reviewed and approved by the Board;
- a code of business conduct covering relations with customers, shareholders, colleagues, suppliers, community and competitors;
- a whistleblowing policy and procedure which provides for any employee to report, in confidence, suspected serious malpractice;
- internal audit, risk and compliance functions that review the system of internal control; and
- a control self assessment process designed to fully support the annual review of the effectiveness of the system of internal control and enable continual monitoring and improvement of the internal control environment.

Remuneration report

Committee Chair's summary

"The committee will continue to focus on the linking of reward to business and individual performance and the strengthening of co-operative values which include a strong belief in the stewardship of all the Society's resources, and, therefore which are consistent with and promote effective risk management."

Important principles which make Co-operative Bank Remuneration Policy distinctive from other PLCs include:
- levels of variable pay (annual and long term bonus) opportunity are modest, consistently set at levels lower than in comparably sized PLCs;
- the construct of both the annual and long term bonus plans is based on a balanced scorecard that includes significant non-financial measures which ensure that there is no encouragement of inappropriate risk taking;
- balanced scorecard linked to co-operative values and principles;

Key considerations for this year have included:
- payment of zero awards under the 2012 annual incentive plan, the 2010–12 long term plan and deferred payments due to 2012 and cumulative financial targets not being achieved;
- continuation of dialogue with the Financial Services Authority (FSA) in connection with our current and future remuneration practices. All remuneration arrangements and practices in place are compliant with the FSA Remuneration Code; and
- focus on risk adjustment and remuneration policies which promote effective risk management.

The committee's responsibility is to determine and oversee remuneration policy that seeks to retain and motivate talented individuals, align with co-operative values and principles, and comply with best practice and FSA Remuneration Code requirements.

The committee reviews the ongoing appropriateness and relevance of remuneration policy and takes into account many factors including the need for remuneration to be structured so as to link rewards to business and individual performance.

With regard to future remuneration policy, the committee believes annual and long term incentive schemes to be appropriate and as such will motivate the senior executives to achieve short to medium and long term business objectives.

Ex post risk adjustment; the cancellation or reduction of variable remuneration through malus (for example clawback of an award for an executive action which leads to customer detriment) will be a major area of focus for the committee as we review our future remuneration policies and practices.

In our report, we give further details on our remuneration policy and an overview of senior executive remuneration for 2012.

Anne Gunther, Chair
Co-operative Banking Group Remuneration and Appointments Committee

Introduction

In the interest of good governance the Co-operative Bank (the Bank) uses as a guideline for its remuneration disclosure, the requirements applicable to listed companies, as set out in schedule 8 of the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008 (incorporated into the Companies Act 2006). This remuneration report will be subject to an advisory vote by shareholders of the Bank at its Annual General Meeting to be held on 18 May 2013.

This report provides details of the remuneration of both the senior executives (including executive directors and executive committee members) and the Non-Executive Directors.

In recognition of the draft requirements that the UK Government's Department for Business, Innovation & Skills (BIS) has recently consulted on, the Bank has incorporated emerging practice within its remuneration report.

The remuneration report is presented by the Board and contains the following information:

Policy section:
- a description of the role of the Remuneration and Appointments Committee;
- a summary of the Bank's remuneration policy, including statements of policy in relation to senior executives' remuneration;
- a policy table with supporting notes showing each element of senior executives' remuneration;
- details of the terms of the service contracts and exit payment policy;
- considerations elsewhere in the Bank.

Implementation section:
- details of the current terms of office and total remuneration of each senior executive and Non-Executive Director for the 2012 financial year;
- remuneration governance.

Policy section

Role of the committee

The committee's terms of reference were last revised and approved by the Bank's Board on 5 September 2011.

The committee's principal terms of reference are to:

- determine the policy on remuneration and other main terms and conditions of employment of senior executives;
- oversee contractual arrangements for the senior executives and approve the principal terms and conditions of employment of such senior executives;
- review remuneration using comparisons against the agreed market policy for the senior executives;
- make recommendations on senior executive appointments and the terms and conditions relating to these;
- review and agree the remuneration policy and outcomes in respect of all designated code staff under the FSA Remuneration Code;
- approve any relevant incentive schemes, ensure that they are in line with current market practice and the FSA Remuneration Code, and authorise payments under any incentive schemes in line with their rules; and
- receive, review and decide on issues raised in relation to retirement benefit schemes across the Bank and advise the Board on these issues as appropriate.

The Co-operative Group Remuneration and Appointments Committee governs remuneration in respect of the role of the Bank's Chief Executive.

The terms of reference for the committee are available on The Co-operative Banking Group website.

The committee members are all Non-Executive Directors. They have no personal financial interests in the committee's decisions, and they have no involvement in the day to day management of the Bank.

To ensure that it receives independent advice on remuneration matters, the committee retained New Bridge Street (an Aon Hewitt company) as its advisers during 2012. New Bridge Street has supplied survey data and advised on market trends and other general remuneration issues. Other than specialist advice in relation to remuneration matters, New Bridge Street does not provide other services to the Bank. Addleshaw Goddard LLP was also retained to provide legal advice to the committee with respect to senior executives' service contracts.

Policy on senior executive remuneration

In determining the remuneration policy for senior executives, the committee has considered a number of factors including:

- the importance of attracting, retaining and motivating senior executives of the appropriate calibre to further the success of the Bank;
- the linking of reward to business and individual performance and the application of co-operative values, which include a strong belief in responsible stewardship of all the Bank's resources and prudent management of risk;
- the alignment of the interests of senior executives with those of the wider Group and its members;
- pay practices and conditions of all employees throughout the Bank;
- the motivational impact of incentive arrangements to ensure that they are effective and do not adversely impact matters such as governance, environmental and social issues;
- in conjunction with the Group Remuneration and Appointments Committee ensuring that pay practices are coherent with those in the Co-operative Group as a whole; and
- ensuring appropriate compliance with the FSA Remuneration Code.

The current policy is to pay senior executives base salaries around the market median, when compared with other organisations of comparable size and complexity in relevant business sectors. The committee supports the principle of performance related pay and operates an annual incentive plan (AIP) and a long term incentive plan (LTIP) which, together, mean that over 50% of the remuneration package is performance related. The committee does not consider it appropriate to adhere to the size of variable pay typically available in PLCs and accordingly the amounts payable under these plans are lower than in comparable PLCs. Together, the AIP and LTIP represent total variable remuneration, with awards under the LTIP comprising the deferred element of variable remuneration as required by the FSA.

The committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the Bank's business environment, and in market remuneration practice. Accordingly, the committee keeps the Bank's remuneration policy under review. In particular, the absence of highly 'geared' incentive plans (schemes which pay out significant multiples of base salary when compared with some practices in the PLC sector) is consistent with prudent risk management.

The committee notes that the remuneration practices already adopted by the Bank, in addition to being good business practice, have been endorsed by the FSA through its Remuneration Code. However, the committee will continue to strive for further improvements in its executive remuneration arrangements as best practice evolves.

Policy Table

The main components of senior executive remuneration are summarised in the table below:

Element	Overview	How each element supports the strategic objectives of business	High level details	Clawback provision	Change in approach since last disclosure
Base salary[1]	To provide a competitive base salary to attract and retain talented leaders.	Payment for day to day role and responsibilities, individual performance objectives aligned to overarching business strategy.	Reviewed annually. Targeted around market median. Future increases based on performance results.	N	N
Benefits[2]	To provide benefits in line with normal market practice.	Competitive benefits proposition ensures talent is attracted/retained and able to undertake duties.	Car allowance, medical and life insurance.	N	N
Pension[3]	To provide competitive pension and protection benefits to attract and retain talented leaders.	Retains skills and experiences within the business.	The Co-operative Group provides either a defined benefit or a defined contribution pension plan (on the same basis as applies to all other employees in the Group) and/or an allowance designed so that the total value of the pension element is broadly the same as the value of the defined benefit pension plan. (See page 22.)	N	Y – Group-wide change in pension policy, applicable to all colleagues including senior executives
Annual incentive plan[4]	To incentivise and reward the delivery of superior annual performance, based on the Bank's annual business objectives and co-operative values.	Motivates delivery of business results aligned to the Board agreed balanced scorecard. Inclusion of financial and non-financial targets.	Up to 60% of salary based on The Co-operative Banking Group annual financial and non-financial targets. Incentive opportunity is below the market norm in comparable PLCs. (See page 22.)	Y	N
Long term incentive plan[5]	To incentivise and reward the delivery of superior long term performance, based on the Co-operative Group's objectives and values, and to retain talent.	Encourages long term, sustained performance; motivates delivery of long term business results aligned to the Board agreed balanced scorecard. Inclusion of financial and non-financial targets.	Awards up to 100% of salary for the Bank Chief Executive and 75% for other senior executives based on stretching three-year Group financial and non-financial targets. Incentive opportunity is below the market norm in comparable PLCs. (See page 23.)	Y	N

Remuneration report continued

Policy notes to the policy table:

1 Base salary
It is the committee's policy to ensure that the base salary for each senior executive is appropriate and competitive for the responsibilities involved and experience required. Base salaries for senior executives are reviewed by the committee, usually annually, having regard to competitive market practice, business and individual performance during the financial year and salary levels throughout the Bank. Comparative pay data is used carefully, recognising the potential for an upward ratchet in remuneration caused by over reliance on such data. The normal month for salary review is January. Base salary policy is generally the same for senior executives and all other employees, in the Bank.

2 Benefits
It is the committee's policy to ensure that the benefits for each senior executive are appropriate and competitive in regard to market practice. As is commonplace there are a number of benefits which relate to hierarchy and at managerial grades healthcare benefit and car allowance would be applicable. There are Bank-wide benefits which are generally the same for senior executives and all other employees, in the Bank, for example Employee Member Dividend and staff discounts.

3 Pensions
The Bank participates in the Co-operative Pension Scheme (Pace) which is a registered occupational pension scheme.

The Group harmonised pension arrangements for all employees from 6 October 2012 following completion of a major strategic review. As a result the arrangement is as follows:

- all schemes, other than Pace, were closed to future pension accrual. Defined benefits built up to this date continue to be linked to final pensionable salary at a member's date of leaving or retirement, whichever is earlier.
- Pace remains open for future pension accrual. Two new defined contribution sections were introduced called Pace Essential and Pace Extra and the defined benefit section was renamed Pace Complete.
- members of Pace Essential, into which all eligible employees will be automatically enrolled, currently pay 1% of pay and the employer pays 2%. Members of Pace Extra, which is available to all employees, currently pay 4% of pay and the employer pays 8%.
- all employees can choose to join Pace Complete once they have completed two or more consecutive year's service.
- Pace Complete provides defined benefit pensions based on 1/60th of average pensionable earnings, revalued by inflation for each year of pensionable service (benefits accrued as at 5 April 2006, in respect of membership of the scheme preceding Pace, continue to be linked to final pensionable salary at a member's date of leaving or retirement, whichever is earlier).
- if death occurs in service all sections provide a lump sum benefit and Pace Complete also provides dependants' pensions.

Members of Pace Complete currently contribute 8% of their pensionable salary or 7% of pensionable salary (until October 2013) if they were a contributing member of Pace at 31 December 2011. Prior to 6 October 2012 members of Pace contributed 6% of their pensionable salary. The employer pays the balance of the cost of providing defined benefits.

All members of Pace have the choice of making pension contributions by salary sacrifice.

Furthermore, in the light of the pension tax changes applying to registered schemes from 6 April 2011, Group executive pension policy was revised. Where an executive may be impacted by the Annual Allowance or the Lifetime Allowance, they have the facility of opting out of future pension accrual in favour of a pension allowance or opting for restricted pension accrual based on a capped pensionable salary of £187,500 and receiving a restricted pension allowance, in lieu of pension provision, based on salary, above £187,500. Where paid, the rate of pension allowance is based on the employer contribution rate to Pace Complete. This is currently 16% of pensionable salary (16.7% prior to October 2012). Executives who join Pace Extra are provided with an additional 8% of pay as a pension contribution or pension allowance for the period they are ineligible to join Pace Complete.

Supplementary life cover is provided to executives in order to provide total life cover of 4 x salary when aggregated with benefits from Pace.

Prior to October 2012 different pension arrangements were in place for some Bank colleagues. Following the merger with Britannia Building Society on 1 August 2009, colleagues who at that date were members of the Britannia Pension Scheme ('the Britannia Scheme') continued in membership of the Britannia Scheme. From 1 August 2009 until 6 October 2012 only the defined contribution section of the Britannia Scheme was available to new employees of the financial services' businesses.

The Britannia Scheme, which is also a registered occupational pension scheme, provides benefits under two sections:

- a closed defined benefit section, which provides pensions based on an accrual of 1/80th, 1/60th or up to 1/30th for executives, of final pensionable salary for each year of pensionable service; or
- a defined contribution section with an employer contribution rate of 4%, 6% or 8% depending on the level of member contribution.

Members of the Britannia Scheme contributed 2% to 8% of their pensionable salary, depending on the relevant section.

Prior to the merger on 1 August 2009, the Director, Integration & Change had a contractual arrangement under which he accrued pension benefits in an unfunded employer financed retirement benefits scheme (EFRBS). The EFRBS is in place to provide pension benefits that exceed the lifetime allowance. Benefits up to the lifetime allowance will be provided from the Britannia Scheme. The arrangement was adjusted from 1 August 2011 so that the rate of future pension accrual made available under the Britannia Scheme was aligned to that provided by Pace, with no further accrual in the EFRBS.

4 Annual incentive plan
The annual incentive policy is designed to incentivise and reward senior executives for the achievement of the annual business plan as encapsulated in the balanced scorecard.

Each senior executive is eligible to participate in an annual incentive plan. The committee reviews and sets bonus targets and levels of eligibility annually. Each senior executive is eligible to receive a payment of up to 60% of base salary, although target payment levels are 35% of base salary.

The annual incentive is based on a mixture of financial and non-financial measures. The table below sets out the measures and the weighting of each measure used in 2012.

Balanced scorecard	Metric	Weighting
Financial	Profit Before Tax (PBT)	50%
	Return on Risk Weighted Exposure Amount (RRWEA)	20%
Colleague	Colleague engagement	10%
Customer	Customer satisfaction	10%
Risk	Adherence with risk management framework and risk appetite (as established by the CBG Board)	10%

The balanced scorecard approach represents best practice as set out in the FSA Remuneration Code. This approach and underlying policy is approved by the FSA and aligned to the goals of the business.

All balanced scorecard performance measures and results are audited by an external firm of accountants.

The Chief Executive's AIP is based 2/3rds on the above Banking Group's targets; the balance is based on targets for the wider Co-operative Group: profit (70%), corporate responsibility (10%), colleague engagement (10%) and customer satisfaction (10%).

In addition to achieving performance against the balanced scorecard measures (including the Chief Executive's group AIP element), four further underpins must be achieved before any payment is made. These are as follows:

1. A threshold profit level must be achieved before any element becomes payable.
2. The Bank must stay within its required liquidity range as agreed by The Co-operative Banking Group Board.
3. The Bank must stay above its required minimum capital level as agreed by The Co-operative Banking Group Board.
4. There should be no material breaches of risk in accordance with the risk appetite as agreed by The Co-operative Banking Group Board. The Chief Risk Officer is required to provide an annual report to the committee before bonus payments are signed off.

Additional deferral is also required by the FSA Code: 50% of any AIP earned is paid in March or April following the year end, while the remaining 50%, will be held in an alternative instrument for an additional six months, subject to additional performance conditions. A Contingent Capital Award (CCA) is leveraged as an alternative instrument and constructed as a non tradeable bond with maturity after six months, contingent on specified conditions.

The committee chose profit as the main driver of the annual incentive as it is a good indicator of overall business success being driven by income, impairment, costs and overall operational effectiveness, but the committee believes that other non-financial factors and co-operative values are also important. Non-financial measures are based upon independent external surveys.

AIPs do differ for senior executives in both quantum and scheme architecture from the general management population.

Clawback

In respect of annual incentive payments a clawback provision will apply in line with developing market practice. This enables the committee to seek to recoup part or all of an annual incentive payment by reference to subsequent business performance or individual behaviour of a senior executive. This also applies to any payment in respect of long term incentive.

The Bank also operates malus, a provision where the value of deferred remuneration can be adjusted downwards to take account of specified conditions eg in an instance of an executive action which leads to customer detriment.

5 Long term incentive plan (LTIP)

A Co-operative Group-wide LTIP continues to represent deferred remuneration under the FSA Remuneration Code. The purpose of this plan is to focus senior managers on the achievement and delivery of the medium to long term strategic goals for The Co-operative Group whilst protecting long term firm-wide sustainability.

Eligibility to participate is restricted to senior managers only as it is this group that is responsible for delivering the strategy as set by the Group Board. Opportunity to participate is based on individual performance, criticality and role undertaken.

The scheme and participation in the scheme is reviewed and approved annually by the committee.

Senior executives participate in the LTIP, using cumulative targets over a three year period, as the committee believes this arrangement aligns senior executives with the long term interests of members and aids retention of talent. The maximum payment is 100% of base salary for the Bank's Chief Executive and 75% for other senior executives. The actual amount of award vesting is subject to the achievement of the long term performance measures.

The committee set the following performance metrics and weightings for the 2012–14 plan cycle.

Metric	Weighting
Cumulative Group profit, subject to a minimum level of average Return on Net Operating Assets (RONOA), over the three year performance period	50%
Return on Risk Weighted Exposure Amount (RRWEA)	20%
Group corporate responsibility	10%
Colleague engagement	10%
Customer satisfaction	10%

The committee chose profit as the main driver of the long term incentive as it is a good indicator of overall business success being driven by sales, costs and operational effectiveness, but the committee believes that other non-financial factors and co-operative values are also important. Non-financial measures are based upon independent external surveys. The inclusion of RRWEA meets with FSA requirements on appropriate focus on risk, this measure only being included for Remuneration Code staff.

All balanced scorecard performance measures and results are audited by externally appointed auditors.

Additionally for Remuneration Code staff, the financial and risk underpins applicable to the AIP also apply to the LTIP, ie the four underpins must be met for any LTIP to become payable. These underpins are to provide appropriate risk adjustment and to be compliant with the FSA Remuneration Code.

Additional deferral is required by the FSA Remuneration Code: at the point of vesting, 50%, will be held in an alternative instrument for an additional six months, subject to additional performance conditions (ie for 50% of the LTIP award the total deferral period from grant is three and a half years).

Service contracts and exit payment policy

It is the Bank's policy that the notice period in senior executives' service contracts should not exceed one year. All senior executives have contracts which can be terminated by one year's notice. In the event of termination, the standard payment due to a senior executive would be based on the value of one year's base salary and other contractual benefits. In some circumstances, such as organisational changes as a result of a merger or acquisition, termination payments to colleagues leaving the Bank have been enhanced. In such cases, the formula for the calculation of termination payments to senior executives has also received some enhancement.

In normal circumstances, it is the committee's policy to apply service contracts for any newly recruited senior executives in a similar form to the model that has been developed for existing senior executives.

Remuneration report continued

FSA Remuneration Code

FSA Remuneration Code principles fully apply to all senior executives and all remuneration arrangements and practices in place are compliant with the Remuneration Code.

Code staff remuneration
Code staff are defined by the FSA as those staff having a material impact on a firm's risk profile, including a person who performs a significant influence function for a firm, a senior manager and a risk taker.

Remuneration policy and outcomes for Code staff are determined by the committee. The design of the component parts of remuneration is as set out for the senior executives. For all Code staff, performance related pay is risk adjusted through the use of the underpins to the incentive plans, together with the application of deferrals, clawback and malus adjustments in accordance with the FSA Remuneration Code.

Share option plans

As a co-operative, the Bank does not operate a share or share-option plan.

Non-Executive directorships
The committee has determined that, subject to the committee's approval, senior executives may accept one Non-Executive directorship, or similar, with an external organisation. This represents an important opportunity to further develop individuals' skills and experience, which is beneficial to the Group. During the year, any fees received for such a role were paid to the Group, however at its meeting on 14 January 2013, the committee agreed that going forward any remuneration received as a result of taking up an external Non-Executive directorship could be retained by the individual.

Considerations elsewhere in the Banking Group

The committee takes account of the pay and conditions of other employees in the Bank when reviewing senior executive pay. The committee also considers senior executive pay within the wider context of the UK market in which the Bank competes for talent.

In 2012 the base salary increase of the Chief Executive increased by 2.5% which was generally comparable with that for employees in the Bank. Similar rises were also applied to the wider senior manager group.

Non-Executive Directors
All the Non-Executive Directors are appointed, and their directors' fees are determined and paid, by the Co-operative Group.

Non-Executive Directors who are also Co-operative Group directors waive their entitlement to a fee of £16,937. The basic fee for a Non-Executive Director elected to sit on the Co-operative Group Board who also served on the Boards of the Co-operative Banking Group, The Co-operative Bank, CIS General Insurance (until June 2012) and Co-operative Insurance Society during the year, was £16,937 per annum, and these same Non-Executive Directors receive additional fees for serving on the various Banking Group Board committees (which also have responsibility for Bank business). The Chair of the Bank is a Co-operative Group Board appointee and receives a fee of £117,432 per annum.

The Independent Professional Non-Executive Directors (IPNEDs) are party to agreements with the Co-operative Group governing the terms on which their services are made available to the Bank. These service agreements expire on 31 July 2014, with the exception of David Davies whose service agreement expires on 31 July 2013. The Co-operative Group Board may resolve to reappoint any of the IPNEDs at or before the date their service agreements expire for a further three year term. It is the normal policy of the Board not to allow an IPNED to serve for more than nine years in aggregate.

A benchmarking exercise by New Bridge Street in 2010 set the basic fees for the Banking Group IPNEDs which were approved by the Co-operative Group Board. The IPNEDs and the professional external Non-Executive Director who served on the Board during the year each received a fee of £59,966 per annum. From early 2012, the Group Board agreed that all renewal of terms of office and new service agreements for IPNEDs will provide for fees to increase at the discretion of the Co-operative Group Board and will be effective from the beginning of the financial year. In 2012, no such increase was agreed.

The fees for the Co-operative Group Board directors serving on the various Banking Group Boards and committees, were increased in line with RPI at 3.9% from the beginning of the 2012 financial year.

The IPNEDs who are members of committees do not receive additional fees for such posts. The Chairs of the various committees do receive additional fees, as do the Deputy Chairs to the Board, to reflect their additional responsibilities. However, where a Co-operative Banking Group Deputy Chair is a member of or chairs a committee there is no additional fee payable. Currently, Peter Harvey, who is one of the two Deputy Chairs, also chairs the Co-operative Banking Group Audit Committee.

The Non-Executive Directors' service agreements contain no specific provision for liquidated damages on early termination of an agreement.

None of the IPNEDs are directors of the Co-operative Group or members of any Co-operative Group pension scheme or incentive plan.

Details of the directors' year of appointment and fees are shown in table 3.

Implementation section

Total remuneration received by senior executives in respect of 2012 are set out in table 1 and 1a (on page 26).

Total emoluments include:
- zero annual bonus payments in respect of 2012;
- zero LTIP, plan cycle 2010–12, have vested due to aggregate PBT not being achieved;
- details of the termination payments made to senior executives leaving the Bank during 2012; and
- dates of appointment for senior executives.

2012 AIP Outturn

For the 2012 AIP, zero award is payable due to the threshold profit level not being met. Although balanced scorecard results were strong in areas of colleague engagement, customer advocacy and risk, the scheme profit underpin has not been achieved. Table 1 and 1a show that zero bonus is payable for 2012.

LTIP Outturn

The 2010–12 LTIP cycle was completed in December 2012. Performance was based on shareholder profit, cost management, customer satisfaction and colleague engagement. Zero award is payable due to the Bank not meeting the cumulative profit target. Tables 1 and 1a (column performance related pay medium/long term) show that zero payments are made.

To summarise, senior executives' LTIP grants for 2011–13 and 2012–14 remain outstanding. Payments, if any, would be made in 2014 and 2015 respectively, 50%, will be held in an alternative instrument for an additional six months, subject to additional performance conditions.

Pensions

The Chief Executive and the Managing Director-Retail Bank have restricted pension accrual and were paid a restricted pension allowance.

The Director-Mars Project, the Managing Director-Corporate & Business Banking and the HR Director opted for restricted pension accrual from 1 April 2012 and were paid a restricted pension allowance from that date.

The Managing Director-General Insurance and Director-Integration & Change opted out of future pension accrual from 1 April 2012 and were paid a pension allowance from that date.

The Chief Financial Officer was a member of the Britannia Scheme defined contribution section, under which the contractual employer contribution rate was 12%, until he joined Pace Complete and accrued full pension benefits from 1 April 2012.

The Chief Risk Officer was paid a pension allowance.

All other executives accrued full pension benefits in Pace Complete during the year.

Governance update

Members of the committee during 2012 were Rodney Baker-Bates (Deputy Chair-Co-operative Banking Group) as Chair, together with Len Wardle (Co-operative Group Chair), Peter Marks (Co-operative Group Chief Executive), Paul Flowers (Co-operative Banking Group Chair) and David Davies (Deputy Chair, Co-operative Banking Group). Changes to the committee during 2012 were the appointment of Anne Gunther (Chair) and the resignation of Rodney Baker-Bates. Len Wardle was the interim Chair between Rodney Baker-Bates and Anne Gunther. The Board believes that all members of the committee are independent for the purpose of reviewing remuneration matters.

The Bank's Chief Executive and the HR Director are also invited to attend meetings of the committee except when their own remuneration is being discussed. The Chief Risk Officer provides an annual report to the committee and advice on any specific risk adjustments in relation to remuneration issues as required by the FSA. The committee worked with The Co-operative Group Remuneration and Appointments Committee to ensure consistency, where appropriate, with arrangements across the wider Co-operative Group.

The committee met eight times in the year to 31 December 2012.

FSA Remuneration Code

Details of the aggregate remuneration information required by the FSA are shown in table 4 and are in respect of all the Banking Group's Code staff. The amounts shown in respect of senior executives and Non-Executive Directors do not represent additional remuneration.

By Order of the Board
Anne Gunther, Chair
Co-operative Banking Group Remuneration and Appointments Committee

20 March 2013

Remuneration report continued

Table 1 – Emoluments of senior executives (executive directors) for the year ending 31 December 2012

	Notes	Date of appointment[1]	Basic salary £000	Other supplements[2] £000	Performance related bonus – annual[3] £000	Benefits in kind[4] £000	Total related to 2012 £000	Performance related bonus – long term[5] £000	2012 Total emoluments £000	2011 Total emoluments £000
Barry Tootell		4 April 2008	513	70	–	1	584	–	584	766
Former Directors who served in the Bank in 2011	6								–	1,593
Compensation for loss of office	7								–	1,390
									584	3,749

The table above represents total emoluments for the Executive Directors in relation to services for the Co-operative Banking Group.

Note 1 Date of appointment may differ from date of service commenced with the Bank.

Note 2 Other supplements include full or partial pension allowance in lieu of pension provision and car allowance (ie non-P11D items).

Note 3 Performance related bonus – annual refers to bonus amounts in respect of the whole of 2012. Zero award is payable as the balanced scorecard operating profit level was not met.

Note 4 Benefits in kind include healthcare cover (ie P11D items). In addition to the above the executive director also receives life insurance.

Note 5 Performance related bonus – long term refers to bonus amounts in respect of the 2010–12 plan. Zero award is payable as the three year aggregate operating profit threshold target was not met.

Note 6 Former directors include Neville Richardson, Rod Bulmer, Tim Franklin and Phil Lee.

Note 7 Compensation for loss of office was in respect of Neville Richardson.

Table 1a – Emoluments of senior executives (members of the executive committee) for the year ending 31 December 2012

	Notes	Date of appointment[1]	Basic salary £000	Other supplements[2] £000	Performance related bonus – annual[3] £000	Benefits in kind[4] £000	Total related to 2012 £000	Performance related bonus – long term[5] £000	2012 Total emoluments £000	2011 Total emoluments £000
Rod Bulmer		1 June 2008	410	44	–	1	455	–	455	353
Keith Alderson		1 October 2010	332	28	–	1	361	–	361	392
Helen Taylor	6	1 October 2011	215	20	–	1	236	–	236	81
James Mack	6	1 August 2011	260	16	–	1	277	–	277	122
David Neave	7	1 March 2012	201	43	–	1	245	–	245	–
John Hughes	7	1 March 2012	206	23	–	–	229	–	229	–
Mark Summerfield	7	1 July 2012	120	8	–	1	129	–	129	–
Peter Shaw	7	1 July 2012	175	36	–	–	211	–	211	–
Phil Lee	8, 11	1 August 2009	136	8	–	3	147	–	147	330
Mike Fairbairn	9, 11	16 January 2006	144	10	–	–	154	–	154	352
Total			2,199	236	–	9	2,444	–	2,444	1,630
Former Executives who served in the Bank in 2011	10									613
Compensation for loss of office	11								1,378	1,159
									3,822	3,402

The table above represents total emoluments for the executive committee members in relation to services for the Co-operative Banking Group.

Note 1 Date of appointment may differ from date of service commenced with the Bank.

Note 2 Other supplements include full or partial pension allowance in lieu of pension provision, car allowance, phone and health supplements (ie non-P11D items).

Note 3 Performance related bonus – annual refers to bonus amounts in respect of the whole of 2012. Zero award is payable as the balanced scorecard operating profit level was not met.

Note 4 Benefits in kind include car and healthcare cover (ie P11D items). In addition to the above the executives also receive life insurance.

Note 5 Performance related bonus – long term refers to bonus amounts in respect of the 2010–12 plan. Zero award is payable as the three year aggregate operating profit threshold target was not met.

Note 6 2011 total emoluments for James Mack and Helen Taylor were for a part year only.

Note 7 David Neave and John Hughes were appointed to the Executive Committee on 1 March 2012. Mark Summerfield and Peter Shaw were also appointed to the Executive Committee on 1 July 2012. Total emoluments shown represent earnings from date of appointment.

Note 8 Phil Lee resigned on the 30 April 2012.

Note 9 Mike Fairbairn resigned on the 29 June 2012.

Note 10 Former directors include Karen Moir and Tim Franklin.

Note 11 Compensation for loss of office was in respect of Phil Lee £890,000 and Mike Fairbairn £488,000.

Table 2 – Pension details of senior executives (executive directors or members of the Executive Committee)

	Notes	Years of service	Total accrued pension at £000	Increase in accrued pension during the year £000	Increase in accrued pension during the year (net of inflation) £000	Transfer value of previous column at net of members' contributions £000	Transfer value of total accrued pension at 31 December 2011 £000	Transfer value of total accrued pension at £000	Increase in transfer values net of members' contributions £000
Barry Tootell	5	4	25	4	3	34	274	340	55
Keith Alderson	6	9	33	4	3	34	451	545	81
Rod Bulmer	7	5	25	5	4	27	210	257	32
Mike Fairbairn	8	36	75	5	4	87	1,664	1,820	149
John Hughes	9	8	28	4	3	31	339	410	59
Phil Lee	10	9	90	2	1	2	2,326	2,171	(161)
James Mack	11	2	3	3	3	20	–	33	20
David Neave	12	7	24	1	–	1	312	345	29
Peter Shaw	13	–	–	–	–	–	–	–	–
Mark Summerfield	14	8	30	6	5	58	346	450	89
Helen Taylor	15	6	19	4	3	27	172	219	35

General Notes

Note 1 The table above includes all senior executives who were either executive directors or members of the Executive Committee (or who switched status during the year) for the year ending 31 December 2012 and shows their pension details for the period during the year they were in the employment of the Banking Group.

Note 2 The total accrued pension is that which would be paid annually on retirement at normal retirement age based on service to 31 December 2012 and includes any transferred-in benefits as appropriate. Under the terms of their contracts, existing senior executives at 17 January 2007 may take these benefits from age 60 and new executives after 17 January 2007 may take these benefits from age 65. The transfer values in the table above have been calculated on this basis. Years of service include, where appropriate, pre-merger service with Britannia.

Note 3 All transfer values have been calculated in accordance with the current transfer value method and basis in force for the scheme applicable to the senior executive. This is set by the Trustee(s), after taking actuarial advice, to be consistent with the requirements of legislation and the rules of the scheme.

Note 4 Pension scheme members have the option of paying additional voluntary contributions to their respective pension scheme. Neither these contributions nor the benefits arising from them are shown in the above table.

Individual Notes

Note 5 Barry Tootell has restricted pension accrual and was paid a restricted pension allowance.

Note 6 Keith Alderson was a member of the Executive Committee during the year. He opted for restricted pension accrual from 1 April 2012 and was paid a restricted pension allowance.

Note 7 Rod Bulmer was a member of the Executive Committee during the year. He opted for restricted pension accrual from 1 April 2012 and was paid a restricted pension allowance.

Note 8 Mike Fairbairn opted out of Pace on 23 June 2012 and became entitled to a retirement pension. He left employment on 29 June 2012. His end of year figures are calculated at that date. The figures shown on the table at the start of the year and at the year end are after application of a pension sharing order.

Note 9 John Hughes was appointed to the Executive Committee on 1 March 2012. He has restricted pension accrual and was paid a restricted pension allowance.

Note 10 Phil Lee opted out of the Britannia Scheme from 1 April 2012 and became entitled to a deferred pension from the Britannia Scheme when he left the scheme. He was paid a pension allowance in lieu of pension provision. He left employment on 30 April 2012. His end of year figures are calculated at that date.

Note 11 James Mack was a member of the Executive Committee during the year. He was a member of the Britannia Scheme defined contribution section until he joined Pace Complete from 1 April 2012. His defined contribution pension details are shown on Table 2a.

Note 12 David Neave was appointed to the Executive Committee on 1 March 2012. He opted out of Pace from 1 April 2012 and became entitled to a deferred pension from Pace when he left the scheme. He was paid a pension allowance in lieu of pension provision.

Note 13 Peter Shaw was appointed to the Executive Committee on 1 July 2012. He was paid a pension allowance in lieu of pension provision.

Note 14 Mark Summerfield was appointed to the Executive Committee on 1 July 2012.

Note 15 Helen Taylor was a member of the Executive Committee during the year. She opted for restricted pension accrual from 1 April 2012 and was paid a restricted pension allowance.

Table 2a – Defined Contributions paid for senior executives

Name	Amount £
James Mack	7,108

Remuneration report continued

Table 3 – Non-Executive Directors' remuneration

	Notes	Date appointed	**2012 fees £000**	2011 fees £000
Non-Executive Directors				
Paul Flowers		2009	**125**	120
Duncan Bowdler	2, 8	2009	**22**	17
Peter Marks	1	2009	**–**	–
Ben Reid	2	2009	**20**	20
Len Wardle	8	2006	**20**	23
Martyn Wates	1	2007	**–**	–
Independent professional Non-Executive Directors (IPNEDS)				
David Davies	3, 7, 10	2003	**90**	85
Anne Gunther	6	2011	**60**	19
Peter Harvey	3, 4, 5	2009	**69**	68
Merlyn Lowther	5	2011	**71**	16
Bob Newton	9, 10, 11	2007	**97**	88
Former Directors who resigned during the year				
Rodney Baker-Bates (to 31 July 2012)	3	2009	**44**	75
Paul Hewitt (to 21 September 2012)	5	2003	**53**	68

All fees are pro rata if a position is held for part of the year.

Note 1 Peter Marks and Martyn Wates, who are employees of the Co-operative Group and are entitled to fees of £16,937 per annum have both agreed to waive these.

Note 2 Ben Reid and Duncan Bowdler, who are not IPNEDs and who are members of the Co-operative Banking Group Audit Committee, receive an additional fee of £3,387 per annum.

Note 3 The Deputy Chairs receive an additional fee of £15,720 per annum.

Note 4 The Chair of the Co-operative Banking Group Exposures Committee received an additional fee of £5,240 per annum.

Note 5 The Chair of the Board Risk Committee and the Chair of the Co-operative Banking Group Audit Committee each receive an additional fee of £11,004 per annum.

Note 6 The Chair of the Co-operative Banking Group Remuneration and Appointments Committee receives an additional fee of £9,000 per annum.

Note 7 David Davies receives an additional fee of £11,004 per annum as the Chair of Pace.

Note 8 The Non-Executive Directors who also serve on the Group Board receive an additional fee of £2,258 per annum for serving on the Co-operative Banking Group Remuneration and Appointments Committee and the same fee was payable for serving on the Co-operative Banking Group Exposures Committee until its discontinuation in September 2012.

Note 9 Bob Newton receives an additional fee of £25,000 per annum for serving on the Board of the Reclaim Fund Limited .

Note 10 David Davies and Bob Newton both sit on the Board of CIS General Insurance Limited and with effect from 17 July 2012 Bob Newton receives an additional fee of £11,004 per annum as Chair of the Board and David Davies receives an additional fee of £7,300 per annum as a member of the Board.

Note 11 The Chair of the Co-operative Banking Group Integration and Transformation Committee receives an additional fee of £7,336 per annum.

Table 4 – Aggregate information in respect of Code staff

Number of Code staff	Total remuneration[1] £000	Total fixed remuneration[2] £000	Total variable remuneration[3] £000	Annual incentive plan[4] £000	Long term incentive plan[5] £000	Sign on and severance payments £000	Severance payments made in year[7] £000
Senior Management							
27[6]	6,193	4,439	1,754	–	1,754	–	1378
Other Code staff							
19	3,897	3,495	402	–	402	–	–

The table above represents the emoluments of Code staff in relation to their services for The Co-operative Bank.

Note 1 Total remuneration consists of base salary, allowances, employer pension contributions, together with future maximum earnings opportunity comprised in the 2013–15 long term incentive awards.

Note 2 Total fixed remuneration is base salary plus allowances and employer pension contributions.

Note 3 Total variable remuneration includes only the awards under the 2013–15 long term plan which are performance related and, to the extent achieved will be payable in 2016. All payments as and when due are made in cash.

Note 4 Zero awards are payable for the 2012 AIP, due to not meeting the threshold operating profit level.

Note 5 Awards made under the 2013–15 LTIP are all unvested and represent deferred remuneration in respect of the 2012 financial year, in accordance with the FSA Remuneration Code. Numbers quoted represent maximum earnings opportunities.

Note 6 Senior management consists of executive directors, members of the executive committee and Non-Executive Directors.

Note 7 Severance payments are in respect of redundancy for two senior managers. Severance terms include both redundancy payments and the buyout of notice.

Statutory disclosures information

Principal activities

The Bank and its subsidiary undertakings provide an extensive range of banking and financial services in the United Kingdom.

Results and dividends

Loss before taxation and significant items was £288.9m (2011 profit: £197.5m). Loss attributable to the ordinary shareholders amounted to £509.1m (2011 profit: £48.0m). No dividends were paid during 2012 and the directors recommend that no final dividend is paid in respect of 2012.

Post balance sheet events

On 24 January 2013, the Bank announced plans to merge branches in a number of locations where branches were operating in close proximity.

This will result in the closure of 37 branches.

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 the Bank will benefit from a reduction in its total risk weighted assets.

Supplier payment policy and practice

With the exception of the Britannia business area detailed below, the Group does not pay suppliers directly as all supplies and services are sourced through CFS Management Services Limited, a fellow subsidiary of the Banking Group. A management charge is payable to cover the cost of these services.

Suppliers are paid directly by the former Britannia business where the policy is to agree the terms of payment at the start of trading with the supplier, ensure that suppliers are aware of the terms of payment and pay in accordance with its contractual and other obligations. Creditor days at 31 December 2012 were 8 (2011: 27 days).

Significant contracts

The Bank maintains a number of significant contracts with IT providers, cash-handling entities and mailing-service companies as well as with the Banking Group company, CFS Management Services Limited which provides facilities and services for all Banking Group companies.

Outlets

At 31 December 2012 the Bank had 339 branches (2011: 342 branches).

Going concern

Introduction

These financial statements are prepared on a going concern basis as the directors are satisfied that the Group and parent company have the resources to continue in business for the foreseeable future.

The macro economic environment, which has contributed significantly to the result for the year, indicated the need for a refocusing of the Group's strategy. The economic environment shows little sign of improving in the short term. It is one of slow economic growth, low base rates and constrained demand for new lending and it is likely to continue for several more years. The new governor of the Bank of England has indicated that rates are likely to be low for longer with inflation being allowed to rise to improve growth. In response, a broad-ranging strategic review of the business is underway with the objective of improving the capitalisation and profitability of the Group.

The assessment of the going concern basis of preparation has been subject to a thorough process involving analysis and discussion by management, Executive and Board committees and the Board, in line with our governance processes discussed in the risk management section of these accounts. Analysis covered forecast information for the strategic planning period, 2013-2015 (the Plan), stress testing and reverse stress testing as well as the management actions under consideration as part of the strategic review discussed below.

Profit

The Group statutory loss for the year of £673.7m was driven by the following factors:

- credit impairment on non-core assets;
- intangible asset impairment; and
- Payment Protection Insurance provision.

The core business, reflecting the current strategy and risk appetite of the Bank, delivered an operating result of £96.8m profit (2011: £137.3m profit), which, while lower than 2011, provides a platform for future growth. The non-core business, those activities not congruent with the current strategy, which are managed for value and targeted for run down or exit, generated an operating result of £377.3m loss (2011: £3.8m profit). As a result, the combined operating result was £280.5m loss (2011: £141.1m profit). Looking forward, growth in profitability in the core business is expected to be muted in the short term due to continued margin compression and the costs of restructuring. However, this restructuring, simplification and cost reduction agenda will enhance the profitability of the core business in the medium term.

As the non-core business has been identified as inconsistent with the current strategy of the Group, the sale of a proportion of the assets is included in the Plan, with further sale or de-risking opportunities being pursued. The remainder of the non-core assets are being managed for value or targeted for run down. Following the significant levels of impairment charges in 2012, reflecting a deterioration in outlook and specific charges on a number of large cases, we expect further impairment charges to be more moderate, albeit the de-risking of the balance sheet may give rise to further adjustments to value which are expected to be capital neutral.

Statutory disclosures information continued

Capital

The Group's policy is to conserve a robust capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. However, the Group still recognises the need to maintain a balance between the potential higher returns that might be achieved with greater gearing, and the advantages and security afforded by a sound capital position.

Total capital resources are £2,578.2m (31 December 2011: £2,975.9m), with Core Tier 1 capital after regulatory deductions of £1,576.8m (31 December 2011: £1,947.4m).

The Group's capital position remains acceptable with a period end Core Tier 1 position of 8.8% (31 December 2011: 9.6%). Throughout 2012, the Bank and its individually regulated operations have complied with all externally imposed capital requirements. However, the Board recognises the need to build the capitalisation of the Group to provide increased resilience and capacity for future growth. Actions taken early in 2013 have already improved this position to 9.2%.

Current forecasts show that the Group's capital will remain above minimum regulatory requirements over the period of the Plan. However, in response to the impact of new Basel III regulations and the expectation of a prolonged economic downturn, we are reviewing our business with the intent of improving our profitability and capital position. Without management action, explained in the Opportunities section below, compliance with regulatory capital requirements would come under pressure.

Liquidity

Group liquidity has been reviewed by considering the latest liquidity forecast (part of the Plan), as well as the stress testing results from 31 December 2012 of the internal assessment of liquidity requirements, together with the Group's compliance with its regulatory required levels.

As at 31 December 2012, the Group held significant levels of surplus assets above regulatory required levels, and had a liquid asset ratio of 14.6% compared to 30 June 2012 of 12.7% and 31 December 2011 of 15.5%.

The Group is predominantly customer focused and there are no significant wholesale maturities due in 2013. Customer deposits have been very stable through the downgrades that the Bank has previously experienced. Stress testing forecasts, as at 31 December 2012, shows that sufficient liquidity levels can be maintained under the most severe scenarios. This is also documented in the Individual Liquidity Adequacy Assessment (ILAA). The Bank has available additional collateral equivalent to 20% of minimum regulatory requirements which can be used in any of the Bank of England schemes.

Risks

The idiosyncratic risks that could affect the future performance of the Group are:

- Further impairment of intangible assets, either due to finalisation of Project Verde (purchase of Lloyds Banking Group branches) or, if Verde were not to proceed, the decision to take a different strategic route in regard to banking technology platforms. The carrying value of the intangible asset, in the books of Co-operative Financial Services Management Services Limited, is £179m.
- Further significant loan impairment, for example on higher risk non-core corporate lending. The amount on the watchlist not covered by collateral is £275m. The collective impairment methodology takes into account the value and risk relating to all exposures that are not already in default. There is an additional risk of collateral value erosion, mitigated by non-core corporate disposals.
- Conduct risk issues requiring redress. The costs of redress associated with PPI are estimated at £244m. Another industry-wide issue of this type is a risk to the profitability of the Group. The Group has no material exposure to interest rate swap misselling.
- Potential rating agency downgrades. Although there is a risk of downgrade as evidenced by the negative outlook on ratings, forecasts indicate that the Group has sufficient liquidity surplus to accommodate a severe stress after taking account of the successful completion of management actions.
- Adverse customer reaction to the trading position of the Group.
- Failure to complete management actions to strengthen the Group's capital position.

Opportunities

The Co-operative Bank brand continues to show resilience in these tough market conditions and holds a strong market reputation. This is clearly evidenced by our strong customer advocacy scores and numbers of customers switching to us.

The Board sponsored strategic review seeks to build on this platform. This wide-ranging strategic review of our Banking Group businesses, considers the management actions at the Board's disposal which will be undertaken in order to improve profitability and capitalisation of the Group in line with market expectations and Basel III capital requirements. Initial action from this review was concluded in January 2013 when a securitisation transaction was completed to reduce the credit risk on the balance sheet. This improved the Core Tier 1 ratio by 0.4%. The signing of the Sale and Purchase Agreement and subsequent completion of the sale of our Life and Savings business, followed by the planned downstreaming of capital into the Group will also have positive implications for our capital position, subject to regulatory approval.

Amongst other actions, we intend to significantly deleverage or reduce risk in the balance sheet (facilitated to a large extent by the additional impairment charges taken in 2012) and build upon the strength of the core business through a simplification agenda and cost efficiency programme, as well as conservative credit risk appetite and long term growth strategy focused on our core relationship banking franchise. Some of the actions under consideration, for example, options around the sale of other Banking Group businesses (eg General Insurance and Life and Savings businesses), will require support from the immediate parent company, Co-operative Banking Group Limited, in order to downstream capital into the Group.

Although a subsidiary company of the Co-operative Group (the ultimate parent company), no reliance has been placed on that company for parental support as part of the going concern assessment.

The going concern assessment does not take into account the potential long term benefits of the purchase of the Lloyds Banking Group branches (Project Verde). This deal would provide opportunity to enhance the reach of the Bank, grow our customer base, and become a truly compelling alternative for the UK consumer. The deal will only be pursued if it is in the best interests of our customers and members.

Conclusion

The directors are satisfied that the Group is a going concern, has sufficient profit, capital and liquidity in place and forecast, and has plans in place to strengthen that position going forward.

Employees

The majority of the Banking Group's employees have contracts with CFS Management Services Limited and their services are allocated to subsidiaries, including the Bank. Including these people, the Bank and its subsidiary undertakings employed 7,754 persons at 31 December 2012 (2011: 8,528). The weekly average number of people was 8,107 (2011: 8,364) and their aggregate remuneration, before significant items, for the year was £188.0m (2011: £210.8m).

The Bank, as part of the Banking Group operates learning and development initiatives across the organisation as part of a continuous improvement programme, supporting its approach to performance management, personal development, talent and succession planning.

The Banking Group, in Bank-orientated activities, continues to consult and communicate with colleagues on customer, organisation and business performance issues, using colleague publications, surveys, conferences, videos and both informal and formal consultations with Unite and other unions, which continues to be fully involved where organisational change and other issues affect colleagues.

The Bank, as part of the Banking Group, is a member of the following diversity advisory bodies:

- Employers Forum on Disability;
- Employers Forum on Age;
- Race for Opportunity;
- Opportunity Now; and
- Stonewall.

Employees with disabilities

The Banking Group is a holder of the 'Positive about Disabled People' symbol, a recognition given by Jobcentre Plus to employers who have agreed to meet five commitments regarding the recruitment, employment, retention and career development of disabled people. The Banking Group has policies and processes in place to support disabled colleagues in the workplace.

Further guidance, and information for colleagues, on disability issues is available through human resources and on the colleagues' intranet. The Banking Group recognises its responsibility for making reasonable adjustments for new colleagues with disabilities and for those individuals who develop disabilities whilst in employment.

Employees' wellbeing

The Bank, as part of the Banking Group, recognises that health and wellbeing at work play a vital part in delivering its core values. Wellbeing services include an occupational health scheme, physiotherapy services and seasonal wellbeing initiatives such as discounted allergy testing and flu jabs.

In addition to this, colleagues and their immediate families have access to an external employee assistance programme, providing free expert advice on a wide range of medical, legal and family issues.

Corporate responsibility

The Bank's corporate responsibility activities are outlined on pages 13 and 14. In addition, the Co-operative Group Sustainability Report, which will be published in the first half of 2013, describes how the Co-operative Group Limited, the Banking Group, the Bank, Co-operative Insurance Society Limited and CIS General Insurance Limited manage their social, ethical and environmental impacts.

Political and charitable donations

During the year, CFS Management Services Limited made donations (which exclude affinity card payments) of £0.1m to charitable organisations on behalf of the Bank (2011: £0.3m). A number of securitisation vehicles were closed during the year and a dividend payment of £0.3m was made to their respective holding companies. Under the terms of the trust, this amount was subsequently paid out to charitable organisations. Additional costs associated with the Bank's community involvement are provided within the Co-operative Group Sustainability Report. It is the Bank's policy that no donations are made for political purposes.

Statement of directors' responsibilities in respect of the report of the Board of Directors and the annual report and financial statements

The directors are responsible for preparing the annual report and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare the financial statements for each financial year. Under that law they are required to prepare the financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of their profit or loss for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and parent company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The directors have decided to prepare voluntarily a directors' remuneration report in accordance with Schedule 8 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 made under the Companies Act 2006, as if those requirements were to apply to the Bank. The directors have also decided to prepare voluntarily a corporate governance statement as if the Bank were required to comply with the Listing Rules and the Disclosure and Transparency Rules of the Financial Services Authority in relation to those matters.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Bank's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Financial statements

So far as the directors are aware, there is no relevant audit information of which the Bank's auditors are unaware, and the directors have taken all steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Bank's auditors are aware of that information.

By Order of the Board
Moira Lees, Group Secretary

20 March 2013

Independent auditor's report to the members of The Co-operative Bank plc

We have audited the financial statements of The Co-operative Bank plc for the year ended 31 December 2012 set out on pages 33 to 78, 80 and 81 and pages 83 to 132. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and in respect of reporting on corporate governance, on terms that have been agreed. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and in respect of reporting on corporate governance, those matters that we have agreed to state to them in our report, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 31, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2012 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

In addition to our audit of the financial statements, the directors have engaged us to review their Corporate Governance Statement as if the company were required to comply with the Listing Rules and the Disclosure Rules and Transparency Rules of the Financial Services Authority in relation to those matters. Under the terms of our engagement we are required to review:

- the directors' statement, set out on pages 29 and 30, in relation to going concern; and
- the part of the Corporate Governance Statement on pages 13 to 19 relating to the company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review.

Andrew Walker, Senior Statutory Auditor
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
St James Square
Manchester
M2 6DS

20 March 2013

Consolidated income statement

For the year ended 31 December 2012
All amounts are stated in £m unless otherwise indicated

	Notes	**Before significant items 2012**	**Significant items 2012**	**After significant items 2012**	Before significant items 2011	Significant items 2011	After significant items 2011
Interest receivable and similar income	4	**1,488.3**	**–**	**1,488.3**	1,583.7	–	1,583.7
Interest expense and similar charges	4	**(922.5)**	**–**	**(922.5)**	(948.7)	–	(948.7)
Net interest income		**565.8**	**–**	**565.8**	635.0	–	635.0
Fee and commission income	5	**251.2**	**(149.7)**	**101.5**	251.2	(90.0)	161.2
Fee and commission expense	5	**(74.0)**	**–**	**(74.0)**	(66.0)	–	(66.0)
Net fee and commission income		**177.2**	**(149.7)**	**27.5**	185.2	(90.0)	95.2
Net trading income	6	**14.1**	**–**	**14.1**	4.5	–	4.5
Other operating income	7	**33.9**	**–**	**33.9**	46.3	–	46.3
Operating income		**791.0**	**(149.7)**	**641.3**	871.0	(90.0)	781.0
Operating expenses	8	**(587.6)**	**(235.1)**	**(822.7)**	(528.7)	(53.3)	(582.0)
Financial Services Compensation Scheme levies	32	**(24.8)**	**–**	**(24.8)**	(14.5)	–	(14.5)
Operating profit before impairment losses		**178.6**	**(384.8)**	**(206.2)**	327.8	(143.3)	184.5
Impairment losses on loans and advances	15	**(474.1)**	**–**	**(474.1)**	(120.5)	–	(120.5)
Impairment gains on investments	16	**5.4**	**–**	**5.4**	5.6	–	5.6
Operating (loss)/profit		**(290.1)**	**(384.8)**	**(674.9)**	212.9	(143.3)	69.6
Share of post tax profits from joint ventures	36	**1.2**	**–**	**1.2**	0.2	–	0.2
(Loss)/profit before taxation and profit based payments		**(288.9)**	**(384.8)**	**(673.7)**	213.1	(143.3)	69.8
Profit based payments to members of The Co-operative Group		**–**	**–**	**–**	(15.6)	–	(15.6)
(Loss)/profit before taxation	2	**(288.9)**	**(384.8)**	**(673.7)**	197.5	(143.3)	54.2
Income tax	10	**88.6**	**77.0**	**165.6**	(42.4)	38.0	(4.4)
(Loss)/profit for the financial year		**(200.3)**	**(307.8)**	**(508.1)**	155.1	(105.3)	49.8
Attributable to:							
Equity shareholders	12	**(201.3)**	**(307.8)**	**(509.1)**	153.3	(105.3)	48.0
Minority interests		**1.0**	**–**	**1.0**	1.8	–	1.8
		(200.3)	**(307.8)**	**(508.1)**	155.1	(105.3)	49.8
Earnings per share (basic and diluted)	12	**(2.46)p**	**(3.75)p**	**(6.21)p**	1.87p	(1.28)p	0.59p

The significant items in 2012 relate to:

- £149.7m (2011: £90.0m) of provisions made for potential customer compensation claims relating to past sales of payment protection insurance (notes 5 and 32);
- £38.1m (2011: £nil) of costs incurred as a result of the bid for the Lloyds Bank branches (note 8);
- £47.0m (2011: £53.3m) of costs incurred on a programme of investment and integration (note 8); and
- £150.0m (2011: £nil) of recharged costs relating to intangible asset impairment regarding the development of new banking systems (note 8).

Consolidated statement of comprehensive income

For the year ended 31 December 2012
All amounts are stated in £m unless otherwise indicated

	Group					
	Equity shareholders 2012	**Minority interests 2012**	**Total 2012**	Equity shareholders 2011	Minority interests 2011	Total 2011
(Loss)/profit for the financial year	**(509.1)**	**1.0**	**(508.1)**	48.0	1.8	49.8
Other comprehensive (expense)/income:						
Changes in cashflow hedges						
Net changes in fair value recognised directly in equity	**23.5**	**(0.8)**	**22.7**	88.9	0.3	89.2
Income tax	**(9.9)**	**0.2**	**(9.7)**	(19.8)	(0.1)	(19.9)
Transfers from equity to income or expense	**(30.9)**	**(0.1)**	**(31.0)**	(49.3)	(0.3)	(49.6)
Income tax	**13.4**	**–**	**13.4**	10.9	0.1	11.0
Changes in available for sale assets						
Net changes in fair value recognised directly in equity	**108.7**	**–**	**108.7**	101.6	–	101.6
Income tax	**(26.2)**	**–**	**(26.2)**	(26.9)	–	(26.9)
Transfers from equity to income or expense	**(95.5)**	**–**	**(95.5)**	(55.8)	–	(55.8)
Income tax	**23.5**	**–**	**23.5**	14.8	–	14.8
Revaluation of equity shares	**–**	**–**	**–**	(1.5)	–	(1.5)
Income tax	**–**	**–**	**–**	0.4	–	0.4
Defined benefit plan actuarial losses	**–**	**–**	**–**	–	–	–
Income tax	**(0.1)**	**–**	**(0.1)**	(0.1)	–	(0.1)
Other comprehensive (expense)/income for the financial year, net of income tax	**6.5**	**(0.7)**	**5.8**	63.2	–	63.2
Total comprehensive (expense)/income for the financial year	**(502.6)**	**0.3**	**(502.3)**	111.2	1.8	113.0

Consolidated balance sheet

At 31 December 2012
All amounts are stated in £m unless otherwise indicated

	Notes	**2012**	2011
Assets			
Cash and balances at central banks	13	**5,433.0**	6,696.6
Loans and advances to banks	14	**1,904.1**	2,006.5
Loans and advances to customers	15	**33,339.5**	33,766.0
Fair value adjustments for hedged risk	15	**354.2**	366.3
Investment securities – loans and receivables	16	**295.0**	804.9
Investment securities – available for sale	16	**3,789.4**	3,423.0
Investment securities – fair value through income or expense	16	**1,845.2**	343.1
Investment securities – held for trading	16	**960.2**	–
Derivative financial instruments	17	**818.8**	975.8
Equity shares	18	**5.7**	5.7
Investments in joint ventures	36	**3.9**	2.7
Goodwill	19	**–**	0.6
Intangible fixed assets	20	**34.9**	40.7
Investment properties	21	**173.0**	172.7
Property, plant and equipment	22	**64.1**	80.1
Amounts owed by other Co-operative Group undertakings	37	**256.4**	179.2
Other assets	23	**70.3**	33.0
Prepayments and accrued income	24	**14.9**	18.7
Current tax assets		**172.6**	13.6
Deferred tax assets	33	**38.2**	26.4
Total assets		**49,573.4**	48,955.6
Liabilities			
Deposits by banks	25	**3,612.0**	3,302.7
Customer accounts	26	**35,884.4**	34,990.6
Customer accounts – capital bonds	27	**888.1**	1,429.8
Debt securities in issue	28	**4,713.7**	4,164.8
Derivative financial instruments	17	**967.6**	1,087.9
Other borrowed funds	29	**1,258.6**	1,258.8
Amounts owed to other Co-operative Group undertakings	37	**112.0**	132.3
Other liabilities	30	**104.0**	173.7
Accruals and deferred income	31	**20.1**	39.9
Provisions for liabilities and charges	32	**162.7**	102.0
Total liabilities		**47,723.2**	46,682.5
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	38	**410.0**	410.0
Share premium account	38	**8.8**	8.8
Retained earnings		**1,304.3**	1,733.8
Available for sale reserve		**30.0**	19.5
Cashflow hedging reserve		**63.7**	67.6
		1,816.8	2,239.7
Minority interests		**33.4**	33.4
Total equity		**1,850.2**	2,273.1
Total liabilities and equity		**49,573.4**	48,955.6

Approved by the Board on 20 March 2013 and signed on its behalf by:

Paul Flowers, Chair
Barry Tootell, Chief Executive
Moira Lees, Secretary

The accounting policies and notes on pages 40 to 132 form part of these financial statements.

Bank balance sheet

At 31 December 2012
All amounts are stated in £m unless otherwise indicated

	Notes	**2012**	2011
Assets			
Cash and balances at central banks	13	**5,433.0**	6,696.6
Loans and advances to banks	14	**1,047.2**	1,300.1
Loans and advances to customers	15	**22,785.5**	22,735.0
Fair value adjustments for hedged risk	15	**354.1**	365.8
Investment securities – loans and receivables	16	**355.4**	866.1
Investment securities – available for sale	16	**3,563.9**	3,107.4
Investment securities – fair value through income or expense	16	**1,845.2**	343.1
Investment securities – held for trading	16	**960.2**	–
Derivative financial instruments	17	**590.9**	704.4
Equity shares	18	**5.7**	5.7
Investments in Group undertakings	36	**1,808.5**	1,573.4
Goodwill	19	**–**	0.6
Intangible fixed assets	20	**33.8**	39.3
Investment properties	21	**1.8**	–
Property, plant and equipment	22	**46.2**	61.5
Amounts owed by other Co-operative Group undertakings	37	**12,613.0**	12,961.2
Other assets	23	**67.3**	29.3
Prepayments and accrued income	24	**14.0**	17.7
Current tax assets		**154.0**	48.2
Deferred tax assets	33	**138.8**	110.3
Total assets		**51,818.5**	50,965.7
Liabilities			
Deposits by banks	25	**3,552.9**	3,239.8
Customer accounts	26	**33,750.3**	32,670.1
Customer accounts – capital bonds	27	**867.2**	1,397.3
Debt securities in issue	28	**1,752.2**	1,431.0
Derivative financial instruments	17	**922.6**	1,051.5
Other borrowed funds	29	**1,258.6**	1,258.8
Amounts owed to other Co-operative Group undertakings	37	**7,809.0**	7,461.2
Other liabilities	30	**99.5**	169.1
Accruals and deferred income	31	**15.5**	33.1
Provisions for liabilities and charges	32	**161.6**	93.4
Total liabilities		**50,189.4**	48,805.3
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	38	**410.0**	410.0
Share premium account	38	**8.8**	8.8
Retained earnings		**1,116.9**	1,655.0
Available for sale reserve		**30.0**	19.5
Cashflow hedging reserve		**63.4**	67.1
Total equity		**1,629.1**	2,160.4
Total liabilities and equity		**51,818.5**	50,965.7

Approved by the Board on 20 March 2013 and signed on its behalf by:

Paul Flowers, Chair
Barry Tootell, Chief Executive
Moira Lees, Secretary

The accounting policies and notes on pages 40 to 132 form part of these financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2012
All amounts are stated in £m unless otherwise indicated

	2012	2011
Cash flows from operating activities		
(Loss)/profit before taxation	**(673.7)**	54.2
Adjustments for:		
Increase in prepayments and accrued income	**(8.2)**	(38.3)
Decrease in accruals and deferred income	**(20.0)**	(90.6)
Interest payable in respect of other borrowed funds	**81.4**	86.7
Effect of exchange rate movements	**10.4**	16.0
Effect of non-cash pension costs	**0.1**	–
Impairment losses on loans and advances	**480.2**	130.5
Movements on investment impairments	**(5.4)**	(39.9)
Depreciation and amortisation	**16.4**	21.4
Interest amortisation	**(6.3)**	(15.7)
Amortisation of investment securities	**(71.8)**	(340.8)
Impairment charge to write off goodwill	**0.6**	–
Loss on disposal of fixed assets	**0.9**	0.3
Unwind of fair value adjustments arising on transfer of engagements	**(15.2)**	(86.3)
Preference dividends	**5.6**	5.6
	(205.0)	(296.9)
Increase in deposits by banks	**309.3**	364.1
Increase in customer accounts and capital bonds	**352.6**	2,306.7
Increase/(decrease) in debt securities in issue	**480.3**	(141.0)
Increase in loans and advances to banks	**(68.2)**	(73.2)
Decrease in loans and advances to customers	**53.2**	1,034.2
Increase in amounts owed by other Co-operative Group undertakings	**(77.2)**	(178.6)
Decrease in amounts owed to other Co-operative Group undertakings	**(20.3)**	(56.2)
Net movement of other assets and other liabilities	**(15.3)**	532.3
Income tax paid	**(4.2)**	(21.2)
Net cash flows from operating activities	**805.2**	3,470.2
Cash flows from investing activities		
Purchase of tangible and intangible fixed assets	**(1.9)**	(14.8)
Proceeds from sale of fixed assets	**0.8**	–
Proceeds from sale of investment property	**0.9**	0.8
Purchase of investment securities	**(4,960.9)**	(3,667.6)
Proceeds from sale and maturity of investment securities	**2,616.4**	4,513.5
Net cash flows from investing activities	**(2,344.7)**	831.9
Cash flows from financing activities		
Interest paid on other borrowed funds	**(87.4)**	(69.6)
Repayment of other borrowed funds	**(256.5)**	(102.3)
Issuance of other borrowed funds	**235.4**	273.6
Dividends paid to securitisation holding companies	**(0.3)**	–
Dividends paid to minority interests	**(0.3)**	–
Preference share dividends paid	**(5.6)**	(5.6)
Capital contribution from parent	**80.0**	87.0
Net cash flows from financing activities	**(34.7)**	183.1
(Decrease)/increase in cash and cash equivalents	**(1,574.2)**	4,485.2
Cash and cash equivalents at the beginning of the financial year	**7,888.4**	3,403.2
Cash and cash equivalents at the end of the financial year	**6,314.2**	7,888.4
Cash and balances with central banks (note 13)	**5,393.6**	6,658.6
Loans and advances to banks (note 14)	**850.6**	1,019.8
Short term investments (note 16)	**70.0**	210.0
	6,314.2	7,888.4

The cash flows differ from the Group balance sheet movements as these movements include the non-cash unwinds of the fair value adjustments arising on the transfer of engagements of Britannia Building Society.

Bank statement of cash flows

For the year ended 31 December 2012
All amounts are stated in £m unless otherwise indicated

	2012	2011
Cash flows from operating activities		
Loss before taxation	**(735.2)**	(128.4)
Adjustments for:		
Increase in prepayments and accrued income	**(8.3)**	(39.0)
Decrease in accruals and deferred income	**(18.5)**	(82.9)
Interest payable in respect of other borrowed funds	**81.4**	86.7
Effect of exchange rate movements	**10.4**	16.0
Effect of non-cash pension costs	**0.1**	–
Impairment losses on loans and advances	**261.0**	103.4
Movements on investment securities impairments	**(5.4)**	(39.9)
Depreciation and amortisation	**19.1**	23.9
Interest amortisation	**(6.3)**	(15.7)
Amortisation of investment securities	**(60.7)**	(296.7)
Impairment charge to write off goodwill	**0.6**	–
Loss on disposal of fixed assets	**1.6**	0.2
Unwind of fair value adjustments arising on transfer of engagements	**(57.4)**	(154.0)
Preference dividends	**5.6**	5.6
	(512.0)	(520.8)
Increase in deposits by banks	**313.1**	369.0
Increase in customer accounts and capital bonds	**550.6**	2,412.4
Increase/(decrease) in debt securities in issue	**317.1**	(433.3)
Decrease/(increase) in loans and advances to banks	**79.0**	(31.6)
(Increase)/decrease in loans and advances to customers	**(247.1)**	935.9
Decrease in amounts owed by other Co-operative Group undertakings	**309.5**	1,272.5
Increase/(decrease) in amounts owed to other Co-operative Group undertakings	**347.8**	(879.7)
Net movement of other assets and other liabilities	**(293.9)**	359.6
Income tax received/(paid)	**22.4**	(8.2)
Net cash flows from operating activities	**886.5**	3,475.8
Cash flows from investing activities		
Purchase of tangible and intangible fixed assets	**(1.2)**	(2.4)
Purchase of investment securities	**(4,730.9)**	(3,237.6)
Proceeds from sale and maturity of investment securities	**2,442.2**	3,857.0
Net cash flows from investing activities	**(2,289.9)**	617.0
Cash flows from financing activities		
Interest paid on other borrowed funds	**(87.4)**	(69.6)
Repayment of other borrowed funds	**(256.5)**	(102.3)
Issuance of other borrowed funds	**235.4**	273.6
Preference share dividends paid	**(5.6)**	(5.6)
Capital contribution from parent	**80.0**	87.0
Net cash flows from financing activities	**(34.1)**	183.1
(Decrease)/increase in cash and cash equivalents	**(1,437.5)**	4,275.9
Cash and cash equivalents at the beginning of the financial year	**7,666.9**	3,391.0
Cash and cash equivalents at the end of the financial year	**6,229.4**	7,666.9
Cash and balances with central banks (note 13)	**5,393.6**	6,658.6
Loans and advances to banks (note 14)	**835.8**	1,008.3
Short term investments (note 16)	**–**	–
	6,229.4	7,666.9

The cash flows differ from the Bank balance sheet movements as these movements include the non-cash unwinds of the fair value adjustments arising on the transfer of engagements of Britannia Building Society.

Consolidated and Bank statements of changes in equity

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Company							
	Share capital	Share premium	Available for sale reserve	Cashflow hedging reserve	Retained earnings	Total	Minority interest	Total equity
Group								
2012								
Balance at the beginning of the year	**410.0**	**8.8**	**19.5**	**67.6**	**1,733.8**	**2,239.7**	**33.4**	**2,273.1**
Total comprehensive income for the financial year	**–**	**–**	**10.5**	**(3.9)**	**(509.2)**	**(502.6)**	**0.3**	**(502.3)**
Transactions with owners recorded directly in equity:								
Capital contribution	**–**	**–**	**–**	**–**	**80.0**	**80.0**	**–**	**80.0**
Dividend	**–**	**–**	**–**	**–**	**(0.3)**	**(0.3)**	**(0.3)**	**(0.6)**
Balance at the end of the year	**410.0**	**8.8**	**30.0**	**63.7**	**1,304.3**	**1,816.8**	**33.4**	**1,850.2**
Group								
2011								
Balance at the beginning of the year	410.0	8.8	(13.1)	36.9	1,598.9	2,041.5	31.6	2,073.1
Total comprehensive income for the financial year	–	–	32.6	30.7	47.9	111.2	1.8	113.0
Transactions with owners recorded directly in equity:								
Capital contribution	–	–	–	–	87.0	87.0	–	87.0
Balance at the end of the year	410.0	8.8	19.5	67.6	1,733.8	2,239.7	33.4	2,273.1

During the year, a number of securitisation vehicles were closed and a dividend payment of £0.3m (2011: £nil) was made to their respective holding companies. This amount was subsequently paid out to charitable organisations.

	Attributable to equity holders of the Company					
	Share capital	Share premium	Available for sale reserve	Cashflow hedging reserve	Retained earnings	Total equity
Bank						
2012						
Balance at the beginning of the year	**410.0**	**8.8**	**19.5**	**67.1**	**1,655.0**	**2,160.4**
Total comprehensive income for the financial year	**–**	**–**	**10.5**	**(3.7)**	**(588.3)**	**(581.5)**
Transactions with owners recorded directly in equity:						
Capital contribution	**–**	**–**	**–**	**–**	**80.0**	**80.0**
Fair value unwinds	**–**	**–**	**–**	**–**	**(29.8)**	**(29.8)**
Balance at the end of the year	**410.0**	**8.8**	**30.0**	**63.4**	**1,116.9**	**1,629.1**
Bank						
2011						
Balance at the beginning of the year	410.0	8.8	(13.1)	36.4	1,661.4	2,103.5
Total comprehensive income for the financial year	–	–	32.6	30.7	(93.4)	(30.1)
Transactions with owners recorded directly in equity:						
Capital contribution	–	–	–	–	87.0	87.0
Balance at the end of the year	410.0	8.8	19.5	67.1	1,655.0	2,160.4

Basis of preparation and significant accounting policies

For the year ended 31 December 2012

The Co-operative Bank plc is registered in England and Wales under the Companies Act 2006.

Basis of preparation

Both the parent company financial statements and the Group financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and IFRS Interpretations Committee (IFRIC) guidance as adopted by the European Union (EU). On including the parent company financial statements here together with the Group financial statements, the Company is taking advantage of the exemption in Section 408 of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these approved financial statements. Information in respect of the Company alone is labelled throughout as 'Bank'.

The financial information has been prepared under the historic cost convention as modified by the revaluation of available for sale financial assets, derivative contracts, investment properties and certain other financial assets and financial liabilities held at fair value. The Group applies the recognition, measurement and disclosure requirements of IFRS in issue that are endorsed by the EU and are effective for accounting periods beginning on or after 1 January 2012.

Standards and interpretations issued and effective

In preparing these consolidated financial statements, the Group has adopted the following pronouncements during the year that are new or revised:

- Amended IFRS 7 (Disclosures: Transfers of Financial Assets (2010))
  This amendment's objective is to promote the transparency of off balance sheet activities, particularly in relation to the securitisation of financial assets. Specifically, the transference of these assets and their associated risks are reported in a way that ensures that the user of the accounts is able to understand the financial position of such risks being transferred. The additional disclosure is set out in note 39.
- Amended IAS 12 (Income Taxes: Deferred Tax – Recovery of Underlying Assets (2010))
  This amendment's objective is to refine IAS 12's measurement of deferred tax which relates to the recovery of an entity's assets. Previously, the standard stated that an asset's recovery would occur only when it was either used or sold. However, and as a consequence of this amendment, investment properties measured at fair value are excluded from the standard's scope on recovery. The amendment to IAS 12 has no material impact on the financial statements of the Group.

Standards and interpretations issued but not yet effective

- IFRS 9 (Financial Instruments: Classification and Measurement (2010))
  This new standard replaces IAS 39 (Financial Instruments: Recognition and Measurement (2009)). Phase one requires financial assets to be classified as at amortised cost or at fair value. Further phases of IFRS 9 are scheduled to cover impairment and hedge accounting.

  It becomes effective for accounting periods beginning on or after 1 January 2015. Early adoption is permitted, once endorsed by the EU. The impact of IFRS 9 is likely to be material to the Group, due to the value of financial instruments held on the Group's balance sheet. The standard is currently being drafted and so a detailed assessment of its impact is not currently possible.
- IFRS 10 (Consolidated Financial Statements (2011))
  This new standard establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. It supersedes both IAS 27 (Consolidated and Separate Financial Statements (2008)) except where IAS 27 still applies as noted below, and Amended SIC 12 (Consolidation: Special Purpose Entities (2004)). It aims to provide transparency in identifying off balance sheet, parent subsidiary relationships, using a consistent basis for determining the existence and thus consolidation of those underlying entities being controlled by the reporting entity.

  It becomes effective for accounting periods beginning on or after 1 January 2013. It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact to the Group of IFRS 10 is likely to be immaterial.
- IFRS 11 (Joint Arrangements (2011))
  This new standard establishes principles for financial reporting by parties to a joint arrangement. It supersedes both IAS 31 (Interests in Joint Ventures (2010)) and Amended SIC 13 (Jointly Controlled Entities: Non-Monetary Contributions by Venturers (2007)). Recognition criteria now distinguish between joint operations and joint ventures on their relative 'rights and obligations' scope. A joint operation interest is accounted for between assets, liabilities, revenue and expense, whilst a joint venture is restricted to equity accounting.

  It becomes effective for accounting periods beginning on or after 1 January 2013. It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact to the Group of IFRS 11 is likely to be immaterial.
- IFRS 12 (Disclosure of Interests in Other Entities (2011))
  This new standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It aims to provide disclosure transparency on the reporting entity's risks associated with its interests in other entities, in conjunction with IFRS 10's application which determines the existence of such entities.

  It becomes effective for accounting periods beginning on or after 1 January 2013. It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact to the Group of the additional disclosure requirements is likely to be immaterial.
- IFRS 13 (Fair Value Measurement (2011))
  This new standard defines fair value and also acts as its single authority, dealing primarily with both its measurement and disclosure. It does not require fair value measurements in addition to those already required, or permitted by other IFRSs, and is not intended to establish valuation standards or affect valuation practices outside of financial reporting.

  The Group will adopt the standard for the accounting period beginning on 1 January 2013. With the exception of additional disclosure, the impact to the Group of IFRS 13 is likely to be immaterial.
- Amended IAS 1 (Presentation of Items of Other Comprehensive Income)
  This amendment proposes to split the presentation of other comprehensive income into two sections. The different sections will distinguish between items which may or may not be recycled into any future income or expense.

Basis of preparation continued

The Group will adopt the standard for the accounting period beginning on 1 January 2013. The impact of the amendment to IAS 1 is likely to be immaterial to the Group.

- Revised IAS 19 (Employee Benefits (2011))
  This revision covers the standard's recognition, measurement and presentation criteria with regard to a pension scheme's expense contained within IAS 19's 'defined benefit' scope. Actuarial gains or losses will now be fully recognised within income or expense, thus removing the previous partial recognition of 'corridor and spreading'.

  Furthermore, the revision eliminates the 'expected return on assets' from the measurement of a pension's expense and directs entities to instead charge a cost of finance against its net unfunded liability position.

  When determining a discount rate that calculates a pension obligation's present value, reference should be made to market yields. These yields should be matched to high quality corporate bonds, in terms of both the obligation's currency and maturity, ahead of any previously assumed government bond yield reference point.

  The Group will adopt the standard for the accounting period beginning on 1 January 2013. The impact of the revision to IAS 19 is likely to be material to the Group, due to the likely impact on the pension costs recharged to the Group.

- Amended IAS 27 (Consolidated and Separate Financial Statements (2011))
  This amendment occurs as a direct consequence of IFRS 10's issuance, which now acts as the new single authority on consolidation requirements. IAS 27's scope has therefore reduced and focuses more specifically on separate financial statements' accounting bases. An entity shall therefore prepare its separate financial statements using one of two bases; either at cost or in accordance with IFRS 9.

  It becomes effective for accounting periods beginning on or after 1 January 2013. It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact of the amendment to IAS 27 is likely to be immaterial to the Group.

- Amended IAS 28 (Investments in Associates and Joint Ventures (2011))
  This amendment occurs as a direct consequence of IFRS 11's issuance, which now acts as the new single authority on joint arrangements. IAS 28 changes in order to consistently apply equity accounting methods for both joint ventures and associates. An entity shall therefore use IAS 28's equity accounting method, when accounting for any of IFRS 11's joint arrangements.

  It becomes effective for accounting periods beginning on or after 1 January 2013. It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact of the amendment to IAS 28 is likely to be immaterial to the Group.

- Amendments to IFRS 7 (Disclosures Offsetting Financial Assets and Liabilities)
  This amendment requires disclosures to include information that will enable users of an entity's financial statements to evaluate the effect of netting arrangements on the entity's financial position.

  The Group will adopt the standard for the accounting period beginning on 1 January 2013. The impact of the amendment to IFRS 7 is likely to be immaterial to the Group.

- Amendments to IAS 32 (Offsetting Financial Assets and Financial Liabilities)
  The current offsetting model in IAS 32 requires an entity to offset a financial asset and financial liability only when the entity currently has a legally enforceable right of set-off and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. This amendment clarifies the position when offsetting financial assets and financial liabilities. The legal right of set-off must be available today and legally enforceable for all counterparties in the normal course of business, as well as in the event of default, insolvency or bankruptcy. The amended disclosures will require more extensive disclosures than are currently required. The disclosures focus on quantitative information about recognised financial instruments that are offset in the statement of financial position, as well as those recognised financial instruments that are subject to master netting or similar arrangements irrespective of whether they are offset.

  It becomes effective for accounting periods beginning on or after 1 January 2014. It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact of the amendment to IAS 32 is likely to be immaterial to the Group.

  Other standards and interpretations have been issued but these are not considered to be relevant to the Group's operations.

Going concern

The directors' judgment that it is appropriate to use the going concern basis in preparing the Group's accounts is set out in detail in the Directors' report on pages 29 and 30.

The Group's business activities, together with its financial position, and the factors likely to affect its future development and performance, are set out in the business and financial review on pages 6 to 9. In addition, the risk management section on pages 54 to 79 includes the Group's objectives, policies and processes for managing its risk and details of its exposure to risk. The capital management section on pages 80 to 82 provides information on the Group's capital policies and capital resources.

Consequently, after making enquiries, the directors are satisfied that the Group has sufficient resources to continue in business for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements. When making this assessment, the directors act within the principles of the Financial Reporting Council's 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009' report.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2012

Basis of preparation continued

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

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Information about areas of estimation, uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements are described within the risk management section on pages 54 to 79 and the critical judgments section on pages 51 to 53.

Significant accounting policies
The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

1) Business combinations
On 1 August 2009, The Co-operative Bank plc merged with Britannia Building Society, with Britannia transferring their engagements to the Group.

This business combination has been accounted for applying the requirements of IFRS 3 (Business Combinations (2004)).

The consideration transferred was valued by reference to the members' interests acquired. Financial assets and liabilities which, following the Group's accounting policies, would be carried at amortised cost, were brought onto the balance sheet at their fair value at acquisition and were subsequently carried at amortised cost using the effective interest rate method. The income statement includes the results of the engagements transferred from Britannia since the date of acquisition.

2) Basis of consolidation
a) Subsidiaries
Subsidiaries are entities controlled by the Group. Control exists whenever the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The financial statements have been prepared using uniform accounting policies and are based on the same accounting period as the Group.

Intra-group balances and transactions, and any unrealised gains and losses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

b) Special purpose entities
Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well defined objective; for the Group this includes:

- various securitisation transactions in which mortgages were sold to SPEs. The equity of these SPEs is not owned by the Group; and
- Covered Bond Limited Liability Partnerships created in order to act as a guarantor for the issue of covered bonds (refer to note 36 for further information).

An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Group and the SPE's risks and rewards, the Group concludes that it controls the SPE.

The following circumstances may indicate a relationship in which, in substance, the Group controls and consequently consolidates an SPE:

- the activities of the SPE are being conducted on behalf of the Group according to its specific business needs so that the Group obtains benefits from the SPE's operation;
- the Group has the decision making powers to obtain the majority of the benefits of the activities of the SPE;
- the Group has the rights to obtain the majority of the benefits of the SPE and therefore may be exposed to the risks incidental to the activities of the SPE; or
- the Group retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The above circumstances apply to all of the SPEs. Consequently the Group consolidates each SPE.

The assessment of whether the Group has control over an SPE is carried out at inception. No further assessment of control is carried out unless changes in the structure or terms of the SPE or additional transactions between the Group and the SPE occur.

c) Interests in joint ventures
The Group's interests in joint ventures are accounted for using the equity method. The consolidated financial statements include the Group's share of the income and expenses and equity movements of equity accounted investees, after adjustments to align the accounting policies with those of the Group.

3) Revenue recognition
a) Interest income and expense
Interest income and expense is recognised on an effective interest rate (EIR) basis, inclusive of directly attributable incremental transaction costs and fees including arrangement and broker fees, valuation and solicitor costs, discounts and premiums where appropriate and early redemption fees.

The EIR basis spreads the interest income and expense over the expected life of each instrument. The EIR is the rate that, at the inception of the instrument, exactly discounts expected future cash payments and receipts through the expected life of the instrument back to the initial carrying amount. When calculating the EIR, the Group estimates cash flows considering all contractual terms of the instrument (for example, prepayment options) but does not consider assets' future credit losses except for assets acquired at a deep discount.

Significant accounting policies continued

For assets acquired at a value significantly below the carrying value in the acquiree's financial statements because they have incurred loss, expectations of future loss are higher than at origination, and interest spreads have widened because of deteriorating market conditions, the calculation of EIR is the same as shown above with the exception that the estimates of future cash flows include credit losses.

b) Fees and commissions

Fee and commission income is predominantly made up of arrangement and other fees relating to loans and advances to customers that are included in the effective interest calculation. Commitment fees received are deferred and included in the EIR calculation upon completion or taken in full at the date the commitment period expires and completion does not occur.

Fees and commissions payable to introducers in respect of obtaining lending business, where these are direct and incremental costs related to the issue of a financial instrument, are included in interest income as part of the effective interest rate.

All other fee and commission income, such as loan closure fees or arrears fees, not included in the effective interest calculation, is recognised on an accruals basis as the service is provided.

4) Significant items

Items which are material by both size and nature (ie outside of the normal operating activities of the Group) are treated as significant items and disclosed separately on the face of the income statement.

The separate reporting of significant items helps to provide an indication of the Group's underlying business performance. Events which may give rise to the classification of items as significant include individually significant programmes of restructuring, investment, integration and provisions for material non-recurring items.

5) Financial instruments (excluding derivatives)

a) Recognition

The Group initially recognises loans and advances, deposits, debt securities issued and other borrowed funds on the date at which they are originated.

Regular way purchases and sales of financial assets are recognised on the trade date at which the Group commits to purchase or sell the asset. All other financial assets and liabilities are initially recognised on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

b) Derecognition

Financial assets are derecognised when they are qualifying transfers and:

- the rights to receive cash flows from the assets have ceased; or
- the Group has transferred substantially all the risks and rewards of ownership of the assets.

When a financial asset is derecognised in its entirety, the difference between the carrying amount and the sum of the consideration received (including any new asset obtained less any new liability assumed) and any cumulative gain or loss that had been recognised in other comprehensive income is recognised in the income statement.

When available for sale financial assets are derecognised the cumulative gain or loss, including that previously recognised in reserves, is recognised in the income statement.

A financial liability is derecognised when the obligation is discharged, cancelled or expires. Any difference between the carrying amount of a financial liability derecognised and the consideration paid is recognised through the income statement.

c) Financial assets

i. Overview

The Group classifies its financial assets (excluding derivatives) as either:

- loans and receivables;
- available for sale; or
- financial assets at fair value through income or expense.

ii. Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and the Group does not intend to sell immediately or in the near term. These are initially measured at fair value plus transaction costs that are directly attributable to the financial asset. Subsequently, these are measured at amortised cost using the effective interest method. The amortised cost is the amount advanced less principal repayments, plus or minus the cumulative amortisation using the EIR method of any difference between the amount advanced and the maturity amount less impairment provisions for incurred losses.

Loans and receivables mainly comprise loans and advances to banks and customers (except where the Group has elected to carry the loans and advances to customers at fair value through income or expense as described in accounting policy (5c. iv. below) and assets reclassified from available for sale (see below).

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2012

Significant accounting policies continued

iii. Available for sale
Available for sale financial assets are debt securities and equity shares that are not held for trading and are intended to be held for an indefinite period of time. These are measured at fair value based on current bid prices where quoted in an active market. Where the debt securities and equity shares are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Movements in fair value are recorded in equity as they occur. On disposal, gains and losses recognised previously in equity are transferred to the income statement. In exceptional circumstances, for instance where the market in the securities has become inactive, the Group has reclassified such assets as loans and receivables.

Any transfer back from loans and receivables, upon reclassification, would be measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the debt securities or equity shares are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques.

iv. Financial assets at fair value through income or expense
These are:

- financial assets designated at fair value through income or expense
  Financial assets designated at fair value are assets which have been designated to eliminate or significantly reduce a measurement and recognition inconsistency or where management specifically manages an asset or liability on that basis eg capital bonds.

  These assets are measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the securities are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Gains and losses arising from changes in the fair value are brought into the income statement within trading income as they arise.
- financial assets held for trading
  Financial assets held for trading are assets which have been principally acquired for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together for which there is evidence of a recent pattern of short term profit taking. These financial assets are recognised on the date of trade, when the Group enters into contractual arrangements with counterparties to purchase or sell financial instruments, and are normally derecognised when sold. Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequently their fair values are remeasured, and gains and losses from changes therein are recognised in the income statement within trading income.

d) Financial liabilities
i. Overview
Financial liabilities are contractual obligations to deliver cash or another financial asset. Financial liabilities are recognised initially at fair value, net of directly attributable transaction costs.

Financial liabilities, other than derivatives and capital bonds, are subsequently measured at amortised cost.

Capital bonds within customer accounts have been designated at fair value through income or expense upon initial recognition in the balance sheet. Changes in fair value are recognised through the income statement.

The capital bonds are economically matched using equity linked derivatives, which do not meet the requirements for hedge accounting. Recording changes in fair value of both the derivatives and the related liabilities through the income statement most closely reflects the economic reality of the transactions. In doing so this accounting treatment eliminates a measurement inconsistency that would otherwise arise from valuing the capital bonds at amortised cost and the derivatives at fair value.

ii. Borrowed funds
Borrowings are recognised initially at fair value, which equates to issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

The Group classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. The Group's preference shares are classified as financial liabilities as they carry the right to a fixed non-cumulative preferential dividend (further information is provided in note 29) and are subsequently presented in other borrowed funds. The dividends on these preference shares are recognised in the income statement as interest expense on an amortised cost basis using the EIR method.

iii. Perpetual subordinated bonds
Perpetual subordinated bonds are carried at their nominal value plus any premium and a fair value adjustment for hedged risk where items are designated as part of a fair value hedge relationship.

Interest payable on perpetual subordinated bonds is recognised in the income statement using the EIR method.

Significant accounting policies continued

6) Impairment provisions

a) Assessment

i. Objective evidence

At the balance sheet date, the Group assesses its financial assets not at fair value through income or expense for objective evidence that an impairment loss has been incurred.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower, a breach of contract, such as default or delinquency in interest or principal payments, the granting by the Group to the borrower, for economic and legal reasons relating to the borrower's financial difficulty, a concession that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy or other financial reorganisation, or the disappearance of an active market for a security.

The Group considers evidence for impairment for loans and advances at both a specific asset and collective level.

ii. Forbearance

The Group operates a policy of forbearance which mitigates against borrower default. All such cases are included within its provisioning methodology.

- Residential secured mortgages
  If a loan is identified as being subject to forbearance, it is assessed for impairment. Once classified as impaired, mortgages subject to forbearance are treated in the same way as all other impaired mortgages in the impairment provisions calculations.
- Unsecured retail business
  Loans are treated as impaired where the Group has granted forbearance concessions. The amount of the impairment provision will vary with the type of concession granted.
- Corporate business
  Impairment provisions are made for accounts subject to forbearance which are in default or on a watchlist.

  Corporate customers are placed on a watchlist when they show signs of unsatisfactory performance and require close control, but are currently expected to continue trading and where no provision for bad debt is required. Forbearance is a strong indicator that a customer should be placed on the watchlist.

For further information on the Group's approach to forbearance, its management and execution, see the risk management section on pages 54 to 79.

b) Scope

i. Individual accounts

All secured loans and advances are assessed for impairment using a range of criteria graded for levels of risk. Accounts at risk of impairment are monitored and impaired where they display clear indicators of underperformance.

Loans and advances that do not meet the criteria for individual impairment are collectively assessed for impairment by grouping together loans and advances of similar risk characteristics.

ii. Collective accounts

a) Retail

When assessing collective impairment for secured retail loans, the Group estimates incurred losses on mortgages based on the borrower's external credit score or where the loan is identified as being subject to forbearance.

When assessing collective impairment for unsecured retail loans, the Group estimates losses on loans with delinquency greater than a pre-determined trigger point. In addition the Group makes provision on all loans arising from fraud and loans transferred to debt collection agencies. In respect of unsecured loans, the Group uses statistical modelling of historical trends of probability of default, timing of recoveries and the amount of loss incurred.

The model's results are adjusted for management's judgment as to whether current economic and credit conditions are such that actual losses are likely to differ from those suggested by historical modelling. Once impaired, accounts are subjected to higher levels of impairment according to both their relevant stage of delinquency, ie the number of days in arrears, and their consequent likelihood of ultimately being charged off. Default rates, loss rates and future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

b) Corporate

Collective risk cover provides further balance sheet protection for total impairment losses. The amount of collective risk cover is adjusted monthly by the Group. The Group reviews all loans and considers the potential loss which might arise were the borrowers to fail (notwithstanding that continued trading remains the expectation). Trigger events may include a deteriorating balance sheet, material losses, trading difficulties (eg loss of material contracts or suppliers), breach of financial covenants, poor account conduct, arrears and material reduction in value of security. A collective impairment provision is raised against these loans based on the total estimated loss that may arise and the propensity for the borrower to fail.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2012

Significant accounting policies continued

c) Measurement
The amount of the loss is the difference between:

- the asset's carrying amount; and
- the present value of estimated future cash flows (discounted at the asset's original or variable EIR for amortised cost assets and at the current market rate for available for sale assets).

Where the debt is secured, the assessment reflects the expected cash flows from the realisation of the security, net of cost to realise, whether or not foreclosure or realisation of the collateral is probable.

d) Impairment of financial assets carried at amortised cost
The amount of the impairment loss on assets carried at amortised cost is recognised immediately through the income statement and a corresponding reduction in the value of the financial asset is recognised through the use of an allowance account.

A write off is made when all or part of a claim is deemed uncollectable or forgiven after all the possible collection procedures have been completed and the amount of loss has been determined. Write offs are charged against previously established provisions for impairment or directly to the income statement.

Any additional recoveries from borrowers, counterparties or other third parties made in future periods are offset against the write off charge in the income statement once they are received.

Provisions are released at the point when it is deemed that following a subsequent event the risk of loss has reduced to the extent that a provision is no longer required.

e) Impairment of financial assets classified as available for sale
Available for sale assets are assessed at each balance sheet date to see whether there is objective evidence of impairment. In such cases, any impairment losses are recognised by transferring the cumulative loss that has been recognised directly in equity to income or expense.

When a subsequent event causes the amount of impaired loss on available for sale investment securities to decrease, and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income statement.

However any further recovery in fair value of an impaired available for sale equity security is recognised directly in equity.

7) Offsetting
Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to do so and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

8) Sale and repurchase agreements
Securities sold subject to repurchase agreements (repos) are reclassified on the balance sheet as pledged assets when the transferee has the right by contract or custom to sell or repledge the assets. The liability to the transferee is also included on the balance sheet, in deposits by banks. The difference between sale and repurchase price is accrued over the life of the agreements using the EIR method.

Securities purchased under agreements to re-sell (reverse repos) are classified as loans and advances to banks on the balance sheet, as appropriate.

9) Derivative financial instruments and hedge accounting
a) Derivatives used for asset and liability management purposes
Derivatives are used to hedge interest and exchange rate exposures related to non-trading positions. Instruments used for hedging purposes include swaps, forward rate agreements, futures, options and combinations of these instruments. The Group also uses equity derivatives to hedge the equity risks within its capital bonds.

Derivative financial instruments are stated at fair value based on quoted market prices in active markets and, where these are not available, using valuation techniques such as discounted cashflow models. Further information is provided on page 123. All derivatives are carried as assets when the fair value is positive and liabilities when the fair value is negative. The gain or loss on re-measurement to fair value is recognised immediately in the income statement except where derivatives qualify for cashflow hedge accounting.

On initial designation of derivatives and qualifying hedged items as a hedge, the Group formally documents the relationship between the hedging instrument(s) and hedged item(s) including the risk management objective and strategy in undertaking the hedge transaction together with the method used to assess effectiveness of the hedging relationship.

The Group makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, as to whether the hedging instruments are expected to be 'highly effective' on offsetting the changes in fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80% to 125%.

Significant accounting policies continued

i. Cash flow hedges

Where derivatives are designated as hedges of the exposure to variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the portion of the fair value gain or loss on the derivative that is determined to be an effective hedge is recognised directly in equity. The ineffective part of any gain or loss is recognised in the income statement immediately.

The accumulated gains and losses recognised in equity are reclassified to the income statement in the periods in which the hedged item will affect income or expense. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss recognised at that time remains in equity until the forecast transaction is eventually recognised in the income statement.

When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in equity is immediately reclassified to the income statement.

ii. Fair value hedges

Where a derivative is designated as the hedging instrument to hedge the change in fair value of a recognised asset or liability or a firm commitment that could affect income or expense, changes in the value of the derivative are recognised immediately in the income statement together with changes in the fair value of the hedged item that are attributable to the hedged risk.

Fair values are based on quoted market prices in active markets or, where these are not available, using valuation techniques such as discounted cashflow models.

If the derivative expires or is sold, terminated, or exercised, or no longer meets the criteria for fair value hedge accounting, or the designation is revoked, then hedge accounting is prospectively discontinued. Any adjustment up to that point, to a hedged item for which the EIR method is used, is amortised to income or expense as part of the recalculated EIR of the item over its remaining life.

iii. Fair value hedge accounting for a portfolio hedge of interest rate risk

As part of its risk management process the Group identifies portfolios whose interest rate risk it wishes to hedge. The portfolios may comprise only assets, only liabilities or both assets and liabilities. The Group analyses each portfolio into repricing time periods based on expected repricing dates, by scheduling cash flows into the periods in which they are expected to occur. Using this analysis, the Group decides the amount it wishes to hedge and designates as the hedged item an amount of assets or liabilities from each portfolio equal to this.

The Group measures monthly the change in fair value of the portfolio relating to the risk that is being hedged. Provided that the hedge has been highly effective, the Group recognises the change in fair value of each hedged item in the income statement with the cumulative movement in its value being shown on the balance sheet as a separate item, fair value adjustment for hedged risk, either within assets or liabilities as appropriate. If the hedge no longer meets the criteria for hedge accounting, this amount is amortised to the income statement over the remaining average useful life of the hedge relationship.

The Group measures the fair value of each hedging instrument monthly. The value is included in derivative financial instruments in either assets or liabilities as appropriate, with the change in value recorded in the income statement.

Any hedge ineffectiveness is recognised in the income statement as the difference between the change in fair value of the hedged item and the change in fair value of the hedging instrument.

b) Embedded derivatives

A derivative may be embedded in another instrument, known as the host contract. Where the economic characteristics and risks of an embedded derivative are not closely related to those of the host contract (and the host contract is not carried at fair value through income or expense), the embedded derivative is separated from the host and held on balance sheet at fair value.

Movements in fair value are posted to the income statement, whilst the host contract is accounted for according to the relevant accounting policy for that particular asset or liability.

c) Derivatives used for trading purposes

Derivatives entered into for trading purposes include swaps, forward rate agreements, futures, options and combinations of these instruments. Derivatives used for trading purposes are measured at fair value and any gains or losses are included in the income statement. The use of derivatives and their sale to customers as risk management products is an integral part of the Group's trading activities.

10) Financial guarantee contracts

Other financial guarantees, in respect of intra-group funding and the pension deficit in respect of the Britannia Pension Scheme, between the Group and its subsidiaries are treated as insurance contracts in accordance with IFRS 4 (Insurance Contracts (2004)). In accordance with the standard, the recognised insurance liability is assessed based on the current estimate of forecast future cash flows. If this highlights that the liability is inadequate, the liability is increased and the corresponding charge taken through the income statement.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2012

Significant accounting policies continued

11) Property, plant and equipment
Items of property, plant and equipment are stated at cost less any accumulated depreciation and impairment losses. Depreciation is provided on a straight line basis at the following rates, which are estimated to write down the assets to realisable values at the end of their useful lives.

Freehold and long leasehold land and buildings	40–50 years
Freehold and leasehold improvements	10–40 years
Short leasehold buildings	life of lease
Equipment:	
Computer	3–7 years
Furniture and equipment	3–10 years

All items of property, plant and equipment are reviewed for indications of impairment on a regular basis and at each balance sheet date. If impairment is indicated, the asset's recoverable amount (being the greater of fair value less cost to sell and value in use) is estimated. Value in use is calculated by discounting the future cash flows generated from the continuing use of the asset.

If the carrying value of the asset is less than the recoverable amount an impairment charge is recognised in the income statement.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment, and are recognised net within operating expenses in the income statement.

12) Intangible assets
a) Computer software
Computer software is stated at cost less cumulative amortisation and impairment and comprises computer software together with the costs of development of the software.

Acquired computer software licences are capitalised on the basis of cost incurred to acquire and bring the software to use.

Costs that are directly associated with the internal production of software products that will generate future economic benefit are capitalised. Only costs which meet the definition of development costs under IAS 38 (Intangible Assets) are capitalised, with costs being capitalised only if the asset can be reliably measured, will generate future economic benefits and there is an ability to use the asset. Expenditure that is not directly attributable to the development of such assets is recognised in the income statement in the period to which it relates.

The expenditure capitalised includes direct employee costs and an appropriate portion of relevant direct overheads. Amortisation is charged to the income statement on a straight line basis to allocate the cost over the estimated useful life up to a maximum of seven years.

b) Other intangible assets
Other intangible assets are stated at cost less cumulative amortisation and impairment. Amortisation is charged over the useful life of the asset. For core systems, such as core deposit intangibles, a review of the asset's useful life is carried out and a maximum useful life of up to ten years is applied.

c) Impairment
Intangible assets are assessed for indications of impairment annually. If impairment is indicated, the asset's recoverable amount (being the greater of fair value less cost to sell and value in use) is estimated. Value in use is calculated by discounting the future cash flows generated from the continuing use of the asset. If the carrying value of the asset is less than the greater of the value in use and the fair value less costs to sell, an impairment charge is recognised to this value in the income statement. Irrespective of whether there is any indication of impairment, intangible assets in the course of construction are tested for impairment at least annually.

13) Goodwill
All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries, associates and joint ventures and represents the difference between the cost of the acquisition and the fair value of the identifiable assets, liabilities and contingent liabilities acquired.

If a business combination is achieved without transfer of consideration, the amount of goodwill is calculated by reference to the fair value of the Group's interest in the acquiree using a valuation technique. The technique involves assessing the future net profit of the acquiree and then discounting using a rate that reflects current market assessment of the time value of money and risks specific to the acquiree.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is not amortised but is tested for impairment on an annual basis. Where impairment is required, the amount is recognised in the income statement and cannot be subsequently reversed.

Significant accounting policies continued

14) Leases

a) Overview

The Group enters into leases for land and buildings and operating leases for vehicles and equipment.

Leases for land and buildings are split between leases for the land and leases for the buildings for accounting purposes only. The leases are separately assessed as to whether they are finance or operating leases.

The Group policy is to provide for the minimum future lease payments on buildings that it does not currently use, net of expected rental income from sub-leases.

b) Assets leased to customers

All leases of assets to customers are finance leases. Income from assets leased to customers is credited to the income statement based on a pattern reflecting a constant periodic rate of return on the net investment in the lease.

c) Assets leased from third parties

i. Finance leases

Finance lease assets are initially recorded at the lower of fair value and the present value of the minimum lease payments, and subsequently in accordance with the relevant policy for the underlying asset. An equal liability is recorded in other liabilities. Interest is allocated to the lease payments so as to record a constant periodic rate of charge on the outstanding liability.

ii. Operating leases

Operating lease payments are charged to the income statement on a straight line basis over the term of the lease and the asset is not recognised on the balance sheet.

15) Investment property

Property held for long term rental yields that is not occupied by the Group, or property held for capital appreciation, is classified as investment property.

Investment property comprises freehold land and buildings. It is carried at fair value. Fair value is based on discounted expected future cashflows and is representative of current prices in an active market for similar properties in the same location and condition. No depreciation is provided on these properties. Any gain or loss arising from a change in fair value is recognised in the income statement.

If the Group takes occupancy of an investment property, it is reclassified as property, plant and equipment and its fair value at the date of reclassification becomes its cost for subsequent accounting purposes. Similarly, transfers to the investment property portfolio are made when occupancy by the Group ceases and the property meets the criteria of an investment property under IAS 40. Prior to such a transfer the property is measured at fair value with any gain or loss recognised in the income statement.

16) Cash and cash equivalents

Cash and cash equivalents comprises cash balances and balances with a maturity of three months or less from the acquisition date, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management are included as a component of cash and cash equivalents for the purpose of the cashflow statement .

17) Income tax

a) Overview

Tax on the income statement for the year comprises current and deferred tax, which is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in the statement of comprehensive income.

b) Current tax

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

c) Deferred tax

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided for is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2012

Significant accounting policies continued

18) Pension costs

a) Defined contribution basis

With effect from 6 April 2006, the Group, along with other businesses within The Co-operative Group, has participated in the Co-operative Group Pension (average career earnings) Scheme (the Pace scheme), the assets of which are held in a separate fund administered by trustees. The Group's de facto participation level is on a defined contribution basis, as it pays fixed sums into the fund on a regular basis. This level of participation is required because the Pace defined benefit scheme exposes the participating businesses to actuarial risks associated with the current and former employees of other group companies, with the result that there is no consistent and reliable basis for allocating Pace's liabilities, assets and costs to individual companies participating in the scheme. Therefore pension costs in respect of the scheme are accounted for on a defined contribution basis and recognised as an expense in the income statement as incurred.

b) Former Britannia Building Society pension scheme

Following the transfer of engagements of Britannia Building Society, the Britannia defined benefit pension scheme transferred to the Co-operative Financial Services Management Services Limited (CFSMS), a fellow subsidiary undertaking of The Co-operative Banking Group. In accordance with policy 18.a, the pension costs in respect of this scheme are accounted for, by the Bank, on a defined contribution basis and recognised as an expense in the income statement as incurred.

19) Foreign currency

The functional and presentational currency for the Group is sterling. Transactions in foreign currencies are translated at the foreign exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to sterling at the foreign exchange rate ruling at that date. Foreign currency differences arising on translation are recognised in the income statement, except for foreign currency differences arising on translation of available for sale equity instruments or a qualifying cashflow hedge, which are recognised directly in the statement of comprehensive income. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair values are translated to sterling at the exchange rates prevailing at the dates the values were determined.

20) Investments in Group undertakings

Investments in subsidiaries are initially measured at fair value which equates to cost and subsequently valued at cost less impairment.

21) Provisions for liabilities and charges

A provision is recognised in the balance sheet if the Group has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

22) Profit based payments to members of The Co-operative Group

Members of The Co-operative Group receive a dividend based on their transactions with The Co-operative Group and its subsidiaries including the Bank. Once these profit based payments are approved by The Co-operative Group Limited, the Bank is recharged an amount which reflects its eligible products' contribution to the overall Co-operative Group member dividend.

Critical judgments and estimates

For the year ended 31 December 2012
All amounts are stated in £m unless otherwise indicated

1. Overview

The Group makes critical judgments and estimates which affect its reported assets, liabilities and profits. Estimates are calculated using various assumptions. Critical judgments, and the assumptions used in calculating estimates, are continually assessed and reviewed, and are based on historical experience and reasonable expectations of future events. Actual results may differ from these judgments and estimates.

2. Loans and advances

a. Overview

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

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

Where loans are subject to forbearance, they may be treated as impaired. Further explanation of the treatment of forborne balances is included in the Group's risk management disclosures in sections 1.4.1.3, 1.4.1.4 and 1.4.1.5 on pages 60 to 70.

b. Collective provisions

i. Unsecured and secured residential

Personal advances are identified as impaired by taking account of the age of the debt's delinquency, the product type and the regularity of payments made whilst in arrears. The provision is calculated by applying a percentage rate to different categories and ages of impairment debt. The provision rates reflect the likelihood that the debt in that category/age will be written off or charged off at some point in the future. The rates are based on historical experience and current trends, incorporate the effects of discounting at the customer interest rate and are subject to regular review. The provision is the product of the rate and the balance for the relevant arrears band.

The majority of provisions are made against unsecured loans. A key estimate within this provisioning model is the percentage of accounts that will be charged off. A 1% change would change the collective provision by £0.9m.

ii. Corporate

The Group's corporate collective provision has increased to £22.4m (2011: £12.2m), reflecting the continuing difficulties and uncertainties currently being experienced in this sector. This is a consequence of increasing the pool of accounts which are identified as at risk.

Following a review of the loan loss provisioning for the 2012 year end, the collective unimpaired provision methodology has been refined for Corporate.

The methodology has been based on risk parameters defined by the Group. It is a risk based approach, covering accounts with exposures less than £0.5m, not individually reviewed and where a trigger event could have occurred but has not yet been observed.

The formula underpinning this methodology applied to the unimpaired portfolio is:

Exposure x Probability of Default x Loss Given Default x Loss emergence period of six months

A key estimate within the corporate collective model is the loss emergence period. A movement of 1 month in this estimate would change the provision by £6.2m.

c. Individual provisions

i. Secured residential

Mortgage accounts are identified as impaired and provided for on an individual basis by taking account of the age of the debt's delinquency on a case by case basis.

Due to continuing difficulties and uncertainties currently being experienced in this sector, the Group now classifies all accounts with arrears outstanding equivalent to 30 days or more as individually impaired. Previously, the trigger for recognition of individual impairment was 90 days or more.

A total of £5.3bn of impaired Britannia loans and advances to customers were acquired at a deep discount due to estimated future credit losses. This £121.1m discount (2011: £144.9m), is realised on the actual redemptions of the associated mortgages (mainly in Optimum). A key assumption in the judgment of estimated future credit losses is our estimate of future HPI movements. If future HPI movements were to differ from expectations by 5%, the impact on the estimate would be £4.4m.

Following a review of the parameters of the model, the Group maintains its view that no further write backs of the deep discount (2011: £20.0m) will be made due to the remaining uncertainties in the exact timing of economic recovery.

Critical judgments and estimates continued

For the year ended 31 December 2012
All amounts are stated in £m unless otherwise indicated

2. Loans and advances continued

ii. Corporate

The Group's corporate individual provision has increased to £433.6m (2011: £105.1m). It reflects both the impact to the Group of having exhausted its associated fair value adjustment for credit risk within the year, and a deterioration of expected future recoveries against impaired loans.

Given the continuing and persistent weakness in economic recovery and the increasing levels of risk associated with refinancing and interest payment cover currently being experienced in this sector, a significantly higher number of cases meet the definition of corporate loans identified as being individually impaired.

Each corporate account is assessed and allocated a 'risk grade' to enable the Group to monitor the overall quality of its lending assets. Those of lesser quality, where the lending is potentially at risk and provisions for loss may be required, are centrally monitored with specific management actions taken at each stage within laid down procedures and specific provisioning criteria. Provisions represent the likely net loss after realisation of any security.

A key estimate within the corporate individual model is collateral valuation. A 10% movement in this estimate would change the provision by £106.2m.

For further information on credit risk and impairment, see section 1 of risk management disclosures.

3. Effective interest rate

IAS 39 requires interest income to be recognised on an effective interest rate (EIR) basis, inclusive of directly attributable incremental transaction costs and fees, and discounts and premiums where appropriate.

The EIR basis spreads the interest income over the expected life of the instrument. The expected life of an instrument is the period from its inception up to its redemption or maturity date, ie for the mortgage portfolio it would be its redemption date, whilst for the non-mortgage portfolio it would be its maturity date.

On applying this approach to the mortgage portfolio, judgments are made in relation to estimating its average life. These judgments are made based on specific factors including product terms and historical repayment data. The estimates are updated in each reporting period to reflect actual performance. Key judgment areas, regularly reviewed for both current and expected levels of mortgage balance experience, are the average and total lives of the mortgage portfolio.

An increase or decrease in the average life by one year would increase or decrease gross interest income by 0.2% respectively.

During 2012, the Group's Optimum mortgage portfolio (which contains products sourced via intermediaries and purchases of mortgage portfolios up to the end of 2008) was remodelled to reflect both current experience of rising average lives (ie higher balances then expected), and projected trends of borrower behaviour predominantly contained within interest only products. In updating for this trend, the Group expects a higher level of mortgage balances over the majority of the contractual term and has therefore extended the end year of the total portfolio life from 2023 to 2035. Extending the average mortgage lives also impacts on redemption rates of the debt securities in issue. The impact of increasing the mortgage redemptions by 10% per annum relating to the fair value adjustments relating to debt securities in issue is to decrease profits by a total of £1.8m in the years up to 2013 and to increase profits by the same amount in the following years up to 2017.

4. Provisions for liabilities and charges

Provisions are carried in respect of certain known or forecast future expenditure, as described in note 32.

a. Financial Services Compensation Scheme levy

i. Background

The Financial Services Compensation Scheme (FSCS) provides compensation to customers of financial institutions in the event that an institution is unable to pay claims against it. As a result of a number of institutions' failures during 2008, the FSCS borrowed £19.7bn from HM Treasury (HMT) in order to meet its obligations to the depositors. These borrowings are anticipated to be repaid substantially from the realisation of the assets of the failed institutions. The FSCS raises annual levies from the banking industry in order to meet its management expenses and compensation cost.

The Group's provision is now made up of two components, an interest levy and a capital levy.

ii. Current expectations of performance

The Group has provided £38.6m (2011: £25.0m) for its share of levies that will be raised by the FSCS.

The interest levy element of the provision is £27.7m and relates to interest on the loan from HMT in respect of the levy years to 31 March 2014. This provision includes estimates for the interest that the FSCS will pay on the loan and of the Group's market participation in the relevant periods.

For every 50bps that 12 month LIBOR is increased, the Group's year end provision for the FSCS levy would increase by £2.9m.

The FSCS has announced that a capital levy totalling £802m will be charged from 2013/14. The Group has provided £10.9m for its share of this additional charge in 2012.

4. Provisions for liabilities and charges continued

b. Payment protection insurance (PPI) provision

i. Background

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

ii. Current position and expectations of PPI exposure

The Group has recognised a charge in 2012 of £149.7m (2011: £90.0m) for compensation relating to past sale of PPI policies. The provision represents management's best estimate of the anticipated costs of related customer contact and redress, including administration expenses. At 31 December 2012, after redress and operating costs paid during the year, the remaining provision was £116.0m.

The provision is based on the FSA's policy statement and industry claims experience. Its calculation requires significant judgment by management in determining appropriate assumptions, which include the level of complaints, uphold rates, proactive contact and response rates, and Financial Ombudsman Service referral and uphold rates. A 20% increase in the expected level of complaints would increase the provision by £40m.

The remaining provision is currently management's best estimate of total future settlements and the costs of handling them.

5. Transformation plan

The Banking Group has a strategic programme of investment around the replacement of the core banking system. This intangible asset is held on the balance sheet of CFSMS, a sister company of the Bank. It undergoes an annual impairment review, where the present values of projected future benefits are assessed against the carrying value of the asset plus estimated costs to complete.

After conducting the 2012 annual review, £150m of impairment has been recognised in the accounts of CFSMS, and recharged to the Bank. This impairment reflects a worse economic scenario than in the original business case and an increased understanding of the costs to complete.

This is a highly judgmental review, which uses estimated costs and benefits and relies of judgments around the strategic direction of the business, the future economic environment and the businesses' ability to exploit a new system.

There are inherent uncertainties in such estimates. Outside of the inherent uncertainties in estimating costs and benefits, there are two other material and sensitive judgments which must be made, being the discount rate and the date of implementation. A 1% change in the discount rate would increase/decrease the impairment by £26m in 2012. A six month delay in implementation would reduce the value in use by £35m.

The remaining £179m of spend, held on the balance sheet of CFSMS, would be written off if Project Verde were to be successfully concluded, given the intention to adopt the core banking platform used by the Verde business. Should Project Verde not be completed, this project would be reinvigorated and the directors are confident of a successful implementation.

6. Deferred tax

The Group has a net deferred tax asset balance of £37.2m that will result in future tax deductions.

Recognition of deferred tax assets is only possible to the extent it is probable that future taxable profits will be available against which the unused tax losses and tax credits can be utilised. The deferred tax asset representing tax losses carried forward can only be offset against future taxable profits in the Bank.

Other elements of the deferred tax asset will give rise to timing differences which can be used to offset against future taxable profits in the rest of The Co-operative Group.

After preparing forecasts and projections of profits before tax for The Co-operative Banking Group, the directors are satisfied that there will be sufficient profits in the foreseeable future to absorb this level of unused tax losses.

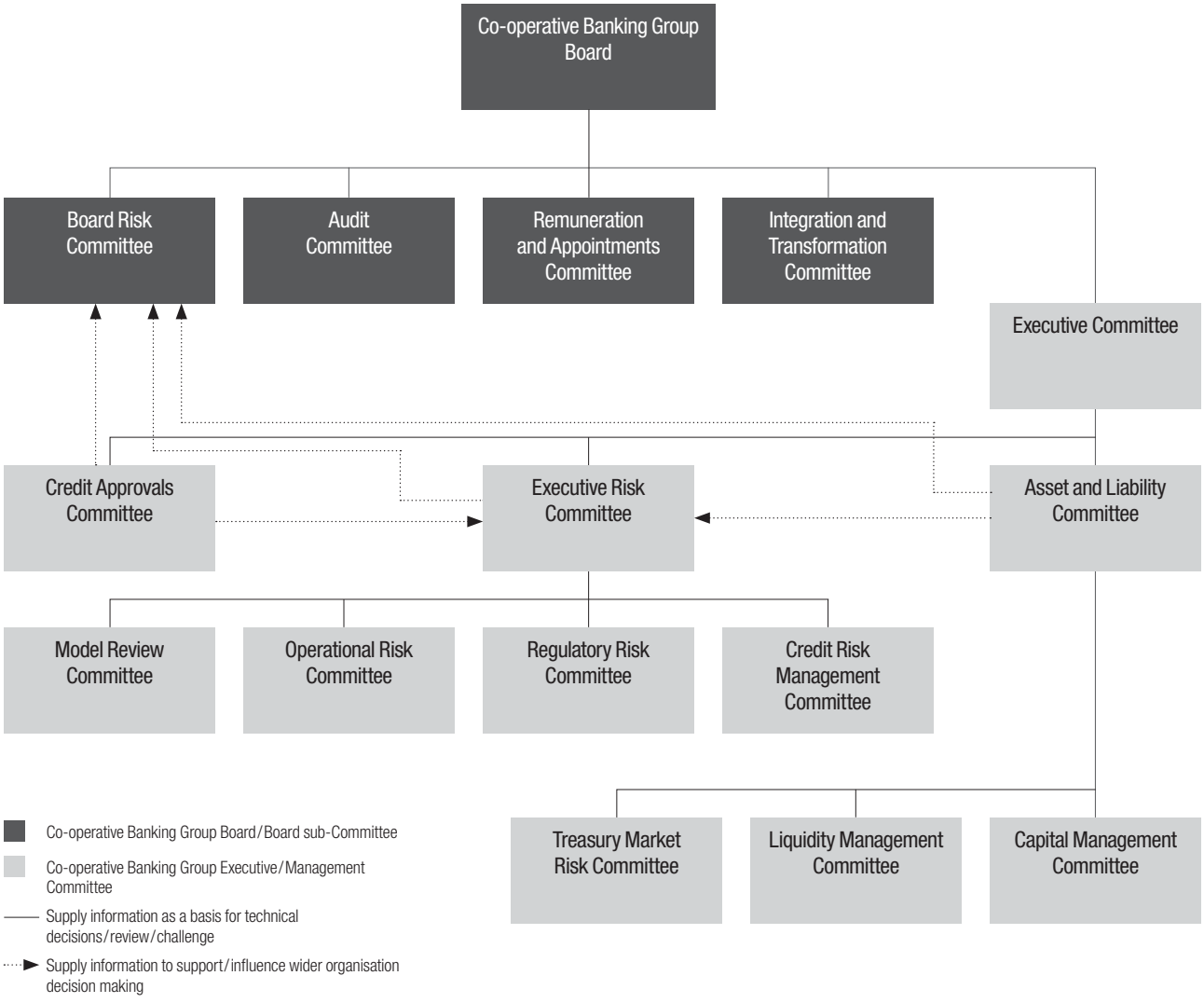
Risk management

For the year ended 31 December 2012
All amounts are stated in £m unless otherwise indicated

Risk management structure

The Co-operative Banking Group (the Banking Group) includes The Co-operative Insurance Society Limited, CIS General Insurance Limited and The Co-operative Bank plc.

The Banking Group has developed and implemented a common governance and organisation structure, which supports all of the Boards within the Banking Group. The following is that part of the governance structure applicable to The Co-operative Bank plc and its subsidiaries.



The Co-operative Banking Group Board

The Co-operative Banking Group Board (the Board) is responsible for approving the Banking Group strategy, its principal markets and the level of acceptable risks articulated through its statement of risk appetite. It is also responsible for overall corporate governance which includes ensuring that there is an adequate system of risk management and that the levels of capital and liquidity held are consistent with the risk profile of the business.

Board delegation

The Board has established Board sub-committees and senior management committees whose responsibilities include:

- overseeing the risk management process;
- identifying the key risks facing the business; and
- assessing the effectiveness of planned management actions.

Specific Board authority has been delegated to Board sub-committees and the Chief Executive Officer (CEO) who may, in turn, delegate authority to appropriate executive directors and their senior line managers.

This includes:

- setting limits for individual types of risk; and
- approving (at least annually) and monitoring compliance with risk policies and delegated levels of authority.

Board Risk Committee (BRC)
The BRC provides oversight and advice to the Board on current and potential risks and the overall risk framework. Its responsibilities include:

- reviewing and challenging the design, implementation, quality and effectiveness of the risk management framework including internal controls and principal risk coverage;
- monitoring the organisation's performance and compliance against high level risk appetite limits and tolerances;
- 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.

Audit Committee (AC)
The AC provides oversight on financial reporting, internal control, regulatory compliance and external and internal audit. Its responsibilities include:

- assisting the Board in carrying out its responsibilities relating to internal control, including control breaches and remediation; and
- exercising oversight of identified risk control framework failings and weaknesses as well as management actions taken to resolve them.

Remuneration and Appointments Committee
The terms of reference of the Remuneration and Appointments Committee are explained in the Directors' report on pages 20 to 25.

Integration and Transformation Committee
The role of the Integration and Transformation Committee is to provide oversight by in depth review of transformation activity within the organisation in order to give assurance on progress.

Executive Committee
The Executive Committee manages the business in line with the Board 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 Board agreed risk management framework;
- supporting the CEO in developing, reviewing and approving detailed risk appetite limits and tolerances as delegated by the Board; and
- ensuring the implementation of the risk strategy set by the Board so as to deliver an effective risk management environment for the Banking Group.

Credit Approvals Committee
The Credit Approvals Committee supports the CEO to carry out responsibilities, including but not limited to:

- sanctioning large counterparty transactions; and
- managing large exposure positions.

Executive Risk Committee (ERC)
The ERC is chaired by the Chief Risk Officer (CRO). Its purpose is to provide a mechanism to ensure all the Banking Group's risks are reviewed, challenged and approved (with escalation to 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 Banking Group;
- driving the detailed implementation of the Banking Group's 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 BRC and the Board for approval where required; and
- monitoring the business' risk profile against the agreed limits and tolerances and reporting on these to the BRC.

Asset and Liability Committee (ALCO)
ALCO is chaired by the CEO. It is primarily responsible for overseeing the management of capital, market, liquidity and funding risks. Its responsibilities include:

- identifying, managing and controlling the Banking Group balance sheet risks in executing its chosen business strategy;
- ensuring that the capital and solvency position is managed in line with policy and that adequate capital is maintained at all times;
- overseeing and monitoring relevant risk control frameworks; and
- recommending to the CEO and ERC relevant principal risk policies and detailed risk appetite limits for approval.

To assist in carrying out these responsibilities, ALCO is supported by a Treasury Market Risk Committee, Liquidity Management Committee and Capital Management Committee.

Risk and capital management sub-committees
Model Review Committee (MRC)
The MRC provides oversight and challenge of model governance across the Banking Group in support of the Enterprise Risk Director.

Operational Risk Committee (ORC)
The ORC 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 or transfer them.

Risk management continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

Regulatory Risk Committee (RRC)

The RRC supports the Regulatory Risk Director in oversight of:

- regulatory reporting requirements;
- ongoing regulatory engagement;
- conduct of business issues including fair treatment of customers; and
- the maintenance of the appropriate authorisations for the regulated entities within the Banking Group (including oversight of any variation to permission).

Credit Risk Management Committee (CRMC)

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

- designing the credit risk control implementation approach, the credit control framework and making recommendations to the ERC;
- reviewing and recommending to the ERC the Banking Group credit risk policy and credit measurement methodologies;
- defining and recommending the credit risk appetite and limits to the ERC; and
- reviewing and challenging the Banking Group's credit risk processes and procedures including the credit risk rating systems.

Treasury Market Risk Committee (TMRC)

The role of the TMRC is to review, challenge and monitor the market risk profile for the Banking Group, in line with policy and within risk appetite.

Liquidity Management Committee (LMC)

The role of the LMC is to enable more detailed discussion on all aspects of Banking Group 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 Banking Group's liquidity position remains in line with agreed levels.

Capital Management Committee (CMC)

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

Risk Management Forums

There is also a framework of sector specific management forums supporting risk and capital management, optimising performance and monitoring adherence policy.

Roles and Responsibilities

The Banking Group operates a three lines of defence governance model to ensure appropriate responsibility and accountability is allocated to the management, reporting and escalation of risks.

Business management act as the first line of defence. They are responsible for identifying where the business area is exposed to risks, including from the development of new products, processes or other business change. They also manage the risks that reside within their business areas on a day to day basis, implementing effective monitoring and control processes to ensure that the business' risk profile is understood and maintained within the Board defined risk appetite.

The risk function act as the second line of defence. They oversee and challenge the implementation and monitoring of the risk framework and consider current and emerging risks across the Bank. They also provide review and challenge of the delegated authority framework and oversee appropriate escalation of breaches, mitigating actions and reporting to the ERC.

Internal Audit act 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 Audit Committee and senior management on the adequacy of both the first and second lines.

Recovery and Resolution Planning (RRP)

RRP is a Bank of England/FSA requirement, which has two distinct elements:

- the recovery plan is the Group's menu of options for addressing a range of financial stresses caused by idiosyncratic problems, market wide stresses, or both; and
- resolution planning is the provision of information and analysis to the authorities, in order to help them prepare a resolution plan for the Group.

There are six separate modules for RRP, all of which have gone through formal governance approval. The approval route is as follows:

- Executive team;
- ERC;
- BRC; and
- the Board.

In addition, as the recovery plan (module two) has been live since June 2012, a series of management information triggers and early warning signals are reported each month to the ERC, for the committee to determine whether to recommend the invocation of the recovery plan.

Significant risks

The following are considered to be the most significant risks facing the Group:

Risk type		Definition	Page
1.	**Credit risk**	Credit risk is the current or prospective risk to earnings and capital arising from a borrower's failure to meet the terms of any contract with the Group or their failure to perform as agreed.	57
2.	**Liquidity and funding risk**	Liquidity and funding risk is the risk that the Group'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 a stress. It arises from the mismatch of timings of cash flows generated from the Group's assets and liabilities (including derivatives).	74
3.	**Market risk**	Market risk is the risk that the value 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 Group's market risk arises from changes in interest rates.	76
4.	**Operational risk**	Operational risk is 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.	79
5.	**Reputational risk**	Reputational risk is the risk associated with an issue which could in some way be damaging to the brand of the Group either through its strategic decisions, business performance, an operational failure or external perception.	79
6.	**Strategic and business risk**	Strategic and business risk arises from changes to the Group's business and the environment in which it operates, specifically the risk of not being able to carry out the Group's business plan and desired strategy.	79
7.	**Conduct risk**	Conduct risk is the risk that the Group's behaviours, offerings or interactions will result in unfair outcomes for customers.	79
8.	**Pension risk**	Pension risk is defined as the risk to Group capital and company funds from exposure to scheme liabilities and risks inherent in the valuation of scheme liabilities and assets.	79

The Board is aware that, as the potential acquisition of Verde progresses, the risk profile of the Group will continue to evolve. A considerable amount of work is underway to implement and embed the improvements to the risk management framework that were designed in 2012 and align it to the project work underway for Verde.

1. Credit risk

1.1 Overview

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

All authority to take credit risk derives from the Banking Group's Board. This authority is delegated to the CEO and then on to other 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.

1.2 Credit risk policy

The principal risk policy for credit risk is approved annually by the ERC and defines appropriate standards and principles for the effective management of credit risk throughout the Group.

The key principles of the policy are:

- credit risk management is fully embedded in Group operations and the business is managed in line with the risk strategy and risk appetite set by the Board;
- identified, emerging or current risks are actively managed in line with the Group's overall risk management approach of identification, measurement, management, monitoring and reporting;
- risk measurement is based on a set of metrics/ratios which are aligned with the risk appetite and support the limits framework;
- timely processes for assessing and reviewing credit risks throughout the credit life cycle are established and documented including completion of risk reports; and
- credit risk decisions are supported by fully evidenced rationale with all material credit risk exceptions reported promptly to the Credit Risk Director.

1.3 Credit exposure

1.3.1 Definitions

Impaired and not impaired in the tables below are defined in the following sections on retail and corporate credit risk and investment securities.

Fair value adjustments represent lifetime expected credit losses on assets acquired on the merger of the Bank and Britannia Building Society on 1 August 2009 and are reviewed on a regular basis to ensure appropriate allocation and utilisation.

Risk management continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

1.3.2 Analyses of credit exposure

The following analysis of credit exposure shows:

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

Cash and balances at central banks are credit exposures with the Bank of England and have been excluded from the analysis.

	Loans and advances to banks	**Loans and advances to customers**	**Investment securities**	**Derivative financial instruments**	**Total**
2012					
Analysis of balance in note	14	15	16	17	
Gross balance	**1,904.1**	**33,982.5**	**6,928.8**	**818.8**	**43,634.2**
Less: allowance for losses	**–**	**(643.0)**	**(39.0)**	**–**	**(682.0)**
	1,904.1	**33,339.5**	**6,889.8**	**818.8**	**42,952.2**
Analysis of credit risk exposure					
Not impaired	**1,904.1**	**30,632.8**	**6,900.8**	**818.8**	**40,256.5**
Impaired	**–**	**3,686.7**	**39.0**	**–**	**3,725.7**
	1,904.1	**34,319.5**	**6,939.8**	**818.8**	**43,982.2**
Credit commitments	**54.1**	**4,885.0**	**–**	**–**	**4,939.1**
Gross credit risk exposure	**1,958.2**	**39,204.5**	**6,939.8**	**818.8**	**48,921.3**
Less:					
Fair value adjustments	**–**	**(337.0)**	**(11.0)**	**–**	**(348.0)**
Allowance for losses	**–**	**(643.0)**	**(39.0)**	**–**	**(682.0)**
Net credit risk exposure	**1,958.2**	**38,224.5**	**6,889.8**	**818.8**	**47,891.3**

	Loans and advances to banks	Loans and advances to customers	Investment securities	Derivative financial instruments	Total
2011					
Analysis of balance in note	14	15	16	17	
Gross balance	2,006.5	34,058.0	4,616.2	975.8	41,656.5
Less: allowance for losses	–	(292.0)	(45.2)	–	(337.2)
	2,006.5	33,766.0	4,571.0	975.8	41,319.3
Analysis of credit risk exposure					
Not impaired	2,001.9	31,681.7	4,589.6	975.4	39,248.6
Impaired	21.0	2,772.7	46.4	0.4	2,840.5
	2,022.9	34,454.4	4,636.0	975.8	42,089.1
Credit commitments	40.6	4,858.7	–	–	4,899.3
Gross credit risk exposure	2,063.5	39,313.1	4,636.0	975.8	46,988.4
Less:					
Fair value adjustments	(16.4)	(396.4)	(19.8)	–	(432.6)
Allowance for losses	–	(292.0)	(45.2)	–	(337.2)
Net credit risk exposure	2,047.1	38,624.7	4,571.0	975.8	46,218.6

The comparative table has been updated to include the changes made to impairment criteria. An analysis of the credit risk exposure for the Bank is provided in note 40.

1.4 Analysis of impaired assets and associated collateral

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

- loans and advances to customers;
- investment securities; and
- loans and advances to banks.

1. Credit risk continued

1.4.1 Loans and advances to customers

1.4.1.1 How we oversee and control credit risk

The credit risk team is part of the risk directorate, independent from business management, and provides second line risk oversight. The credit risk team performs the following tasks and responsibilities related to its role:

- design and implementation of risk assessment and rating systems;
- monitoring of risk assessment and rating systems;
- maintenance of lending policy and procedures, and upkeep of various returns and reporting requirements;
- benchmarking against third party data and vendor model sources;
- reviewing the risk criteria to ensure they remain predictive of risk;
- oversight of independent validation;
- development and monitoring of risk appetites; and
- liaison with the FSA regarding proposed changes to rating systems and forecast regulatory capital levels.

On pages 60 to 70 the management of credit risk by portfolio is described covering:

- acquisition and account management;
- collateral;
- impairment assessment; and
- forbearance.

1.4.1.2 Assessment for impairment

The loan portfolios are periodically reviewed to assess impairment. A loan is deemed to be impaired when there is objective evidence that a loss event has occurred after recognition of an asset and by 31 December 2012.

Once a loan is defined as impaired the provision is calculated as the difference between the current carrying value of the asset (including fair value adjustments) and the expected future recovery, discounted at the loan's effective interest rate, taking into account the expected charge off rate and any supporting collateral.

Full details are contained in the significant accounting policies on page 45 and in the following credit risk sections.

The tables below analyse the gross balance by impairment classification for the Retail and Corporate and Business Banking (CABB) business segments. They include credit commitments, impairment provisions, fair value adjustments and a reconciliation to gross customer balances as this is the basis on which the business manages risk.

	Retail		CABB			Total
	Secured	Unsecured	Corporate		Optimum	
			Core	Non-core		
2012						
Analysis of balance in note 15						
Gross balance	**15,987.2**	**1,393.1**	**6,097.1**	**3,166.4**	**7,338.7**	**33,982.5**
Less: allowance for losses	**(3.2)**	**(172.8)**	**(137.3)**	**(318.7)**	**(11.0)**	**(643.0)**
	15,984.0	**1,220.3**	**5,959.8**	**2,847.7**	**7,327.7**	**33,339.5**
Analysis of credit risk exposure						
Not impaired	**15,836.3**	**1,179.4**	**5,827.8**	**1,617.5**	**6,171.8**	**30,632.8**
Impaired	**156.1**	**213.7**	**269.3**	**1,764.8**	**1,282.8**	**3,686.7**
	15,992.4	**1,393.1**	**6,097.1**	**3,382.3**	**7,454.6**	**34,319.5**
Credit commitments	**389.8**	**2,332.2**	**2,114.3**	**48.4**	**0.3**	**4,885.0**
Gross credit risk exposure	**16,382.2**	**3,725.3**	**8,211.4**	**3,430.7**	**7,454.9**	**39,204.5**
Less:						
Fair value adjustments	**(5.2)**	**–**	**–**	**(215.9)**	**(115.9)**	**(337.0)**
Allowance for losses	**(3.2)**	**(172.8)**	**(137.3)**	**(318.7)**	**(11.0)**	**(643.0)**
Net credit risk exposure	**16,373.8**	**3,552.5**	**8,074.1**	**2,896.1**	**7,328.0**	**38,224.5**
Reconciliation of accounting to customer balances						
Gross balance	**15,987.2**	**1,393.1**	**6,097.1**	**3,166.4**	**7,338.7**	**33,982.5**
Fair value adjustments	**5.2**	**–**	**–**	**215.9**	**115.9**	**337.0**
Other accounting adjustments	**(61.4)**	**95.4**	**32.5**	**(64.1)**	**37.6**	**40.0**
Gross customer balances	**15,931.0**	**1,488.5**	**6,129.6**	**3,318.2**	**7,492.2**	**34,359.5**

Risk management continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

	Retail		CABB			Total
	Secured	Unsecured	Corporate		Optimum	
			Core	Non-core		
2011						
Analysis of balance in note 15						
Gross balance	15,802.5	1,518.1	5,538.8	3,452.7	7,745.9	34,058.0
Less: allowance for losses	(3.1)	(163.3)	(82.9)	(34.4)	(8.3)	(292.0)
	15,799.4	1,354.8	5,455.9	3,418.3	7,737.6	33,766.0
Analysis of credit risk exposure						
Not impaired	15,665.3	1,298.5	5,354.1	2,928.2	6,435.6	31,681.7
Impaired	143.9	219.6	184.7	776.0	1,448.5	2,772.7
	15,809.2	1,518.1	5,538.8	3,704.2	7,884.1	34,454.4
Credit commitments	311.9	2,422.8	2,048.0	75.0	1.0	4,858.7
Gross credit risk exposure	16,121.1	3,940.9	7,586.8	3,779.2	7,885.1	39,313.1
Less:						
Fair value adjustments	(6.7)	–	–	(251.5)	(138.2)	(396.4)
Allowance for losses	(3.1)	(163.3)	(82.9)	(34.4)	(8.3)	(292.0)
Net credit risk exposure	16,111.3	3,777.6	7,503.9	3,493.3	7,738.6	38,624.7
Reconciliation of accounting to customer balances						
Gross balance	15,802.5	1,518.1	5,538.8	3,452.7	7,745.9	34,058.0
Fair value adjustments	6.7	–	–	251.5	138.2	396.4
Other accounting adjustments	(16.3)	17.5	(35.2)	(64.7)	50.1	(48.6)
Gross customer balances	15,792.9	1,535.6	5,503.6	3,639.5	7,934.2	34,405.8

The comparative table has been updated to include the changes made to impairment criteria and to include Platform within the Retail segment.

The disclosures in sections 1.4.1.3 Secured residential credit risk, 1.4.1.4 Unsecured retail credit risk and 1.4.1.5 Corporate credit risk are all based on the gross customer balances in the above tables.

1.4.1.3 Secured residential credit risk

Acquisition and account management

Mortgages are loans to customers secured by a first charge over a residential property. Mortgages are originated directly to customers via branches, telephone and the internet under the Britannia and Co-operative Bank brands, and via intermediaries under the Platform brand. In 2012 70% (2011: 55%) of mortgages were originated directly and 30% (2011: 45%) through intermediaries.

The Britannia and Co-operative Bank brands only originate prime residential mortgages, while Platform originates a combination of prime and 'almost prime' residential mortgages and buy to let loans. All new advances are on a repayment basis, with the exception of buy to lets.

The table below shows residential mortgage completions in the period, analysed by loan to value (LTV) and repayment method:

	2012			2011		
	Amount advanced	**Average LTV %**	**Interest only %**	Amount advanced	Average LTV %	Interest only %
Retail prime	**1,854.7**	**60.3**	**7.8**	790.5	57.9	11.8
Platform prime	**248.1**	**62.0**	**17.5**	182.1	66.1	22.1
Total prime	**2,102.8**	**60.5**	**8.9**	972.6	59.3	13.0
Buy to let	**538.7**	**63.1**	**84.3**	446.3	62.6	83.0
Almost prime	**7.6**	**57.0**	**1.2**	10.3	52.9	13.4
Total completions	**2,649.1**	**61.0**	**24.6**	1,429.2	60.4	30.4

Mortgages originated by Platform prior to 2009 and those acquired by Britannia Treasury Services are managed as part of a closed portfolio, Optimum. These loans include a range of asset types, including prime residential (both income verified and self-certified), buy to let, and non-conforming mortgages.

Loans may have been advanced on a capital and interest repayment basis, where the loan is repaid over the term of the loan, or interest only, where the capital element of the loan is repayable at the end of the term.

1. Credit risk continued

The table below shows residential mortgages gross customer balances analysed by LTV banding:

	2012			2011		
	Retail secured	**Optimum**	**Total**	Retail secured	Optimum	Total
Less than 50%	**5,459.9**	**460.3**	**5,920.2**	5,706.7	484.0	6,190.7
50% to 60%	**2,233.1**	**358.6**	**2,591.7**	2,157.8	372.7	2,530.5
60% to 70%	**2,621.6**	**657.1**	**3,278.7**	2,418.0	673.0	3,091.0
70% to 80%	**2,698.0**	**1,013.8**	**3,711.8**	2,563.4	1,067.7	3,631.1
80% to 90%	**1,914.6**	**1,470.2**	**3,384.8**	1,874.5	1,604.9	3,479.4
90% to 100%	**621.0**	**1,537.9**	**2,158.9**	651.8	1,696.2	2,348.0
Greater than 100%	**382.8**	**1,994.3**	**2,377.1**	420.7	2,035.7	2,456.4
	15,931.0	**7,492.2**	**23,423.2**	15,792.9	7,934.2	23,727.1

The table below shows gross customer balances for residential mortgages analysed by asset class:

	2012			2011		
	Exposure	**Average LTV %**	**Interest only %**	Exposure	Average LTV %	Interest only %
Prime residential	**15,377.2**	**44.5**	**22.3**	15,745.9	43.5	25.1
Buy to let	**3,256.0**	**74.9**	**90.5**	2,881.3	76.1	90.5
Self-certified	**2,091.5**	**76.8**	**77.7**	2,228.7	76.6	77.3
Almost prime	**940.9**	**89.8**	**67.4**	997.1	89.5	67.1
Non-conforming	**1,757.6**	**77.6**	**66.7**	1,874.1	77.1	65.7
	23,423.2	**53.6**	**41.9**	23,727.1	52.7	42.9

Collateral

All mortgages are secured by a first charge over the property being purchased or remortgaged. Valuation of the property is normally assessed by a RICS certified valuer from the Group's approved panel of valuers. For low LTV remortgages, valuation may be assessed through the use of an automated valuation model (AVM). Performance of AVMs is monitored on a regular basis to ensure their ongoing accuracy.

It is not normal practice to reassess the valuation of collateral unless further lending is being considered, or the property has been repossessed, but on a quarterly basis the valuation is restated using a regional property price index.

The risk in the portfolio is revalued monthly using internally developed behavioural models, to assess the likelihood of loss and to reflect any changes in the value of collateral (see below). The revaluation will determine the amount of capital required to be held for individual loans.

The table below analyses the fair value of property collateral held against mortgage portfolios:

	2012			2011		
	Exposure	**Collateral**	**Cover %**	Exposure	Collateral	Cover %
Impaired	**1,445.3**	**1,386.3**	**95.9**	1,603.5	1,541.4	96.1
Not impaired	**21,977.9**	**21,831.7**	**99.3**	22,123.6	21,990.3	99.4
	23,423.2	**23,218.0**	**99.1**	23,727.1	23,531.7	99.2

Impairment

A loan is considered to be individually impaired when:

- arrears outstanding are equivalent to 30 days or more; or
- the loan is more than 90 days past its due date for final repayment but has not been repaid; or
- the account is in litigation or the property is in possession; or
- the estimated forced sale value of the collateral on a roll up mortgage has reduced below the loan balance outstanding.

Loans meeting any of these criteria are considered impaired even if a loss is not expected in the event of repossession.

Loans are also assessed for impairment where any of the following criteria apply, although these factors alone are not deemed to be objective evidence of impairment and therefore a collective provision is held against potential losses:

- the loan is in arrears by less than 30 days; or
- there has been a material deterioration in the borrower's external credit score in the last 12 months; or
- the loan is identified as being subject to forbearance (refer to forbearance section).

On the Optimum portfolio only, any loans not meeting any of the preceding criteria are assessed for impairment based on the probability that they will move to 90 days in arrears within the next three months.

Risk management continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

For each loan assessed for impairment a shortfall is calculated based on the difference between the current loan balance and the expected 'forced sale' price of the collateral, discounted at the current interest rate to reflect the anticipated time to sale, and taking into account anticipated fees and costs prior to sale. This shortfall is then reduced on a collective basis to reflect the probability of the loan being taken into possession.

The table below shows:

- impaired customer balances as a percentage of gross customer balances; and
- impairment coverage, ie impairment provisions and fair value adjustments as a percentage of impaired customer balances.

	2012			2011		
	Retail secured	**Optimum**	**Total**	Retail secured	Optimum	Total
Gross customer balances	**15,931.0**	**7,492.2**	**23,423.2**	15,792.9	7,934.2	23,727.1
Impaired customer balances	**156.0**	**1,289.3**	**1,445.3**	144.3	1,459.2	1,603.5
Impaired as a % of gross customer balances	**1.0%**	**17.2%**	**6.2%**	0.9%	18.4%	6.8%
Credit protection						
Impairment provisions	**3.2**	**11.0**	**14.2**	3.1	8.3	11.4
Fair value adjustments	**5.2**	**115.9**	**121.1**	6.7	138.2	144.9
	8.4	**126.9**	**135.3**	9.8	146.5	156.3
Credit protection as a % of impaired customer balances	**5.4%**	**9.8%**	**9.4%**	6.8%	10.0%	9.7%

The comparative figures have been updated to include additional balances subject to forbearance and Platform as it is now included within this segment.

The table below shows the credit quality of loans and advances that are not impaired:

	2012			2011		
	Retail secured	**Optimum**	**Total**	Retail secured	Optimum	Total
Low to medium risk	**14,931.6**	**5,901.0**	**20,832.6**	14,796.8	6,218.4	21,015.2
Medium to high risk	**843.4**	**301.9**	**1,145.3**	851.8	256.6	1,108.4
	15,775.0	**6,202.9**	**21,977.9**	15,648.6	6,475.0	22,123.6

Low to medium risk is defined as exposures with a probability of default (PD) in the next year of 1% or below using the internal ratings based (IRB) approach under Basel II. Medium to high risk is defined as exposures with a PD in the next year of greater than 1%.

Forbearance

A number of options are available to borrowers in financial difficulty. Repossession of the property will only be considered when all other avenues have been explored. The precise treatment selected depends on the borrower's individual circumstances, but may include:

- arrangements to repay outstanding arrears over a period of time, by making payments above the contractual amount. The loan is deemed to be impaired, until the arrears have been cleared in full;
- short term concessions, where the borrower is allowed to make reduced repayments (or, in exceptional circumstances, no repayments) on a temporary basis to assist with a short term financial hardship. In these cases the shortfall on the repayments will accrue as arrears and the loan is deemed to be impaired;
- payment holidays are allowed as part of a customer's flexible mortgage contract. Payment holidays are not knowingly allowed for customers experiencing financial hardship. However, in the absence of evidence to the contrary, loans that have had a payment holiday in the last two years are treated as being subject to forbearance;
- temporary conversion of a mortgage to interest only repayments. The capital repayments due in this period are spread over the remaining term on conversion back to capital repayment as part of an instalment recalculation exercise;
- a permanent switch from capital and interest repayments to interest only repayments, provided the borrower declares they have an alternative means of repaying the capital at the end of the term;
- an extension to the mortgage term to reduce the borrower's repayments. Loans that have had a term extension in the last two years (or since 2008 in the case of the Optimum portfolio) are considered to be subject to forbearance;
- capitalisation, where outstanding arrears are added to the capital value of the loan to be repaid over the remaining term. This is only considered where it is appropriate for the borrower's circumstances, and where the borrower has been performing for at least six months. During 2012, 20 (2011: 90) loans had arrears capitalised of £0.03m (2011: £0.3m). These loans are not treated as impaired unless the borrower meets another impairment trigger (eg misses a mortgage payment); and
- where applicable we will work with the customer as part of a government support scheme. Unmet loan payments will continue to accrue as arrears until such time as the loan is cleared, or the outstanding payments are brought up to date.

1. Credit risk continued

The Group does not offer all forms of forbearance that are cited within the FSA's Finalised Guidance on Forbearance and Impairment. In particular, the following are not offered by the Group:

- change in payment date (other than a change to an alternative payment date within the same calendar month);
- deferral of payment (other than through an agreed concession as shown above);
- use of linked pre-approved reserve/credit/overdraft limits to meet an overdue mortgage payment;
- transfer to a lower interest rate, whether by variation to the agreed rate or through a concessionary product; and
- financial support to customers through assisted sales or partial debt write-off to reduce the amount owing.

The underlying basis for the calculation of residential mortgage impairment provisions remains unchanged. Mortgages subject to forbearance, once classified as impaired, are treated in the same way as all other impaired mortgages in the impairment provisions calculations.

The table below analyses secured residential mortgage balances by type of forbearance and the associated gross impairment coverage, including credit fair value adjustments:

	Neither past due nor impaired	**Impaired**	**Loans subject to forbearance**	**Impairment coverage**
2012				
Arrangements	**52.3**	**449.2**	**501.5**	**(22.2)**
Concessions	**1.0**	**4.4**	**5.4**	**(0.1)**
Payment holidays	**160.0**	**–**	**160.0**	**–**
Interest only switches	**582.2**	**0.1**	**582.3**	**(0.8)**
Term extensions	**313.5**	**–**	**313.5**	**–**
Capitalisations	**0.8**	**–**	**0.8**	**–**
	1,109.8	**453.7**	**1,563.5**	**(23.1)**

	Neither past due nor impaired	Impaired	Loans subject to forbearance	Impairment coverage
2011				
Arrangements	59.2	487.4	546.6	(26.0)
Concessions	1.9	5.3	7.2	(0.1)
Payment holidays	175.8	–	175.8	–
Interest only switches	564.2	0.6	564.8	(0.9)
Term extensions	146.5	–	146.5	(0.1)
Capitalisations	10.6	0.2	10.8	–
	958.2	493.5	1,451.7	(27.1)

1.4.1.4 Unsecured retail credit risk

Acquisition and account management

The Group offers unsecured lending through fixed repayment loans, credit cards and overdrafts. Borrowers are assessed using a combination of credit scoring and policy rules to ensure that expected delinquency levels are within the risk appetite of the business and deliver an appropriate level of return. Credit cards and overdrafts are subject to ongoing account management to increase or decrease credit limits and manage over limit authorisations.

The risk in the portfolio is reassessed monthly using internally developed behavioural scorecards to determine the amount of capital required to be held for individual loans.

The following table shows unsecured lending gross customer balances (including undrawn commitments) by product type:

	2012	2011
Loans	**734.3**	751.0
Credit cards	**2,703.6**	2,841.4
Overdrafts	**382.8**	377.0
	3,820.7	3,969.4

Impairment

Provisions are made on all debts with delinquency greater than a pre-determined trigger point, which the Group deems to be the point of impairment, and on all fraud and debt at agents' accounts.

Credit cards are identified as impaired immediately if the borrower fails to make the minimum payment by the due date.

Loans are identified as impaired if a monthly payment has not been made 15 days after it was due.

An overdraft is defined as impaired if the account has been overdrawn in excess of any agreed limit for 45 days, or if the agreed overdraft has expired but the account remains overdrawn.

Risk management continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Accounts identified as impaired are segmented according to the number of days that the loan has been impaired. The provision for each segment is based on the loss expected. An account is charged off when all internal economical avenues to recover the debt have been exhausted, and written off when all external avenues have been exhausted.

The table below shows:

- gross customer balances (excluding undrawn commitments);
- impaired customer balances as a percentage of gross customer balances; and
- impairment coverage, ie impairment provisions including those charged off in relation to Debt Collection Agencies (DCA) as a percentage of impaired customer balances.

	2012	2011
Gross customer balances	**1,488.5**	1,535.6
Impaired customer balances	**301.1**	309.7
Impaired as a % of gross customer balances	**20.2%**	20.2%
Credit protection		
Impairment provisions	**172.8**	163.3
DCA balances charged off	**86.8**	90.0
	259.6	253.3
Credit protection as a % of impaired customer balances	**86.2%**	81.8%

The impaired customer balances and credit protection shown above include provisions charged off in relation to DCA cases.

Forbearance

A number of forbearance options are available to borrowers in financial difficulty. These include arrangements to repay arrears over a period of time or to accept payments of less than the contractual amount during a period of temporary financial hardship. In these circumstances, the loan continues to be reported as impaired until the arrears are cleared in full. Arrangements can be made directly with the customer or through a third party whom they have chosen to represent them.

Additional forbearance includes the following three treatments with an incremental provision of £3m raised in 2012:

- reducing overdrafts: this option is used to reduce the overdraft levels on current accounts in excess of the agreed formal overdraft or limit reduction applied by the Group. For this situation, the customer is given up to eight months to move the account back within the agreed limit;
- re-ages: there are a small number of credit card re-ages performed each month for customer service reasons; and
- debt consolidation loans: in certain circumstances, customers are offered a consolidation loan to pay off other internal debt.

1.4.1.5 Corporate credit risk

Acquisition and account management

The Group is managed through two distinct classifications. The Core business represents activity consistent with the strategy and risk appetite for the Group and within corporate comprises corporate banking, business banking and business services. Non-core business lines include activities not congruent with the current strategy of the Group, which are managed for value and targeted for run down or exit.

The Group operates to a new lending policy which is subject to meeting criteria as laid down in the corresponding sector strategy guidelines and strict policy with regards single name and sector concentrations. New lending is approved by experienced staff within the centrally based credit underwriting team, independent from income generation. Lending discretions are based on the risk profile of the customer and the amount of exposure. The lending discretions of the Credit Risk Director, the CEO and the Credit Approvals Committee are operated to sanction the largest credit applications.

The credit underwriting team uses the relevant 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, the financial stability of the counterparty and its ability to withstand such change.

Monitoring of portfolios and impairment provisioning governance is in place across the portfolios. 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 CRMC and ERC (and by exception BRC) receive regular reports on the performance of the portfolio.

1. Credit risk continued

The tables below show the distribution of the Corporate and Business Banking gross customer balances (including commitments, but excluding Unity Trust Bank) by sector and risk grade, where PD grades have been mapped to regulatory slotting categories for ease of interpretation in this report.

	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
2012							
Core							
Accommodation, food and licensed services	**278.2**	**119.2**	**151.6**	**21.7**	**18.1**	**9.0**	**597.8**
Care	**249.3**	**35.8**	**73.1**	**31.5**	**0.5**	**2.1**	**392.3**
Education	**67.0**	**60.5**	**3.4**	**1.2**	**–**	**–**	**132.1**
Financial services	**83.6**	**79.3**	**30.5**	**3.6**	**–**	**4.8**	**201.8**
Football clubs	**–**	**33.2**	**–**	**0.4**	**0.1**	**0.9**	**34.6**
Housing associations	**8.3**	**256.3**	**0.9**	**–**	**–**	**–**	**265.5**
Manufacturing	**87.5**	**19.8**	**44.5**	**13.0**	**15.2**	**9.5**	**189.5**
Motor trade and garages	**24.9**	**57.3**	**26.2**	**10.3**	**0.8**	**3.7**	**123.2**
PFI	**–**	**1.1**	**1,250.3**	**34.7**	**–**	**10.7**	**1,296.8**
Professional services	**70.7**	**71.5**	**21.3**	**13.1**	**0.8**	**3.5**	**180.9**
Property and construction:							
Commercial investment	**49.8**	**92.3**	**1,157.5**	**178.2**	**25.0**	**87.4**	**1,590.2**
Residential investment	**13.4**	**5.9**	**115.9**	**15.1**	**7.3**	**7.8**	**165.4**
Commercial development	**2.7**	**10.1**	**154.9**	**75.4**	**15.2**	**35.6**	**293.9**
Residential development	**1.4**	**5.4**	**60.7**	**14.1**	**8.2**	**5.8**	**95.6**
Public sector entities	**180.0**	**1.3**	**–**	**–**	**–**	**–**	**181.3**
Renewable energy	**605.8**	**–**	**–**	**–**	**–**	**9.2**	**615.0**
Retail and wholesale trade	**108.3**	**396.8**	**55.6**	**12.4**	**5.4**	**19.3**	**597.8**
Services	**465.9**	**120.4**	**59.1**	**30.4**	**17.9**	**23.9**	**717.6**
Transport, storage and communication	**105.4**	**58.1**	**5.3**	**16.1**	**0.4**	**15.2**	**200.5**
Utilities	**94.4**	**1.6**	**2.0**	**0.5**	**–**	**0.6**	**99.1**
Business banking	**0.8**	**35.1**	**6.7**	**2.9**	**0.4**	**0.5**	**46.4**
Other	**7.3**	**1.9**	**1.5**	**5.3**	**–**	**2.1**	**18.1**
	2,504.7	**1,462.9**	**3,221.0**	**479.9**	**115.3**	**251.6**	**8,035.4**
Non-core							
Accommodation, food and licensed services	**38.3**	**–**	**0.6**	**–**	**–**	**269.1**	**308.0**
Football clubs	**–**	**–**	**–**	**–**	**–**	**18.3**	**18.3**
Housing associations	**–**	**834.3**	**45.0**	**–**	**–**	**–**	**879.3**
Property and construction:							
Commercial investment	**16.2**	**1.5**	**274.5**	**93.9**	**101.1**	**1,336.7**	**1,823.9**
Residential investment	**–**	**–**	**99.9**	**47.4**	**42.9**	**112.6**	**302.8**
Commercial development	**–**	**–**	**–**	**–**	**–**	**6.4**	**6.4**
Renewable energy	**27.9**	**–**	**–**	**–**	**–**	**–**	**27.9**
	82.4	**835.8**	**420.0**	**141.3**	**144.0**	**1,743.1**	**3,366.6**
Total exposure	**2,587.1**	**2,298.7**	**3,641.0**	**621.2**	**259.3**	**1,994.7**	**11,402.0**

Risk management continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
2011							
Core							
Accommodation, food and licensed services	256.1	60.9	52.7	31.4	1.5	10.8	413.4
Care	177.0	29.1	19.3	26.9	2.9	–	255.2
Education	68.6	46.1	11.6	0.8	–	–	127.1
Financial services	82.1	54.1	40.3	4.8	–	3.7	185.0
Football clubs	–	41.6	–	0.9	–	2.5	45.0
Housing associations	212.9	–	0.5	–	–	–	213.4
Manufacturing	92.4	15.9	40.5	20.9	24.4	1.6	195.7
Motor trade and garages	34.1	39.9	22.8	1.9	8.6	4.0	111.3
PFI	0.8	–	1,260.8	–	14.6	–	1,276.2
Professional services	61.6	26.6	27.4	7.9	3.3	4.2	131.0
Property and construction:							
Commercial investment	16.8	93.3	1,131.2	211.4	38.6	49.9	1,541.2
Residential investment	9.4	10.3	112.5	5.5	0.7	10.9	149.3
Commercial development	6.8	9.1	112.5	123.0	24.1	11.1	286.6
Residential development	1.7	1.8	65.3	35.1	13.4	3.9	121.2
Public sector entities	198.0	–	–	–	–	–	198.0
Renewable energy	407.2	–	–	–	–	10.3	417.5
Retail and wholesale trade	107.4	335.2	69.9	19.5	1.0	0.3	533.3
Services	460.3	103.3	50.5	60.8	8.4	21.6	704.9
Transport, storage and communication	168.5	53.5	11.0	7.4	15.0	23.9	279.3
Utilities	74.5	0.8	1.5	10.5	–	0.6	87.9
Business banking	0.8	32.6	7.5	3.3	0.9	0.5	45.6
Other	11.9	1.1	1.9	4.1	–	2.1	21.1
	2,448.9	955.2	3,039.7	576.1	157.4	161.9	7,339.2
Non-core							
Accommodation, food and licensed services	63.4	–	0.6	–	–	99.3	163.3
Football clubs	–	–	–	–	15.1	3.2	18.3
Housing associations	919.9	–	–	–	–	–	919.9
Professional services	–	–	–	–	–	0.3	0.3
Property and construction:							
Commercial investment	106.4	81.1	335.2	556.3	545.8	512.8	2,137.6
Residential investment	1.6	48.8	116.5	110.8	23.3	143.8	444.8
Renewable energy	30.3	–	–	–	–	–	30.3
	1,121.6	129.9	452.3	667.1	584.2	759.4	3,714.5
Total exposure	3,570.5	1,085.1	3,492.0	1,243.2	741.6	921.3	11,053.7

The Standardised category relates to customers who have not defaulted and, for the purposes of capital calculations, are not rated with a regulatory approved rating model. These typically belong to the public sector entities and renewable energy sectors, and to the following customer types within other sectors: other energy efficiency schemes, leveraged, newly established companies with an insufficient number of published financial accounts, project finance and charities. During 2012 the Group was granted regulatory approval to rate housing associations with a PD model; hence a significant amount of exposure has migrated from Standardised to the Strong category.

The movement of balances from Satisfactory and Weak to Default in the period is reflective of both the continued challenging commercial property environment and the Group's focus on the expected outlook for this sector and the consequential forbearance strategies and the completion of the Bank's review of its default and provisioning strategy.

1. Credit risk continued

Collateral

The Group uses guarantees and collateral to mitigate credit risk. Collateral is regularly revalued and guarantees are reviewed to ensure continuing effectiveness.

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 customer, 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.

The table below analyses the fair value of the property collateral held against assets in the property and construction sectors (commonly referred to as commercial real estate):

	2012			2011		
Core	**Exposure**	**Collateral**	**Impairment provision**	Exposure	Collateral	Impairment provision
Non-default loans with <= 1 year & all defaulted exposures regardless of term						
Less than 50%	**69.3**	**69.3**	**–**	51.2	51.1	–
50% to 60%	**85.7**	**85.3**	**0.4**	53.0	53.0	–
60% to 70%	**106.6**	**106.6**	**–**	54.6	54.6	–
70% to 80%	**113.6**	**113.6**	**–**	88.5	88.5	–
80% to 90%	**26.7**	**26.2**	**0.5**	62.7	60.3	2.4
90% to 100%	**30.9**	**30.6**	**0.3**	18.8	18.0	0.8
Greater than 100%	**156.2**	**96.9**	**36.4**	145.8	87.5	12.4
Unsecured	**36.0**	**–**	**7.6**	33.2	–	6.1
	625.0	**528.5**	**45.2**	507.8	413.0	21.7
Non-default loans with > 1 year						
Less than 50%	**245.5**	**245.5**	**–**	221.1	221.1	–
50% to 60%	**292.5**	**292.5**	**–**	230.8	230.8	–
60% to 70%	**402.4**	**402.4**	**–**	276.8	276.8	–
70% to 80%	**309.1**	**309.1**	**–**	293.0	293.0	–
80% to 90%	**61.8**	**61.8**	**–**	132.1	132.1	–
90% to 100%	**33.5**	**33.5**	**–**	87.7	87.7	–
Greater than 100%	**105.2**	**78.3**	**–**	262.8	216.6	–
Unsecured	**70.1**	**–**	**–**	86.2	–	–
	1,520.1	**1,423.1**	**–**	1,590.5	1,458.1	–
	2,145.1	**1,951.6**	**45.2**	2,098.3	1,871.1	21.7

Risk management continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

	2012			2011		
Non-core	**Exposure**	**Collateral**	**Impairment provision**	Exposure	Collateral	Impairment provision
Non-default loans with <= 1 year & all defaulted exposures regardless of term						
Less than 50%	**0.6**	**0.5**	**0.1**	3.0	3.0	–
50% to 60%	**1.5**	**1.5**	**–**	6.5	–	6.5
60% to 70%	**36.8**	**34.2**	**2.6**	0.8	0.8	–
70% to 80%	**2.4**	**2.4**	**–**	117.0	116.3	0.7
80% to 90%	**45.8**	**44.5**	**1.3**	54.7	54.7	–
90% to 100%	**72.3**	**47.8**	**24.4**	53.4	49.8	3.6
Greater than 100%	**1,185.7**	**816.1**	**299.8**	781.1	489.0	182.7
Unsecured	**177.8**	**–**	**59.8**	31.8	–	2.4
	1,522.9	**947.0**	**388.0**	1,048.3	713.6	195.9
Non-default loans with > 1 year						
Less than 50%	**30.1**	**30.1**	**–**	59.4	59.4	–
50% to 60%	**63.7**	**63.7**	**–**	75.5	75.5	–
60% to 70%	**185.5**	**185.5**	**–**	146.5	146.5	–
70% to 80%	**30.5**	**30.5**	**–**	126.0	126.0	–
80% to 90%	**90.5**	**90.5**	**–**	210.7	210.6	0.1
90% to 100%	**67.9**	**67.9**	**–**	98.4	98.4	–
Greater than 100%	**124.2**	**93.1**	**–**	692.7	598.0	9.3
Unsecured	**17.8**	**–**	**–**	124.9	–	–
	610.2	**561.3**	**–**	1,534.1	1,314.4	9.4
	2,133.1	**1,508.3**	**388.0**	2,582.4	2,028.0	205.3

Of the above, £50m (2011: £48m) is not held as first charge.

Impairment

Corporate customers are placed on a watchlist when they show signs of unsatisfactory performance and require close control. Strong indicators that a customer should be placed on watchlist include but are not limited to:

- unsatisfactory account operation – both lending facility and current accounts;
- considerable reduction in value of collateral;
- deteriorating balance sheet position and/or material losses/cashflow pressures;
- breach of covenants; and
- application of forbearance strategies.

Dependent on the Group's satisfaction that the triggers leading to inclusion on the watchlist no longer apply, customers who stop exhibiting higher risk traits are removed from the watchlist.

Removal from the watchlist usually requires the customer's management information to show that trading is achieving the revised plan with objective evidence that this will continue.

The Group also reviews monthly all higher risk loans (including those accounts subject to forbearance) and considers the potential loss which might arise were the borrowers to fail (notwithstanding that continued trading remains the expectation).

Individual impairment provisions are raised at the point when business performance is assessed to have deteriorated to the extent that there is a real risk of loss of principal, interest or fees. Provisions will be required on some or all of the entire shortfall between the security held and the loan balance outstanding and represent a realistic assessment of the likely net loss after realisation of any security.

Objective evidence of impairment may include but is not limited to:

- an instalment on a loan account being overdue, or having been in excess of its limit (or being overdrawn without an agreed limit) for 90 days or more;
- an event likely to result in insolvency which may involve bankruptcy, or the appointment of an administrative receiver, liquidator or administrator; or
- if the Group considers that at some point (normally taken within the next 12 months) actions such as an issue of formal demand will be required in order to achieve full repayment.

1. Credit risk continued

For provisioning purposes, an up to date property valuation or selling agent's recommendation is discounted to take into account selling and legal costs and also to build in a contingency to cover potential reductions in the selling price based upon the type of security and entity and the existence or otherwise of a contracted sale. In some cases, calculation of the provision is based on an up to date assessment (often following an independent business review by a firm of accountants) of likely receivables from the business or a formal estimated outcome statement from an insolvency practitioner where the business has failed.

Provisioning adjustments are also recorded, as appropriate, against loans whose interest terms have changed such that revised future cashflows discounted at the original interest rate are less than the current carrying amount.

Collective impairment provisions are based on the remaining portfolio where a trigger event could have occurred but has not yet been observed.

There has been a continued deterioration in the commercial property sector and with the relatively significant exposure to commercial property, the directors have reassessed the carrying value of the Group's loan portfolio.

The table below shows:

- impaired customer balances as a percentage of gross customer balances; and
- credit protection, ie impairment provisions and fair value adjustments as a percentage of impaired customer balances.

	2012		2011	
	Core	**Non-core**	Core	Non-core
Gross customer balances	**6,129.6**	**3,318.2**	5,503.6	3,639.5
Impaired customer balances	**242.9**	**1,739.1**	184.7	775.8
Impaired as a % of gross customer balances	**4.0%**	**52.4%**	3.4%	21.3%
Credit protection				
Impairment provisions	**137.3**	**318.7**	82.9	34.4
Fair value adjustments	**–**	**215.9**	–	251.5
	137.3	**534.6**	82.9	285.9
Credit protection as a % of impaired customer balances	**56.5%**	**30.7%**	44.9%	36.9%

Despite a substantial increase in provisions for corporate non-core loans, the impairment cover as a percentage of impaired customer balances has fallen from 36.9% last year to 30.7% in 2012. The newly impaired balances have a low credit protection rate reflecting the high average value of collateral held.

Core impaired balances have increased by £58.2m with an increase in the credit protection rate of 11.6%. This reflects the nature of the core portfolio which would generally have lower value security.

Forbearance

If the Group is convinced of a customer's ability and commitment to address their financial difficulties, it may agree to grant concessions to the original contractual terms. Such concessions typically include:

- restructuring, waiving or reserving rights in the event of covenant breaches;
- postponement of principal payments;
- restructures of principal payments;
- extension of loan maturities;
- partial or full capitalisation of interest payments; or
- swap restructures.

In addition to the above, other forbearance concessions the Group may grant are considered to be objective evidence of impairment and include:

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

Risk management continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

The table below analyses the exposures subject to forbearance:

	2012			2011		
	Forborne	**Non-forborne**	**Total**	Forborne	Non-forborne	Total
Core						
Default	**139.4**	**112.2**	**251.6**	60.2	101.7	162.9
On watchlist	**204.9**	**67.3**	**272.2**	198.3	78.8	277.1
Neither default nor on watchlist	**197.9**	**7,313.7**	**7,511.6**	332.3	6,567.9	6,900.2
	542.2	**7,493.2**	**8,035.4**	590.8	6,748.4	7,339.2
Non-core						
Default	**1,118.4**	**624.7**	**1,743.1**	309.0	450.4	759.4
On watchlist	**159.1**	**64.1**	**223.2**	840.2	330.0	1,170.2
Neither default nor on watchlist	**95.2**	**1,305.1**	**1,400.3**	113.2	1,671.7	1,784.9
	1,372.7	**1,993.9**	**3,366.6**	1,262.4	2,452.1	3,714.5
	1,914.9	**9,487.1**	**11,402.0**	1,853.2	9,200.5	11,053.7

Impairment provisions are made for accounts subject to forbearance which are in default or on the watchlist.

For those customers that benefit from ongoing concessions (such as postponement of principal payments), the Group retains the forbearance status for as long as the concession remains in place. In the event of one off concessions (such as capitalisation of interest payments), the Group removes the forbearance status 12 months after their occurrence.

1.4.2 Investment securities

Policies are in place with regard to the management and valuation of collateral. Repos and secured lending positions are revalued daily. Margin calls on collateralised swaps are predominantly made daily, save for several arrangements which permit calls on a weekly basis. Eligible financial collateral for Basel II reporting purposes includes gilts held under reverse repo agreements and cash held under both repo agreements and collaterised swap arrangements. The guarantees relied upon are either parental guarantees held against subsidiary exposures within bank groups or sovereign guarantees.

At the balance sheet date, the Group has a total investment securities portfolio of £6,928.8m (2011: £4,616.2m) of which £39.0m (2011: £46.4m) is considered impaired and against which £39.0m (2011: £45.2m) of provisions are held.

The following tables analyse the gross balance by impairment classification and type of investment security.

		Investment securities			
2012	**Loans and receivables**	**Available for sale**	**Fair value through income or expense**	**Held for trading**	**Total**
Analysis of balance per note 16					
Gross balance	**295.0**	**3,828.4**	**1,845.2**	**960.2**	**6,928.8**
Less: allowance for losses	**–**	**(39.0)**	**–**	**–**	**(39.0)**
	295.0	**3,789.4**	**1,845.2**	**960.2**	**6,889.8**
Analysis of credit risk exposure					
Not impaired	**306.0**	**3,789.4**	**1,845.2**	**960.2**	**6,900.8**
Impaired	**–**	**39.0**	**–**	**–**	**39.0**
Gross credit risk exposure	**306.0**	**3,828.4**	**1,845.2**	**960.2**	**6,939.8**
Less:					
Fair value adjustments	**(11.0)**	**–**	**–**	**–**	**(11.0)**
Allowance for losses	**–**	**(39.0)**	**–**	**–**	**(39.0)**
Net credit risk exposure	**295.0**	**3,789.4**	**1,845.2**	**960.2**	**6,889.8**

1. Credit risk continued

2011	Loans and receivables	Investment securities Available for sale	Investment securities Fair value through income or expense	Held for trading	Total
Analysis of balance per note 16					
Gross balance	807.6	3,465.5	343.1	–	4,616.2
Less: allowance for losses	(2.7)	(42.5)	–	–	(45.2)
	804.9	3,423.0	343.1	–	4,571.0
Analysis of credit risk exposure					
Not impaired	823.5	3,423.0	343.1	–	4,589.6
Impaired	3.9	42.5	–	–	46.4
Gross credit risk exposure	827.4	3,465.5	343.1	–	4,636.0
Less:					
Fair value adjustments	(19.8)	–	–	–	(19.8)
Allowance for losses	(2.7)	(42.5)	–	–	(45.2)
Net credit risk exposure	804.9	3,423.0	343.1	–	4,571.0

An analysis of the credit risk exposure for the Bank is provided in note 40.

1.4.2.1 Impaired assets

Investment securities are considered past due where the contractual interest or principal payments are in arrears and it is determined that the Group will be able to collect all principal and interest outstanding according to the contractual terms of the agreements.

Investment securities are considered impaired where it is determined that the Group will be unable to collect all principal and interest outstanding, according to the contractual terms of the agreements.

At the balance sheet date, the Group assesses its investment securities for objective evidence that an impairment loss has occurred, for example this may be indicated by the disappearance of an active market. For available for sale securities particular consideration is given to evidence of any significant difficulty of the issuer or measurable decrease in the estimated cash flows from the investments.

1.4.2.2 Not impaired

The Group only invests in treasury assets which comply with the treasury credit risk policy. Within the treasury investment security portfolio 99% (2011: 89%) of exposures have an external credit rating equivalent to Fitch A or above.

1.4.3 Loans and advances to banks

None of the Group's exposures to loans and advances to banks are impaired. The Group considers that its exposures to loans and advances to banks are all of low to medium risk.

1.5 Eurozone risk

The Group remains a UK focused retail and commercial operation. It has no sovereign exposure to 'peripheral' eurozone countries (Portugal, Ireland, Italy, Greece and Spain). As at 2012 the Group had a £306.7m (2011: £90.0m) gross exposure to the Government of Finland, £89.9m (2011: £nil) to the Swedish Export Credit Corporation and £12.3m (2011: £nil) to the Government of the Netherlands, repayable in over one year. It held no other non-UK sovereign debt.

Other than a £25k exposure to the London subsidiary of a Greek bank, the Group has no direct exposure to Greek financial institutions or any other counterparty types.

Risk management continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

1.5.1 Direct exposures

The analyses on the following pages set out the Group's exposures to financial institutions in European countries, both by asset maturity and by asset type.

The Group has exposures to financial institutions in the following European countries at 31 December 2012:

Country	Repayable within 30 days	Repayable within 1 year but more than 30 days	Repayable in over 1 year	Total gross exposure	Credit risk mitigation	Total net exposure
2012						
Austria	**–**	**–**	**–**	**–**	**–**	**–**
Belgium	**–**	**–**	**–**	**–**	**–**	**–**
Denmark	**7.9**	**–**	**–**	**7.9**	**–**	**7.9**
Finland	**–**	**–**	**25.0**	**25.0**	**–**	**25.0**
France	**163.8**	**53.7**	**125.6**	**343.1**	**(34.0)**	**309.1**
Germany	**31.6**	**48.1**	**663.7**	**743.4**	**(689.5)**	**53.9**
Ireland	**–**	**–**	**–**	**–**	**–**	**–**
Italy	**0.1**	**–**	**–**	**0.1**	**–**	**0.1**
Netherlands	**0.1**	**59.7**	**412.6**	**472.4**	**–**	**472.4**
Norway	**–**	**–**	**72.3**	**72.3**	**(72.3)**	**–**
Portugal	**–**	**–**	**–**	**–**	**–**	**–**
Spain	**–**	**–**	**–**	**–**	**–**	**–**
Sweden	**0.4**	**–**	**64.0**	**64.4**	**–**	**64.4**
Switzerland	**59.1**	**608.0**	**56.9**	**724.0**	**(521.1)**	**202.9**
	263.0	**769.5**	**1,420.1**	**2,452.6**	**(1,316.9)**	**1,135.7**

Country	Repayable within 30 days	Repayable within 1 year but more than 30 days	Repayable in over 1 year	Total gross exposure	Credit risk mitigation	Total net exposure
2011						
Austria	–	44.2	–	44.2	(4.1)	40.1
Belgium	–	20.0	34.0	54.0	(34.0)	20.0
Denmark	7.8	–	–	7.8	–	7.8
Finland	–	–	–	–	–	–
France	174.7	5.3	135.3	315.3	–	315.3
Germany	39.2	104.5	38.4	182.1	(15.7)	166.4
Ireland	5.0	25.0	–	30.0	–	30.0
Italy	–	–	–	–	–	–
Netherlands	0.1	40.2	210.6	250.9	–	250.9
Norway	–	–	–	–	–	–
Portugal	–	33.5	–	33.5	–	33.5
Spain	59.0	84.2	33.6	176.8	(31.5)	145.3
Sweden	10.2	10.0	7.3	27.5	–	27.5
Switzerland	73.1	10.0	413.8	496.9	(263.6)	233.3
	369.1	376.9	873.0	1,619.0	(348.9)	1,270.1

For the purposes of the above table, exposures to counterparties which comprise subsidiaries of larger banking groups within which Treasury maintains additional counterparty relationships are aggregated at the group level with the associated risk country being that of the ultimate parent entity. As at 31 December 2012 an exposure of £13.4m to an Irish subsidiary of a major American bank group was accordingly reported as exposure to the American based parent and is thus excluded from the analysis above. This exposure is fully guaranteed by the group holding company.

Credit risk mitigation takes the form of UK gilt collateral held in relation to reverse repo transactions, cash collateral held in relation to sold repo and derivative transactions, and sovereign/sub-sovereign guarantees in relation to specific debt security holdings.

1. Credit risk continued

The table below shows the Group's exposure to financial institutions in European countries by asset type.

Country	Bank and money market balances	Bonds	Derivatives	Other	Total net exposure
2012					
Austria	**–**	**–**	**–**	**–**	**–**
Belgium	**–**	**–**	**–**	**–**	**–**
Denmark	**0.1**	**–**	**–**	**7.8**	**7.9**
Finland	**–**	**25.0**	**–**	**–**	**25.0**
France	**0.1**	**100.3**	**16.9**	**191.8**	**309.1**
Germany	**0.3**	**–**	**22.3**	**31.3**	**53.9**
Ireland	**–**	**–**	**–**	**–**	**–**
Italy	**0.1**	**–**	**–**	**–**	**0.1**
Netherlands	**0.1**	**472.3**	**–**	**–**	**472.4**
Norway	**–**	**–**	**–**	**–**	**–**
Portugal	**–**	**–**	**–**	**–**	**–**
Spain	**–**	**–**	**–**	**–**	**–**
Sweden	**0.2**	**64.0**	**–**	**0.2**	**64.4**
Switzerland	**0.4**	**–**	**51.6**	**150.9**	**202.9**
	1.3	**661.6**	**90.8**	**382.0**	**1,135.7**

Country	Bank and money market balances	Bonds	Derivatives	Other	Total net exposure
2011					
Austria	–	40.1	–	–	40.1
Belgium	–	20.0	–	–	20.0
Denmark	1.0	–	–	6.8	7.8
Finland	–	–	–	–	–
France	–	63.2	24.4	227.7	315.3
Germany	0.2	103.3	23.9	39.0	166.4
Ireland	–	30.0	–	–	30.0
Italy	–	–	–	–	–
Netherlands	0.1	250.8	–	–	250.9
Norway	–	–	–	–	–
Portugal	–	33.5	–	–	33.5
Spain	–	126.3	19.0	–	145.3
Sweden	20.2	7.3	–	–	27.5
Switzerland	20.7	–	53.3	159.3	233.3
	42.2	674.5	120.6	432.8	1,270.1

In addition to the above exposures to financial institutions:

- in the overseas European Economic Area (EEA as defined by the European Banking Authority) and Switzerland, corporate customer exposures at 31 December 2012 totalled £170.8m (2011: £184.4m). There are no exposures to retail customers based outside of the UK and Channel Islands;
- gross exposure to European multilateral development banks (not included in the above table given the supranational status associated with these institutions) stood at £1,444.0m (2011: £529.0m) before credit risk mitigation (£997.8m post credit risk mitigation (2011: £457.5m)) of which £543.8m matures within a year (2011: £81.8m); and
- ABS/MBS exposures of £10.8m and £2.8m to Spanish and Belgian special purpose entities respectively were outstanding as at 31 December 2012.

The Group continues to monitor developments daily across all countries as they affect the Treasury portfolio. Proactive management actions have been taken to reduce risk within the Treasury portfolio with an underlying theme of reducing exposure in the south (peripheral eurozone) and increasing exposure in the north (eg Germany, the Netherlands, Finland and Sweden) where economies are more robust. Credit quality and liquidity within the portfolio have been enhanced by concentrating asset purchases in the shorter dated debt securities issued by AAA rated supranational financial institutions, government agencies and sovereign or state owned banks. Ongoing exposure to financial institutions within the peripheral eurozone is primarily restricted to selective short term money market lending and nostro account balances.

Risk management continued

For the year ended 31 December 2012
All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Treasury operates a risk based approach which monitors counterparty limits and exposure via a credit risk register. The counterparties or the assets held are monitored against a Board approved matrix of risk tolerance and associated indicators. The credit risk register is updated for rating actions, market events and financial results as they are announced which may influence a change in risk status and possible escalation requiring management actions and inclusion on the watchlist.

The Treasury risk team reviews the entire portfolio and watchlists monthly for appropriate risk status bandings and any associated management actions.

As at 31 December 2012 there were no high risk watchlist exposures (2011: £277m). All high risk watchlist exposures, consisting entirely of debt security holdings, reached final maturity during the period to 31 December 2012 and were repaid in full.

1.5.2 Indirect exposures

Treasury risk management monitoring extends beyond the direct risk incurred through counterparty trading, to the underlying exposures (eg to peripheral eurozone countries) which Treasury's counterparties may maintain on their own balance sheets. In analysing each counterparty's secondary exposure we assess the vulnerability and impact on that firm should it suffer different degrees of losses.

Where secondary sovereign exposure or contagion risk is deemed to undermine the performance of the counterparty, remedial management actions are taken in respect of Treasury's counterparty limits and exposure, often well ahead of any associated rating actions.

2. Liquidity risk

2.1 Capital and liquidity framework

The Group's capital and liquidity risk management framework comprises:

- a defined risk appetite, controls and governance in the Group's capital and liquidity management policies;
- articulation of how capital and liquidity risk is identified, measured, monitored and managed in the Internal Capital Adequacy Assessment Process (ICAAP), Individual Liquidity Adequacy Assessment (ILAA) and procedures and governance in place to mitigate the risk;
- capital and liquidity risk quantification and mitigation techniques and processes;
- management actions linked through to stress testing and capital 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 Group operates within its agreed risk appetite parameters in all planning models;
- ongoing development and enhancement of the Group's capital and liquidity risk appetite framework; and
- a process to attribute the cost, benefit and risks of liquidity to specific business lines via the Group's Funds Transfer Pricing mechanism.

2.2 Liquidity risk

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

- survival periods which measure the degree of sufficiency of liquid assets to support the Group'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 (from three months to one year) and a range of adverse liquidity events, both firm specific and market wide, which cover all aspects of the liquidity risk to which the Group is exposed. These stress tests include a number of downgrade scenarios, from one notch to multi-notch long term and short term downgrades.

The strategic measures approved by the Board include:

- customer loan/deposit ratio, 92% (2011: 94%) – the ratio of customer loans to customer deposits;
- encumbrance ratio, 27% (2011: 24%) – the ratio of encumbered assets divided by total assets;
- regulatory limits – Internal Liquidity Guidance and Net Stable Funding ratio; and
- internal liquidity stress tests – the survival period of the Group under a range of stressed scenarios.

2.3 Liquidity risk management overview

Liquidity risk arising from the structure of the balance sheet (structural liquidity) is managed in line with policies developed by LMC and ALCO. The Group's liquidity management policies are reviewed and approved annually by the BRC (on behalf of the Board) and compliance reviewed by LMC and monthly by ALCO. The Group's policy is to ensure that sufficient funds are 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 Group monitors its liquidity position on a daily basis and has a weekly LMC which operates to oversee the operational liquidity management. A range of indicators to detect early signs of liquidity risk either in the market or specific to the Group are also monitored. LMC 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 meetings ensure that the business plans are accurate and can be flexed as required.

The liquidity position is reported monthly to ALCO and the Board. It 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 Group's liquidity management framework is designed in line with FSA BIPRU regulations and industry guidelines.

2. Liquidity risk continued

2.3.1 Liquid asset portfolios

The Group holds a number of marketable asset pools that it uses for liquidity management through the Treasury operation. These include:

- liquid asset buffer (LAB); the highest quality debt and comprise of cash at the Bank of England, gilts, central government and multilateral development bank bonds. The liquid asset ratio was 14.6% at 31 December 2012 (2011: 15.5%). The table below shows the market value and composition of the liquid asset buffer:

Qualifying stock	**2012**	2011
Operational balance with central banks (note 13)	**5,121.0**	6,378.3
Gilts	**648.0**	1,085.5
Central government and multilateral development bank bonds	**1,455.1**	162.1
	7,240.9	7,625.9

- non-buffer assets, these assets are not as liquid as LAB assets, however they exist to diversify the liquid asset pool and enhance returns; and
- own retained asset pool, the Group has securitised part of its asset balance sheet and retained the issued notes. These assets form part of the Group's contingent funding plans.

The Group uses any combination of these asset pools to manage liquidity, with LAB and non-buffer assets used predominantly for short term cashflow movements, with the own retained asset pool creating longer term or contingent liquidity. Regular realisation through repo transactions and outright sales provide assurance that these asset pools remain sufficiently liquid.

2.3.2 Wholesale funding

The majority of the Group's funding comes from retail and commercial customer accounts. The Group's primary objective in respect of wholesale funding is 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 Group.

The Group also has access to a variety of long term wholesale funding sources including securitisations, covered bonds and Euro Medium Term Notes. In 2012 it raised £1,290.4m through these sources. The Group will continue to issue from the programmes as funding requirements and market conditions permit. The Group has a smaller presence in the shorter term wholesale liability markets, which it uses to manage short term cashflow requirements.

2.4 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 Group'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 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.

	Carrying value	Gross nominal outflow	Less than 1 month	1–3 months	3–12 months	1–5 years	Over 5 years
2012							
Contractual cash flows							
Non-derivative 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**
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	**112.0**	**112.0**	**112.0**	**–**	**–**	**–**	**–**
	46,468.8	**49,207.8**	**26,774.2**	**2,468.9**	**7,500.8**	**10,303.5**	**2,160.4**
Derivative liabilities							
Net outflow	**967.6**	**1,650.6**	**20.0**	**48.2**	**180.4**	**588.2**	**813.8**
	47,436.4	**50,858.4**	**26,794.2**	**2,517.1**	**7,681.2**	**10,891.7**	**2,974.2**
Other liabilities	**286.8**	**–**	**–**	**–**	**–**	**–**	**–**
Total recognised liabilities	**47,723.2**	**50,858.4**	**26,794.2**	**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	**52,493.5**	**55,628.7**	**31,545.4**	**2,536.2**	**7,681.2**	**10,891.7**	**2,974.2**
Behavioural adjustments							
Customer accounts	**–**	**–**	**(21,219.3)**	**570.8**	**2,410.2**	**18,238.3**	**–**
Total liabilities – behavioural	**52,493.5**	**55,628.7**	**10,326.1**	**3,107.0**	**10,091.4**	**29,130.0**	**2,974.2**

Risk management continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

2. Liquidity risk continued

	Carrying value	Gross nominal outflow	Less than 1 month	1–3 months	3–12 months	1–5 years	Over 5 years
2011							
Contractual cash flows							
Non-derivative liabilities							
Deposits by banks	3,302.7	3,397.1	1,591.2	583.9	323.1	898.9	–
Customer accounts	34,990.6	35,109.5	23,457.6	2,540.4	7,126.5	1,985.0	–
Customer accounts – capital bonds	1,429.8	1,420.3	–	97.9	425.3	892.4	4.7
Debt securities in issue	4,164.8	5,187.2	147.8	138.7	186.9	3,264.7	1,449.1
Other borrowed funds	1,258.8	2,305.8	7.2	4.6	77.1	878.6	1,338.3
Amounts owed to other Co-operative Group undertakings	132.3	132.3	132.3	–	–	–	–
	45,279.0	47,552.2	25,336.1	3,365.5	8,138.9	7,919.6	2,792.1
Derivative liabilities							
Net outflow	1,087.9	2,137.0	284.5	31.3	204.9	559.7	1,056.6
	46,366.9	49,689.2	25,620.6	3,396.8	8,343.8	8,479.3	3,848.7
Other liabilities	315.6	–	–	–	–	–	–
Total recognised liabilities	46,682.5	49,689.2	25,620.6	3,396.8	8,343.8	8,479.3	3,848.7
Unrecognised loan commitments	4,752.7	4,752.7	4,571.3	160.6	20.8	–	–
Total liabilities	51,435.2	54,441.9	30,191.9	3,557.4	8,364.6	8,479.3	3,848.7
Behavioural adjustments							
Customer accounts	–	–	(20,526.5)	464.1	1,230.3	18,832.1	–
Total liabilities – behavioural	51,435.2	54,441.9	9,665.4	4,021.5	9,594.9	27,311.4	3,848.7

The Bank's gross cash flow maturity analysis has not been disclosed as it is not materially different from the above Group disclosure.

2.5 Encumbrance

The Group ensures that sufficient eligible and unencumbered assets are available at all times to meet the needs of its secured funding programmes. Details of the Group's encumbered assets are shown in note 39d Fair value of transferred assets and associated liabilities.

3. Market risk

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

The main source of market risk within the Group 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 create market risk through its various portfolio management and trading activities along with currency risk.

3.1 Interest rate risk

Interest rate risk policy statements, approved by the ERC on behalf of the Board, specify the scope of the Group's wholesale market activity, market risk limits and delegated authorities. The policy is managed by the TMRC and ALCO. Their prime task is to assess the interest rate risk inherent in the maturity and repricing characteristics of the Group's assets and liabilities. The Group seeks to minimise the volatility of future earnings from interest rate changes and all interest rate risk exposure is removed from the retail and CABB 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 Group. 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 TMRC and ALCO review the balance sheet risk positions and the utilisation of wholesale market risk limits.

3. Market risk continued

3.1.1 Non-treasury interest rate risk

The Group (excluding wholesale) uses a gap report and earnings approach for managing interest rate risk, focusing in detail on the sensitivity of assumed changes in interest rates on net interest income for one year. Higher level analysis is performed for subsequent years.

TMRC monitors the non-trading interest rate risk which is split between certain wholesale portfolios, banking and investment books, and the rest of the Group's balance sheet. The following describes the Group 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 set 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) is 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) are deemed to re-price 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 Group 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 2012 as customers continue to favour variable rate mortgages (where the introductory rate is linked to Bank of England base rate) and administered and fixed rate savings. Basis risk is monitored by TMRC 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 Group'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 Group is not exposed to sudden rate movements. The net position shows the amount that the Group is either over or under invested in the month. A £100m positive gap position would equate to the Group's income increasing by £1m per annum if rates increased by 1%. The maximum sensitivity for the period shown below equates to approximately a £10.9m decrease in income if rates increased by 1%.

	2012	2011
Net greater than 12 month gap position		
At the year end	**(928)**	(279)
Average for the year	**(612)**	(330)
Maximum sensitivity for the year	**(1,090)**	806
Minimum sensitivity for the year	**(248)**	(51)

3.1.2 Treasury interest rate risk

Treasury executes short term funding and hedging transactions with the wholesale markets on behalf of the Group and its customers. It also generates incremental income from proprietary trading within strict risk limits. There are two prime measures of risk supplemented by additional controls such as maturity and stop loss limits.

3.1.2.1 Value at Risk (VaR)

VaR measures the daily maximum potential gain or loss due to market volatility within a statistical confidence level of 95% and a one day holding period. The VaR methodology employed is historical simulation using a time series of one year to latest day and was £0.4m at 31 December 2012 for the trading portfolios (2011: £0.4m). The VaR methodology has inherent limitations in that market volatility in the past may not be a reliable predictor of the future, and may not reflect the time required to hedge or dispose of the position, hence VaR is not used as the sole measure of risk.

3.1.2.2 PV100

This illustrates the change in valuation on a fixed income portfolio experienced given a 1% increase and decrease in interest rates, representing the treasury banking book and treasury trading book. PV100 is the effect on the net present value (NPV) of the wholesale portfolio to a parallel shift of 100 basis points upon the base yield curve. The effects of a 1% increase in interest rates are (£3.0m) (2011: £15.1m) and a 1% decrease £14.6m (2011: (£16.0m)).

3.2 Currency risk

The Group'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.

Risk management continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

3. Market risk continued

The table below provides an analysis of the Group's assets and liabilities by currency:

	2012					2011				
	£	**$**	**€**	**Other**	**Total**	£	$	€	Other	Total
Assets										
Cash and balances at central banks	**5,433.0**	**–**	**–**	**–**	**5,433.0**	6,696.6	–	–	–	6,696.6
Loans and advances to banks	**1,738.4**	**38.4**	**124.5**	**2.8**	**1,904.1**	1,568.1	59.5	373.4	5.5	2,006.5
Loans and advances to customers	**33,121.3**	**40.2**	**153.4**	**24.6**	**33,339.5**	33,513.4	54.7	157.3	40.6	33,766.0
Fair value adjustments for hedged risk	**354.2**	**–**	**–**	**–**	**354.2**	366.3	–	–	–	366.3
Investment securities – loans and receivables	**237.7**	**12.8**	**44.5**	**–**	**295.0**	656.8	16.2	131.9	–	804.9
Investment securities – available for sale	**3,669.4**	**70.8**	**49.2**	**–**	**3,789.4**	3,127.8	124.7	170.5	–	3,423.0
Investment securities – fair value through income or expense	**1,821.9**	**12.3**	**11.0**	**–**	**1,845.2**	335.8	–	7.3	–	343.1
Investment securities – held for trading	**870.2**	**17.3**	**72.7**	**–**	**960.2**	–	–	–	–	–
Derivative financial instruments	**818.6**	**–**	**0.2**	**–**	**818.8**	975.3	0.2	0.3	–	975.8
Equity shares	**5.7**	**–**	**–**	**–**	**5.7**	5.7	–	–	–	5.7
Investments in joint ventures	**3.9**	**–**	**–**	**–**	**3.9**	2.7	–	–	–	2.7
Goodwill	**–**	**–**	**–**	**–**	**–**	0.6	–	–	–	0.6
Intangible fixed assets	**34.9**	**–**	**–**	**–**	**34.9**	40.7	–	–	–	40.7
Investment properties	**173.0**	**–**	**–**	**–**	**173.0**	172.7	–	–	–	172.7
Property, plant and equipment	**64.1**	**–**	**–**	**–**	**64.1**	80.1	–	–	–	80.1
Amounts owed by other Co-operative Group undertakings	**256.4**	**–**	**–**	**–**	**256.4**	179.2	–	–	–	179.2
Other assets	**69.7**	**0.2**	**0.4**	**–**	**70.3**	31.3	0.2	1.5	–	33.0
Prepayments and accrued income	**14.9**	**–**	**–**	**–**	**14.9**	18.7	–	–	–	18.7
Current tax assets	**172.6**	**–**	**–**	**–**	**172.6**	13.6	–	–	–	13.6
Deferred tax assets	**38.2**	**–**	**–**	**–**	**38.2**	26.4	–	–	–	26.4
Total assets	**48,898.1**	**192.0**	**455.9**	**27.4**	**49,573.4**	47,811.8	255.5	842.2	46.1	48,955.6
Liabilities										
Deposits by banks	**2,995.4**	**173.5**	**443.0**	**0.1**	**3,612.0**	2,567.3	260.6	474.7	0.1	3,302.7
Customer accounts	**35,784.6**	**47.5**	**49.7**	**2.6**	**35,884.4**	34,899.1	35.5	52.3	3.7	34,990.6
Customer accounts – capital bonds	**888.1**	**–**	**–**	**–**	**888.1**	1,429.8	–	–	–	1,429.8
Debt securities in issue	**4,705.5**	**–**	**8.2**	**–**	**4,713.7**	4,039.4	–	125.4	–	4,164.8
Derivative financial instruments	**967.4**	**–**	**0.2**	**–**	**967.6**	1,083.7	1.3	2.9	–	1,087.9
Other borrowed funds	**1,230.0**	**–**	**28.6**	**–**	**1,258.6**	1,229.5	–	29.3	–	1,258.8
Amounts owed to other Co-operative Group undertakings	**112.0**	**–**	**–**	**–**	**112.0**	132.3	–	–	–	132.3
Other liabilities	**103.6**	**0.2**	**0.2**	**–**	**104.0**	172.9	0.3	0.5	–	173.7
Accruals and deferred income	**20.1**	**–**	**–**	**–**	**20.1**	39.9	–	–	–	39.9
Provisions for liabilities and charges	**162.7**	**–**	**–**	**–**	**162.7**	102.0	–	–	–	102.0
Deferred tax liabilities	**–**	**–**	**–**	**–**	**–**	–	–	–	–	–
Total liabilities	**46,969.4**	**221.2**	**529.9**	**2.7**	**47,723.2**	45,695.9	297.7	685.1	3.8	46,682.5
Net on balance sheet position	**1,928.7**	**(29.2)**	**(74.0)**	**24.7**	**1,850.2**	2,115.9	(42.2)	157.1	42.3	2,273.1

The Bank's currency analysis has not been disclosed as it is not materially different from the above Group disclosure.

At 31 December 2012 the Group's open position was £2.7m (2011: £0.4m) representing a potential loss of £0.1m given a 3% depreciation in sterling (2011: £nil). The open position is monitored against limits in addition to limits in place on individual currencies. All figures are in £ sterling equivalent.

3. Market risk continued

The following risks (Operational to Pension) do not form part of the audited accounts and are not audited.

4. Operational risk

Operational risk is defined within the Banking Group as 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.

In order to meet the Banking Group's appetite for operational risk, appropriate controls are in place to minimise the chance of any significant disruption and to protect our reputation.

Operational risks are identified, managed and mitigated through ongoing risk management practices including risk assessments, formal control procedures and contingency planning. Operational risks and key controls are formally reviewed on a regular basis. Significant operational risks and the associated capital requirements are regularly reported to the ORC, the ERC and the BRC. These meet regularly to monitor the suitability of the risk management framework and management of significant risks within the Banking Group.

Business continuity arrangements are in place which set out to minimise the risk of disruption in the event of a sudden, unplanned occurrence that could seriously disrupt business operations. This includes developing and exercising crisis and incident management teams to maintain appropriate preparedness in the event of a major operational disruption.

The Banking Group also has a corporate insurance programme to transfer specific risks to insurers as part of its risk management approach.

5. Reputational risk

Reputational risk is defined as the risk associated with an issue which could in some way be damaging to the brand of The Co-operative Banking Group either through its strategic decisions, business performance, an operational failure or external perception.

As part of the assessment and control of this risk, 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 member, customer and market confidence.

6. Strategic and business risk

Strategic and business risk arises from changes to the Banking Group's business and the environment in which it operates, specifically the risk of not being able to carry out the Banking Group's business plan and desired strategy.

The Group's strategy is to grow our business in order to achieve the Banking Group's vision of becoming the compelling, co-operative alternative in the markets in which we compete.

The main risks to delivering the business plan and achieving the strategy are the challenging economic environment, the changing regulatory environment and the significant change programme being managed within the Group and the wider Co-operative Group.

The Board and Executive set and monitor the strategic plan in the light of this background having considered the stresses that extreme but plausible scenarios could have upon it.

7. Conduct risk

Conduct risk is the risk that the Banking Group's behaviours, offerings or interactions will result in unfair outcomes for customers. Accordingly, conduct risk may arise from any aspect of the way a business is conducted, the sole test being whether the outcome is an unfair one for customers.

The Banking Group mitigates and prevents emerging conduct risk through established systems and controls including ongoing oversight and monitoring from risk functions.

Significant conduct risks are reported through existing management structures and committees and challenged by the BRC.

8. Pension risk

Pension risk is defined as the risk of exposure to pension scheme liabilities and risks inherent in the valuation of scheme liabilities and assets resulting in a detriment to Banking Group capital. Risks are identified at The Co-operative Group level, with the impact of any potential changes to contribution assessed under the Banking Group's risk management framework.

The Banking Group is exposed to pension risk through two schemes:

- Pace – CFS Management Services Ltd (CFSMS) and the Bank are participating members of The Co-operative Pension Scheme (Pace) – defined benefit and contribution scheme; and
- Britannia Pension Scheme – CFSMS is the principal employer of the Britannia Pension Scheme – defined benefit and contribution sections (defined benefit section closed to new members in 2001, defined contribution section closed to new members in October 2012).

The Pace Trustee, in consultation with The Co-operative Group, is responsible for the risk management arrangements for Pace, agreeing suitable contribution rates, investment strategy and for taking professional advice as appropriate.

The Britannia Pension Scheme Trustee, in consultation with CFSMS, is responsible for the risk management arrangements for the Britannia Pension Scheme, agreeing suitable contribution rates, investment strategy and for taking professional advice as appropriate.

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

Capital management

For the period ended 31 December 2012
All the amounts are stated in £m unless otherwise indicated

Capital resources (audited)

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. However, the Bank still recognises the need to maintain a balance between the potential higher returns that might be achieved with greater gearing, and the advantages and security afforded by a sound capital position.

Our submissions to the FSA in the period have shown that the Bank and its individually regulated operations have complied with all externally imposed capital requirements.

The Bank's Core Tier 1 capital position at the year end was 8.8% (2011: 9.6%). However, the Board recognises the need to build the capitalisation of the Bank to provide increased resilience and capacity for future growth. To this end, a strategic review is underway targeting growth in the Core Tier 1 ratio. Part of this was concluded in January 2013 when a risk mitigation transaction completed which would increase the year end ratio to 9.2% on a proforma basis.

Adequate capitalisation can be maintained at all times even under the most severe stress scenarios, including the revised FSA 'anchor' stress scenario.

A capital buffer above Individual Capital Guidance (ICG) is being maintained, to provide the ability to absorb capital shocks and ensure sufficient surplus capital is available at all times to cover the Bank's regulatory minimum requirements.

The Bank's regulatory capital is analysed into two tiers:

Tier 1 capital

Tier 1 capital includes share capital, retained earnings, and non-cumulative irredeemable preference shares. Retained earnings exclude gains or losses on cashflow hedges and available for sale assets.

Tier 2 capital

Revaluation reserves relating to net gains on equity held in the available for sale financial assets category are included in Tier 2 capital.

The Tier 2 capital includes subordinated debt issues and perpetual subordinated bonds (PSBs). The rights of payment to the holders of this debt are subordinated to the claims of depositors and other creditors of the Bank. More information on these can be found in note 29.

	2012	2011
Reconciliation of equity per balance sheet to Core Tier 1 capital		
Total equity per balance sheet	**1,850.2**	2,273.1
Regulatory adjustments:		
Minority interests	**(0.4)**	(1.2)
Retained earnings	**–**	(49.8)
Available for sale reserve	**(30.0)**	(19.5)
Cashflow hedging reserve	**(63.7)**	(67.6)
Core Tier 1 capital before regulatory deductions	**1,756.1**	2,135.0

	2012	2011
Core Tier 1 capital before regulatory deductions:		
Permanent share capital	**410.0**	410.0
Retained earnings	**1,813.4**	1,686.0
Minority interests	**32.0**	30.2
Losses for the year	**(508.1)**	–
Share premium account	**8.8**	8.8
Total Core Tier 1 capital before regulatory deductions	**1,756.1**	2,135.0
Regulatory deductions from Core Tier 1 capital:		
Intangible assets	**(27.9)**	(71.1)
50% of excess of expected losses over impairment (net of tax)	**(159.7)**	(114.2)
50% of securitisation positions	**(0.7)**	(2.3)
Total Core Tier 1 capital after regulatory deductions	**1,567.8**	1,947.4
Other Tier 1 capital:		
Non-cumulative irredeemable preference shares	**60.0**	60.0
Regulatory deductions from other Tier 1 capital:		
50% of tax on excess of expected losses over impairment	**51.8**	41.1
50% of material holdings	**(2.0)**	(1.3)
Total Tier 1 capital after regulatory deductions	**1,677.6**	2,047.2
Tier 2 capital before regulatory deductions:		
Revaluation reserves	**2.0**	2.9
Collective provisions	**0.7**	0.7
Subordinated notes and perpetual subordinated bonds	**1,112.1**	1,084.0
Total Tier 2 capital before regulatory deductions	**1,114.8**	1,087.6
Regulatory deductions from Tier 2 capital:		
50% of excess of expected losses over impairment (gross of tax)	**(211.5)**	(155.3)
50% of securitisation positions	**(0.7)**	(2.3)
50% of material holdings	**(2.0)**	(1.3)
Total Tier 2 capital after regulatory deductions	**900.6**	928.7
Total capital resources	**2,578.2**	2,975.9

The capital ratios reported in the business and financial review are based on the Pillar I capital requirement.

Capital allocation
The allocation of capital among specific operations and activities is driven by optimisation of the return achieved on the capital allocated, and is based upon the regulatory capital. Capital allocation is undertaken independently of those responsible for capital management, and is reviewed by ALCO. Each new product must earn at least the Bank's minimum target return on equity.

Capital management continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

	2012	2011
Capital ratios (unaudited)		
Core Tier 1 ratio	**8.8%**	9.6%
Tier 1 ratio	**9.4%**	10.1%
Total capital ratio	**14.4%**	14.7%
Risk-weighted assets (unaudited)		
Credit risk	**15,974.8**	18,687.4
Market and counterparty risk	**492.6**	51.6
Operational risk	**1,441.3**	1,521.0
Total risk-weighted assets	**17,908.7**	20,260.0
Segmental analysis of credit risk risk-weighted assets (unaudited)		
Retail	**2,410.1**	2,333.9
Corporate	**7,760.3**	9,777.2
Other CABB	**4,361.2**	4,786.7
CABB total	**12,121.5**	14,563.9
Treasury	**1,149.1**	1,151.3
Other	**294.1**	638.3
Total credit risk risk-weighted assets	**15,974.8**	18,687.4

Core Tier 1 ratio has reduced by 0.8% to 8.8% as at 31 December 2012. This is due to a 19% (£379.6m) decrease in Core Tier 1 after deductions offset by a 12% (£2,351.3m) decrease in risk-weighted assets.

The reduction in Core Tier 1 is primarily due to the £673.7m before tax (£508.1m after tax) statutory loss. The result for the year was principally driven by a £468.7m credit impairment, £150.0m asset impairment and £149.7m PPI provision offset by a £96.8m operating profit in the core business. Core Tier 1 has benefited from a £80m capital injection from The Co-operative Banking Group.

The reduction in risk-weighted assets is primarily due to a 21% (£2,016.9m) reduction in corporate risk-weighted assets. The change is driven by the reassessment of the carrying value of corporate real estate exposures together with an ongoing review of regulatory capital requirements. Slotting models are used to analyse and monitor specialised lending exposures to property which are assigned to FSA supervisory categories with predefined risk-weights. A significant proportion of loans have been downgraded with many moving into default. Loans in default have a zero risk-weight (but a 50% expected loss). Downgrades are the primary reason for the reduction in corporate risk-weighted assets.

In addition, other CABB risk-weighted assets, mainly Optimum, have decreased by 9% (£425.5m) due to continuing run-off of the book. However, market and counterparty risk capital requirements have increased by £441.0m. This is primarily due to increased holdings of short dated gilts, UK covered and UK government guaranteed bond holdings which were purchased to invest the Bank's surplus liquidity.

Total excess of expected loss over impairment, a deduction from capital resources, has increased by £91.0m. Although credit impairments have increased significantly this has been more than offset by higher expected loss which has been driven by corporate downgrades.

Since the year end, the Bank has completed a securitisation transaction to reduce risk in the balance sheet which has improved the Core Tier 1 ratio by 0.4%. The signing of the Sale and Purchase Agreement relating to the Life and Savings business owned by The Co-operative Banking Group in 2013 is expected to further strengthen the capital position.

Basel III

Basel III rules in the EU (collectively known as CRD IV) have yet to be finalised and the implementation date is not known. The new rules will be implemented on a transitional basis from their effective date to full implementation in 2022 (at the earliest). During the transitional period to full implementation of Basel III the Bank will have the opportunity to generate additional capital from earnings and to implement management actions in order to mitigate the impact of Basel III and meet capital ratios. The Bank expects to be able to comply fully with the new requirements when they become applicable, including the proposed minimum leverage ratio of 3%.

The Bank continues to monitor its capital position under draft rules on both a transitional and full implementation basis. An analysis of capital resources and leverage ratio assuming draft Basel III rules were in place as at 31 December 2012 which can be found in the Bank Pillar 3 disclosure.

Notes to the financial statements

For the year ended 31 December 2012
All amounts are stated in £m unless otherwise indicated

1. Segmental information

In 2011, the Bank reported its operating segments as Retail, Corporate and Business Banking (CABB) and Other, based on differences in products and services. In 2012, the Bank has further refined this to split its Corporate area into core and non-core and to move the Platform portfolio from CABB to the Retail business. The comparatives throughout the note have been restated as appropriate.

This level of information has been presented to the Board throughout the year. Revenues are attributed to the segment in which they are generated. Transactions between the reportable segments are on normal commercial terms and internal charges and transfer pricing adjustments have been reflected in each segment.

The Bank is comprised of the following main reportable segments:

- **Retail** – customer focused products and services for individuals, sole traders and small businesses. This includes mortgages, credit cards, consumer loans, current accounts and savings products;
- **CABB** – customer focused products and services for businesses, including large corporate and commercial entities. It includes loans, asset finance, current accounts and savings products. Core Corporate banking represents lines of business that are consistent with our strategy and risk appetite while non-core lines of business are targeted for run down or exit. CABB also includes the Optimum closed book of acquired mortgage portfolios and mortgages originated via intermediaries by Britannia, and the Illius portfolio of investment properties; and
- **Other** – includes Treasury, other central costs and Unity Trust Bank. Treasury comprises asset and liability management across the balance sheet, including trading activities. Unity Trust is a subsidiary bank operating in the corporate banking and social economy sectors on behalf of trade unions.

			Non-core						
	Retail	Corporate core	Corporate non-core	Other CABB	**Total CABB**	Treasury	Other	**Total Other**	**Total**
2012									
Net interest income	**399.9**	108.4	(22.6)	9.6	**95.4**	41.2	9.3	**50.5**	**545.8**
Non-interest income	**135.8**	55.2	2.7	15.4	**73.3**	14.8	1.5	**16.3**	**225.4**
Operating income	**535.7**	163.6	(19.9)	25.0	**168.7**	56.0	10.8	**66.8**	**771.2**
Operating expenses	**(444.2)**	(80.0)	(5.7)	(25.6)	**(111.3)**	(20.0)	(7.5)	**(27.5)**	**(583.0)**
Impairment losses on loans and advances	**(41.4)**	(79.9)	(346.6)	(4.5)	**(431.0)**	–	(1.7)	**(1.7)**	**(474.1)**
Impairment gains on investments	**–**	–	–	–	**–**	5.3	0.1	**5.4**	**5.4**
Operating profit/(loss)	**50.1**	3.7	(372.2)	(5.1)	**(373.6)**	41.3	1.7	**43.0**	**(280.5)**
Significant items									**(85.1)**
Asset impairment									**(150.0)**
PPI provision									**(149.7)**
Share of post tax profits from joint ventures									**1.2**
Financial Services Compensation Scheme levies									**(24.8)**
Fair value amortisation									**15.2**
Loss before taxation									**(673.7)**
Income tax									**165.6**
Loss for the financial year									**(508.1)**

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

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

1. Segmental information continued

	2012
Reconciliation to statutory income statement	
Net interest income	
Total interest margin for reportable segments	**545.8**
Interest fair value unwind	**20.0**
Net interest income	**565.8**
Non-interest income	
Total non-interest income for reportable segments	**225.4**
Interest fair value unwind	**(0.2)**
Non-interest income before significant items	**225.2**
Comprising:	
Net fee and commission income	**177.2**
Net trading income	**14.1**
Other operating income	**33.9**
Non-interest income before significant items	**225.2**
Operating expenses	
Total operating expenses for reportable segments	**(583.0)**
Interest fair value unwind	**(4.6)**
Operating expenses before significant items	**(587.6)**
Interest fair value unwind	
Total interest unwind for reportable segments	**15.2**
Interest margin unwind	**(20.0)**
Non-interest income unwind	**0.2**
Operating expenses unwind	**4.6**
Interest fair value unwind	**–**

			Non-core						
	Retail	Corporate core	Corporate non-core	Other CABB	Total CABB	Treasury	Other	Total Other	Total
2011									
Net interest income	400.5	101.7	(19.2)	65.4	147.9	59.2	11.2	70.4	618.8
Non-interest income	149.5	51.5	1.9	15.3	68.7	(20.6)	1.2	(19.4)	198.8
Operating income	550.0	153.2	(17.3)	80.7	216.6	38.6	12.4	51.0	817.6
Operating expenses	(423.5)	(79.2)	(6.8)	(29.7)	(115.7)	(15.3)	(7.1)	(22.4)	(561.6)
Impairment losses on loans and advances	(34.4)	(61.5)	(25.9)	2.8	(84.6)	–	(1.5)	(1.5)	(120.5)
Impairment gains on investments	–	–	–	–	–	5.6	–	5.6	5.6
Operating profit/(loss)	92.1	12.5	(50.0)	53.8	16.3	28.9	3.8	32.7	141.1
Significant items									(53.3)
PPI provision									(90.0)
Share of post tax profits from joint ventures									0.2
Financial Services Compensation Scheme levies									(14.5)
Fair value amortisation									86.3
Membership dividends									(15.6)
Profit before taxation									54.2
Income tax									(4.4)
Profit for the financial year									49.8

1. Segmental information continued

	2011
Reconciliation to statutory income statement	
Net interest income	
Total interest margin for reportable segments	618.8
Gains on sale of investment securities – loans and receivables	(37.2)
Interest fair value unwind	53.4
Net interest income	635.0
Non-interest income	
Total non-interest income for reportable segments	198.8
Gains on sale of investment securities – loans and receivables	37.2
Non-interest income before significant items	236.0
Comprising:	
Net fee and commission income	185.2
Net trading income	4.5
Other operating income	46.3
Non-interest income before significant items	236.0
Operating expenses	
Total operating expenses for reportable segments	(561.6)
Interest fair value unwind	32.9
Operating expenses before significant items	(528.7)
Interest fair value unwind	
Total interest unwind for reportable segments	86.3
Interest margin unwind	(53.4)
Operating expenses unwind	(32.9)
Interest fair value unwind	–

	Retail	Corporate core	Corporate non-core	Optimum	Treasury	Total
2012						
Segment assets	**17,662.7**	**5,412.5**	**2,837.5**	**7,645.2**	**13,170.9**	**46,728.8**
Unallocated assets						**1,858.5**
Total assets for reportable segments						**48,587.3**
Statutory reclassifications						**986.1**
Consolidated total assets						**49,573.4**

	Retail	Corporate core	Corporate non-core	Optimum	Treasury	Total
Segment liabilities	**28,141.5**	**7,582.8**	**–**	**–**	**9,884.7**	**45,609.0**
Unallocated liabilities						**863.9**
Total liabilities for reportable segments						**46,472.9**
Statutory reclassifications						**1,250.3**
Consolidated total liabilities						**47,723.2**

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

1. Segmental information continued

	Retail	Corporate core	Corporate non-core	Optimum	Treasury	Total
2011						
Segment assets	17,657.8	5,237.5	3,274.3	8,035.9	12,342.0	46,547.5
Unallocated assets						1,813.2
Total assets for reportable segments						48,360.7
Statutory reclassifications						594.9
Consolidated total assets						48,955.6

	Retail	Corporate core	Corporate non-core	Optimum	Treasury	Total
Segment liabilities	27,859.2	7,657.9	–	–	9,004.9	44,522.0
Unallocated liabilities						1,426.5
Total liabilities for reportable segments						45,948.5
Statutory reclassifications						734.0
Consolidated total liabilities						46,682.5

2. Loss/profit before taxation

	2012 £'000	Restated 2011 £'000
Loss/profit before taxation is stated after:		
Audit of these financial statements	**367**	356
Amounts receivable by the Company's auditor and its associates in respect of:		
Audit of financial statements of subsidiaries of the Company	**325**	335
Audit related assurance services	**28**	11
Other tax advisory services	**–**	311
Other assurance services	**460**	149
Corporate finance services	**–**	90
All other services	**1,944**	365
	3,124	1,617

The Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) (Amendment) Regulations 2011 is mandatory for periods starting on or after 1 October 2011. The comparatives in respect of the disclosures of Auditor Remuneration have been restated accordingly.

Amounts paid to the Bank's auditor and its associates in respect of services to the Bank, other than the audit of the Bank's financial statements, have not been disclosed as the information is required instead to be disclosed on a consolidated basis. Included within all other services are recharges of £1,038k (2011: £nil) in respect of assurance services relating to the bid for the Lloyds Bank branches.

3. Directors' emoluments

	2012 £'000	2011 £'000
Executive directors	**479**	1,645
Compensation for loss of office	**–**	926
	479	2,571

Directors' activities are undertaken across The Co-operative Banking Group. The figures above reflect the Group's share of these services.

Retirement benefits are accruing to one director (2011: one) under defined benefit schemes.

The aggregate of emoluments and amounts receivable under incentive schemes of the highest paid director was £479k (2011: £549k). Accrued pension under defined benefit pension schemes at the year end was £21k (2011: £15k).

All Non-Executive Directors are appointed and their directors' fees are determined and paid by The Co-operative Group and therefore no amounts are shown above (2011: £nil). Further details of directors' emoluments are included in the remuneration report on pages 20 to 28. The remuneration report is unaudited.

4. Net interest income

	2012	2011
Interest receivable and similar income		
On financial assets not at fair value through income or expense:		
On loans and advances to customers	**1,390.0**	1,482.4
On loans and advances to banks	**31.2**	14.3
On investment securities	**149.8**	210.6
	1,571.0	1,707.3
On financial assets at fair value through income or expense:		
Net interest expense on financial instruments hedging assets	**(133.4)**	(128.1)
Net interest income on financial instruments not in a hedging relationship	**50.7**	4.5
	1,488.3	1,583.7

Included within interest receivable is £17.8m (2011: £9.9m) relating to profit on sale of investment securities – available for sale.

Interest income accrued on impaired financial assets during the year was £48.5m (2011: £55.5m, restated to reflect revision of impairment criteria). Interest due to unwinding of discount on impairment provisions relating to impaired financial assets amounted to £7.1m (2011: £2.4m).

In 2011, the Optimum credit fair value adjustment was revalued resulting in additional income of £20.0m. There was no further revaluation in 2012.

	2012	2011
Interest expense and similar charges		
On financial liabilities not at fair value through income or expense:		
On customer accounts	**506.9**	524.4
On bank and other deposits	**227.9**	230.9
On subordinated liabilities	**77.0**	98.5
On perpetual secured debt	**43.2**	42.0
	855.0	895.8
On financial liabilities at fair value through income or expense:		
Net interest expense on financial instruments hedging liabilities	**33.7**	52.0
Net interest expense on financial instruments not in a hedging relationship	**33.8**	0.9
	922.5	948.7

5. Net fee and commission income

	Before significant items 2012	**Significant items 2012**	**After significant items 2012**	Before significant items 2011	Significant items 2011	After significant items 2011
Fee and commission income						
On items not at fair value through income or expense	**251.0**	**(149.7)**	**101.3**	250.1	(90.0)	160.1
On trust or fiduciary activities that result from holding or investing in assets on behalf of others	**0.2**	**–**	**0.2**	1.1	–	1.1
	251.2	**(149.7)**	**101.5**	251.2	(90.0)	161.2
Fee and commission expense						
On items not at fair value through income or expense	**66.0**	**–**	**66.0**	57.6	–	57.6
On items at fair value through income or expense	**8.0**	**–**	**8.0**	8.4	–	8.4
	74.0	**–**	**74.0**	66.0	–	66.0

The significant item in 2012 of £149.7m (2011: £90.0m) is a provision for customer compensation relating to past sales of PPI in response to the FSA's policy statement published on 10 August 2010. The Bank stopped selling non-mortgage PPI at the beginning of 2009 and stopped selling mortgage PPI in 2012.

The 2011 comparatives reflect a reclassification of £11.6m between fee and commission income – items not at fair value through income or expense and fee and commission expense – items not at fair value through income or expense.

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

6. Net trading income

	2012	2011
Foreign exchange	**5.3**	3.7
Other interest rate instruments	**8.8**	0.8
	14.1	4.5

Foreign exchange net trading income includes gains less losses from spot forward and forward contracts, options, futures and translated foreign currency assets and liabilities.

Other interest rate instruments include the result of transacting in government securities, money market instruments, interest rate and currency swaps, options and other derivatives.

7. Other operating income

	2012	2011
Profit on sale of investment securities – loans and receivables	**15.7**	37.2
Profit on sale of loans and advances to banks	**9.3**	–
Rent receivable from investment properties (note 21)	**8.4**	7.9
Other rent receivable	**–**	1.3
Change in fair value of investment properties (note 21)	**0.2**	(0.1)
Other	**0.3**	–
	33.9	46.3

The profit on sale of investment securities arose from the restructuring of a portfolio of assets. Profit on smaller disposals in the normal course of business are included in net interest income.

8. Operating expenses

	Before significant items 2012	**Significant items 2012**	**After significant items 2012**	Before significant items 2011	Significant items 2011	After significant items 2011
Staff costs (note 9)	**266.5**	**27.9**	**294.4**	294.7	34.8	329.5
Administrative expenses	**267.7**	**207.2**	**474.9**	175.6	18.5	194.1
Depreciation of property, plant and equipment (note 22)	**14.8**	**–**	**14.8**	19.6	–	19.6
Amortisation of intangible fixed assets (note 20)	**6.2**	**–**	**6.2**	6.4	–	6.4
Loss on sale of property, plant and equipment	**0.9**	**–**	**0.9**	0.3	–	0.3
Operating lease rentals	**28.0**	**–**	**28.0**	28.4	–	28.4
Property provisions for liabilities and charges provided in the year (note 32)	**0.8**	**–**	**0.8**	0.4	–	0.4
Property provisions for liabilities and charges released during the year (note 32)	**(0.3)**	**–**	**(0.3)**	(0.3)	–	(0.3)
Other provisions for liabilities and charges provided in the year (note 32)	**0.5**	**–**	**0.5**	0.1	–	0.1
Other provisions for liabilities and charges released during the year (note 32)	**(0.6)**	**–**	**(0.6)**	(0.1)	–	(0.1)
Direct expenses from investment properties that generated rental income in the year	**3.0**	**–**	**3.0**	3.5	–	3.5
Direct expenses from investment properties that did not generate rental income in the year	**0.1**	**–**	**0.1**	0.1	–	0.1
	587.6	**235.1**	**822.7**	528.7	53.3	582.0

The significant items relate to £47.0m (2011: £53.3m) of costs incurred on a programme of investment and integration, £38.1m (2011: £nil) of costs incurred as a result of the bid for the Lloyds Bank branches and £150.0m (2011: £nil) of recharged costs relating to impairment of intangible fixed assets.

No expenditure has been incurred in respect of the Government's Bank Levy since the relevant aggregate liabilities of the Group are below the qualifying threshold.

9. Staff costs

	Before significant items 2012	**Significant items 2012**	**After significant items 2012**	Before significant items 2011	Significant items 2011	After significant items 2011
Wages and salaries	**188.0**	**9.8**	**197.8**	210.8	14.1	224.9
Social security costs	**15.8**	**1.0**	**16.8**	20.9	0.7	21.6
Pension costs:						
Defined benefit plans (note 34)	**0.2**	**–**	**0.2**	0.2	–	0.2
Defined contribution plans (note 34)	**32.6**	**1.1**	**33.7**	29.0	0.8	29.8
Other staff costs	**29.9**	**16.0**	**45.9**	33.8	19.2	53.0
	266.5	**27.9**	**294.4**	294.7	34.8	329.5

The Bank staff costs included above are £239.0m before significant items and £266.8m after significant items (2011: £262.5m before significant items, £297.4m after significant items).

Average number of employees

The average number of persons working for the Group and the Bank during the year is as follows:

	Group No. of employees 2012	No. of employees 2011	**Bank No. of employees 2012**	No. of employees 2011
Full time	**6,082**	6,260	**5,630**	5,751
Part time	**2,025**	2,104	**1,916**	1,988
	8,107	8,364	**7,546**	7,739

Employee activities are undertaken across The Co-operative Banking Group and the figures above reflect the Group and Bank's share of these services.

10. Income tax

	Before significant items 2012	**Significant items 2012**	**After significant items 2012**	Before significant items 2011	Significant items 2011	After significant items 2011
Current tax – current year	**(70.4)**	**(77.0)**	**(147.4)**	(3.4)	(38.0)	(41.4)
Current tax – prior year	**(2.5)**	**–**	**(2.5)**	(6.2)	–	(6.2)
Deferred tax – current year (note 33)	**(8.8)**	**–**	**(8.8)**	61.7	–	61.7
Deferred tax – prior year (note 33)	**(6.9)**	**–**	**(6.9)**	(9.7)	–	(9.7)
	(88.6)	**(77.0)**	**(165.6)**	42.4	(38.0)	4.4

Further information on deferred income tax is presented in note 33. The tax on the Group's (loss)/profit before taxation differs from the theoretical amount that would arise using the corporation tax rate in the UK as follows:

	2012	2011
(Loss)/profit before taxation	**(673.7)**	54.2
Tax calculated at a rate of 24.5% (2011: 26.49%)	**(165.0)**	14.4
Effects of:		
Preference share interest not deductible for tax purposes	**1.4**	1.5
Expenses not deductible for tax purposes	**5.1**	0.1
Depreciation of expenditure not qualifying for capital allowances	**1.2**	1.2
Profits taxed at lower rates	**(0.7)**	(1.2)
Non-taxable income	**(0.4)**	(0.1)
Adjustments to tax charge in respect of prior periods	**(9.4)**	(15.9)
Change in rate of deferred tax (note 33)	**4.5**	4.7
Other differences	**(2.3)**	(0.3)
	(165.6)	4.4

The 2012 adjustments to tax charge in respect of prior periods of £9.4m relates to accelerated capital allowances. In 2011, the adjustment included £13.0m relating to the taxation of a contingent consideration.

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

11. Group profit attributable to equity shareholders dealt with in the accounts of The Co-operative Bank plc

	Before significant items 2012	**Significant items 2012**	**After significant items 2012**	Before significant items 2011	Significant items 2011	After significant items 2011
Net (loss)/profit attributable to equity shareholders of the Bank	**(280.4)**	**(307.8)**	**(588.2)**	11.9	(105.2)	(93.3)

As permitted by Section 408 of the Companies Act 2006, the income statement of The Co-operative Bank plc has not been presented separately.

12. Earnings per share

Basic earnings per share is calculated by dividing the net profit attributable to equity shareholders of the Bank by the weighted average number of ordinary shares in issue during the year.

	Before significant items 2012	**Significant items 2012**	**After significant items 2012**	Before significant items 2011	Significant items 2011	After significant items 2011
Profit attributable to equity shareholders of the Bank	**(201.3)**	**(307.8)**	**(509.1)**	153.3	(105.3)	48.0
Ordinary shares in issue (millions)						
At the beginning and end of the year	**8,200.0**	**8,200.0**	**8,200.0**	8,200.0	8,200.0	8,200.0
Weighted average number of ordinary shares in issue (millions)	**8,200.0**	**8,200.0**	**8,200.0**	8,200.0	8,200.0	8,200.0
Basic earnings per share (expressed in pence per share)	**(2.46)**	**(3.75)**	**(6.21)**	1.87	(1.28)	0.59

13. Cash and balances at central banks

	Group		**Bank**	
	2012	2011	**2012**	2011
Cash in hand	**272.6**	280.3	**272.6**	280.3
Balances with the Bank of England other than mandatory reserve deposits	**5,121.0**	6,378.3	**5,121.0**	6,378.3
Included in cash and cash equivalents	**5,393.6**	6,658.6	**5,393.6**	6,658.6
Mandatory reserve deposits with the Bank of England	**39.4**	38.0	**39.4**	38.0
	5,433.0	6,696.6	**5,433.0**	6,696.6

Mandatory reserve deposits are not available for use in the Group and Bank's day to day operations, are non-interest bearing and are not included in cash and cash equivalents.

14. Loans and advances to banks

	Group		**Bank**	
	2012	2011	**2012**	2011
Items in course of collection from other banks	**103.9**	123.2	**103.9**	123.2
Placements with other banks	**746.7**	896.6	**731.9**	885.1
Included in cash and cash equivalents	**850.6**	1,019.8	**835.8**	1,008.3
Other loans and advances to banks	**1,053.5**	986.7	**211.4**	291.8
	1,904.1	2,006.5	**1,047.2**	1,300.1

15. Loans and advances to customers

	Group		**Bank**	
	2012	2011	**2012**	2011
Gross loans and advances	**33,982.5**	34,058.0	**23,203.7**	22,993.1
Less: allowance for losses	**(643.0)**	(292.0)	**(418.2)**	(258.1)
	33,339.5	33,766.0	**22,785.5**	22,735.0

Group and Bank loans and advances to customers include £153.6m (2011: £114.1m) of financial assets at fair value through income or expense designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency. Of these, £48.7m (2011: £36.7m) are secured by real estate collateral.

15. Loans and advances to customers continued

Loans and advances to customers include £10,997.3m (2011: £9,099.8m) securitised under the Group's securitisation and covered bond programmes. The Group remains exposed to substantially all of the risks and rewards of ownership of these assets. Included within Group deposits by banks (note 25) are £58.4m (2011: £61.9m) of loans from external third parties and within Group debt securities in issue (note 28) are £4,144.5m (2011: £3,989.4m) of fixed and floating rate notes, all secured on these mortgage assets. Included within amounts owed by other Co-operative Group undertakings in the Bank are £6,297.3m (2011: £4,749.5m) of floating rate notes issued to the Bank and £1,014.7m (2011: £1,000.3m) of other loans, secured on these mortgage assets.

Concentration of exposure

The Group's exposure is virtually all within the UK. There is a detailed analysis of the concentration of exposure within the risk management disclosures, on pages 65 and 66.

Allowance for losses on loans and advances

Group	Individual retail	Individual corporate	Collective retail	Collective corporate	Total
2012					
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**
2011					
At the beginning of the year	8.6	55.8	157.8	0.4	222.6
Charge against profits	4.9	76.6	36.4	12.6	130.5
Amounts written off	(4.5)	(27.1)	(26.6)	(0.8)	(59.0)
Unwind of discount allowance	–	(0.5)	(1.9)	–	(2.4)
Interest charged on impaired loans	–	0.3	–	–	0.3
At the end of the year	9.0	105.1	165.7	12.2	292.0

Bank	Individual retail	Individual corporate	Collective retail	Collective corporate	Total
2012					
At the beginning of the year	**2.6**	**86.1**	**163.7**	**5.7**	**258.1**
Charge against profits	**1.0**	**171.4**	**42.3**	**9.3**	**224.0**
Amounts written off	**(1.1)**	**(25.9)**	**(29.3)**	**(1.4)**	**(57.7)**
Unwind of discount allowance	**–**	**(2.9)**	**(3.4)**	**–**	**(6.3)**
Interest charged on impaired loans	**–**	**0.1**	**–**	**–**	**0.1**
At the end of the year	**2.5**	**228.8**	**173.3**	**13.6**	**418.2**
2011					
At the beginning of the year	2.9	49.4	157.8	0.4	210.5
Charge against profits	0.5	62.4	34.4	6.1	103.4
Amounts written off	(0.8)	(25.6)	(26.6)	(0.8)	(53.8)
Unwind of discount allowance	–	(0.4)	(1.9)	–	(2.3)
Interest charged on impaired loans	–	0.3	–	–	0.3
At the end of the year	2.6	86.1	163.7	5.7	258.1

The net impairment charge in the Group income statement is £474.1m (2011: £120.5m). This includes amounts recovered by the Group of £6.1m (2011: £10.0m) against amounts previously written off. The recoveries have been made from the mortgagors, from other parties involved in the origination or acquisition of the mortgages and from the sale of written off debt.

The impairment charge also includes a provision of £37.0m (2011: £nil) made against fair value adjustments for hedged risk during the year (as shown in the fair value adjustments for hedged risk tables).

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

15. Loans and advances to customers continued

Loans and advances to customers include finance lease receivables:

	Group		Bank	
	2012	2011	**2012**	2011
Gross investment in finance leases may be analysed as follows:				
No later than one year	**22.2**	26.1	**16.2**	20.2
Later than one year and no later than five years	**68.6**	62.8	**43.6**	41.9
Later than five years	**73.4**	82.2	**66.7**	65.6
	164.2	171.1	**126.5**	127.7
Unearned future finance income on finance leases	**(44.1)**	(47.7)	**(34.7)**	(35.4)
Net investment in finance leases	**120.1**	123.4	**91.8**	92.3
The net investment in finance leases may be analysed as follows:				
No later than one year	**15.5**	19.1	**11.7**	15.6
Later than one year and no later than five years	**47.9**	40.9	**29.0**	27.5
Later than five years	**56.7**	63.4	**51.1**	49.2
	120.1	123.4	**91.8**	92.3

There are no unguaranteed residual values for any of the finance leases.

The Group enters into finance lease and hire purchase arrangements with customers in a wide range of sectors including transport, retail and utilities. The accumulated allowance for uncollectible minimum lease payments receivable is £nil (2011: £0.1m).

Fair value adjustments for hedged risk

The Group has entered into interest rate swaps that protect it from changes in interest rates on the floating rate liabilities that fund its portfolio of fixed rate mortgages. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed rate mortgages.

	Group		Bank	
	2012	2011	**2012**	2011
Gross fair value adjustments for hedged risk	**391.2**	366.3	**391.1**	365.8
Less: impairment provision	**(37.0)**	–	**(37.0)**	–
	354.2	366.3	**354.1**	365.8

Movements on impairment provision on fair value adjustments for hedged risk are shown below:

	Group		Bank	
	2012	2011	**2012**	2011
At the beginning of the year	**–**	–	**–**	–
Charge against profits	**37.0**	–	**37.0**	–
At the end of the year	**37.0**	–	**37.0**	–

16. Investment securities

Loans and receivables

	Group		Bank	
	2012	2011	**2012**	2011
Loans and receivables				
Listed	**–**	113.5	**–**	113.5
Unlisted	**295.0**	694.1	**355.4**	755.3
	295.0	807.6	**355.4**	868.8
Less: allowance for losses	**–**	(2.7)	**–**	(2.7)
	295.0	804.9	**355.4**	866.1
Included in cash and cash equivalents	**–**	–	**–**	–

The movement in investment securities – loans and receivables excluding interest amounts is summarised as follows:

	Group		Bank	
	2012	2011	**2012**	2011
At the beginning of the year	**803.3**	1,914.7	**864.5**	1,984.2
Acquisitions	**–**	107.5	**–**	107.5
Disposals and maturities	**(582.0)**	(1,426.6)	**(587.9)**	(1,430.2)
Exchange adjustments	**(2.8)**	1.6	**(2.8)**	1.6
Fair value movements through income or expense	**–**	–	**–**	(0.3)
Amortisation	**73.5**	195.8	**78.6**	191.4
Release and utilisation of impairment provision	**2.7**	10.3	**2.7**	10.3
At the end of the year	**294.7**	803.3	**355.1**	864.5

Impairment analysis of investment securities – loans and receivables

	Group		Bank	
	2012	2011	**2012**	2011
At the beginning of the year	**2.7**	13.0	**2.7**	13.0
Released during the year	**(2.7)**	(5.6)	**(2.7)**	(5.6)
Utilised during the year	**–**	(4.7)	**–**	(4.7)
At the end of the year	**–**	2.7	**–**	2.7

Available for sale

	Group		Bank	
	2012	2011	**2012**	2011
Available for sale				
Listed	**3,552.3**	3,098.6	**3,552.3**	3,098.6
Unlisted	**276.1**	366.9	**50.6**	51.3
	3,828.4	3,465.5	**3,602.9**	3,149.9
Less: allowance for losses	**(39.0)**	(42.5)	**(39.0)**	(42.5)
	3,789.4	3,423.0	**3,563.9**	3,107.4
Included in cash and cash equivalents	**70.0**	210.0	**–**	–

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

16. Investment securities continued

The movement in investment securities – available for sale excluding interest amounts is summarised as follows:

	Group		Bank	
	2012	2011	**2012**	2011
At the beginning of the year	**3,405.5**	2,948.1	**3,090.5**	2,613.0
Acquisitions	**3,962.8**	8,328.8	**2,617.8**	6,888.9
Disposals and maturities	**(3,608.2)**	(8,122.7)	**(2,173.1)**	(6,662.7)
Exchange adjustments	**(8.1)**	(12.7)	**(8.1)**	(12.7)
Fair value movements through equity	**108.7**	101.6	**108.7**	101.6
Fair value movements through income or expense	**(68.2)**	124.9	**(68.2)**	124.9
Amortisation	**(19.7)**	7.9	**(19.7)**	7.9
Release and utilisation of impairment provision	**2.7**	29.6	**2.7**	29.6
At the end of the year	**3,775.5**	3,405.5	**3,550.6**	3,090.5

The 2011 movement in investment securities – available for sale, for the Group and Bank, have been updated to reflect a reclassification of amortisation.

Impairment analysis of investment securities – available for sale

	Group		Bank	
	2012	2011	**2012**	2011
At the beginning of the year	**42.5**	72.3	**42.5**	72.3
Released during the year	**(2.7)**	–	**(2.7)**	–
Utilised during the year	**–**	(29.6)	**–**	(29.6)
Exchange adjustments	**(0.8)**	(0.2)	**(0.8)**	(0.2)
At the end of the year	**39.0**	42.5	**39.0**	42.5

Fair value through income or expense

	Group		Bank	
	2012	2011	**2012**	2011
Fair value through income or expense				
Listed	**1,845.2**	343.1	**1,845.2**	343.1
	1,845.2	343.1	**1,845.2**	343.1
Less: allowance for losses	**–**	–	**–**	–
	1,845.2	343.1	**1,845.2**	343.1
Included in cash and cash equivalents	**–**	–	**–**	–

The movement in investment securities – fair value through income or expense excluding interest amounts is summarised as follows:

	Group		Bank	
	2012	2011	**2012**	2011
At the beginning of the year	**339.5**	26.5	**339.5**	26.5
Acquisitions	**1,895.5**	339.0	**1,895.5**	339.0
Disposals and maturities	**(410.8)**	(25.0)	**(410.8)**	(25.0)
Exchange adjustments	**(0.1)**	–	**(0.1)**	–
Fair value movements through income or expense	**6.5**	(1.0)	**6.5**	(1.0)
At the end of the year	**1,830.6**	339.5	**1,830.6**	339.5

The 2011 movement in investment securities – fair value through income or expense, for the Group and Bank, have been updated to reflect a reclassification of amortisation.

16. Investment securities continued

Held for trading

	Group		Bank	
	2012	2011	**2012**	2011
Held for trading				
Listed	**960.2**	–	**960.2**	–
	960.2	–	**960.2**	–
Less: allowance for losses	**–**	–	**–**	–
	960.2	–	**960.2**	–
Included in cash and cash equivalents	**–**	–	**–**	–

The movement in investment securities – held for trading excluding interest amounts may be summarised as follows:

	Group		Bank	
	2012	2011	**2012**	2011
At the beginning of the year	**–**	–	**–**	–
Acquisitions	**1,268.8**	280.0	**1,268.8**	280.0
Disposals and maturities	**(321.6)**	(280.0)	**(321.6)**	(280.0)
Fair value movements through income or expense	**7.1**	–	**7.1**	–
At the end of the year	**954.3**	–	**954.3**	–

Analysis of investment securities by issuer

	Group		Bank	
	2012	2011	**2012**	2011
Investment securities issued by public bodies:				
Government securities	**2,184.9**	1,834.5	**2,184.9**	1,834.5
Other public sector securities	**2,208.5**	563.6	**2,208.5**	563.6
	4,393.4	2,398.1	**4,393.4**	2,398.1
Investment securities issued by other issuers:				
Bank and building society certificates of deposits	**225.5**	315.7	**–**	–
Other debt securities:				
Other floating rate notes	**1,975.9**	1,165.9	**1,975.9**	1,165.9
Mortgage backed securities	**295.0**	691.3	**355.4**	752.6
	2,270.9	1,857.2	**2,331.3**	1,918.5
	6,889.8	4,571.0	**6,724.7**	4,316.6

Other floating rate notes (FRNs) relate to sterling, euro and US dollar denominated FRNs with maturities ranging from one month to 12 years from the balance sheet date.

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

17. Derivative financial instruments

The Bank, as principal, has entered into various derivatives either as a trading activity, which includes proprietary transactions and customer facilitation, or as a hedging activity for the management of interest rate risk, equity risk and foreign exchange rate risk. Positive and negative fair values have not been netted as the Group does not have a legal right of offset.

Derivatives held for trading purposes

Trading transactions are wholly interest rate related contracts including swaps, caps and floors, forward rate agreements and exchange traded futures. Trading transactions include derivatives where the Bank enters into a transaction to accommodate a customer together with the corresponding hedge transaction.

Non-trading derivatives

Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions of the Group. Derivatives used to manage interest rate related positions include swaps, caps and floors, forward rate agreements and exchange traded futures. The foreign exchange rate positions are managed using forward currency transactions and swaps. Equity risk is managed using equity swaps.

During the year the Bank has entered into fair value hedges to mitigate price movements due to interest rate sensitivities.

	Group		Bank	
	Fair value		Fair value	
	Assets	Liabilities	Assets	Liabilities
2012				
Derivatives held for trading purposes				
Interest rate derivatives:				
Interest rate swaps	**195.9**	**(167.2)**	**197.4**	**(168.6)**
Over The Counter (OTC) interest rate options	**1.4**	**(1.1)**	**1.4**	**(1.1)**
Total derivative assets/(liabilities) held for trading purposes	**197.3**	**(168.3)**	**198.8**	**(169.7)**
Derivatives held for non-trading purposes				
Derivatives designated as cashflow hedges:				
Interest rate swaps	**120.1**	**(52.3)**	**120.1**	**(52.2)**
Derivatives designated as fair value hedges:				
Interest rate swaps	**110.7**	**(587.0)**	**110.7**	**(586.0)**
Cross currency interest rate swaps	**–**	**(42.6)**	**–**	**(42.6)**
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	**44.8**	**(62.9)**	**10.0**	**(54.2)**
Embedded derivatives – options	**60.6**	**(0.1)**	**60.6**	**(0.1)**
Forward currency transactions	**222.3**	**(51.4)**	**28.7**	**(14.8)**
OTC interest rate options	**–**	**(2.8)**	**–**	**(2.8)**
Equity swaps	**63.0**	**(0.2)**	**62.0**	**(0.2)**
Total derivative assets/(liabilities) held for non-trading purposes	**621.5**	**(799.3)**	**392.1**	**(752.9)**
Total recognised derivative assets/(liabilities)	**818.8**	**(967.6)**	**590.9**	**(922.6)**

17. Derivative financial instruments continued

	Group Fair value		Bank Fair value	
	Assets	Liabilities	Assets	Liabilities
2011				
Derivatives held for trading purposes				
Interest rate derivatives:				
Interest rate swaps	162.0	(141.8)	164.7	(144.3)
Over The Counter (OTC) interest rate options	1.7	(1.7)	1.7	(1.7)
Total derivative assets/(liabilities) held for trading purposes	163.7	(143.5)	166.4	(146.0)
Derivatives held for non-trading purposes				
Derivatives designated as cashflow hedges:				
Interest rate swaps	218.5	(106.2)	218.4	(106.3)
Derivatives designated as fair value hedges:				
Interest rate swaps	137.3	(670.5)	120.1	(666.3)
Cross currency interest rate swaps	0.1	(60.7)	0.1	(60.7)
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	13.7	(50.6)	12.1	(51.0)
Embedded derivatives – options	28.6	(0.4)	28.6	(0.4)
Forward currency transactions	300.9	(52.1)	46.9	(16.9)
OTC interest rate options	–	(3.5)	–	(3.5)
Equity swaps	113.0	(0.4)	111.8	(0.4)
Total derivative assets/(liabilities) held for non-trading purposes	812.1	(944.4)	538.0	(905.5)
Total recognised derivative assets/(liabilities)	975.8	(1,087.9)	704.4	(1,051.5)

The derivatives designated as cashflow hedges are interest rate swaps used to hedge interest rate risk in the Bank's retail operations. Cash flows are hedged by quarterly time periods for durations up to ten years. During the year there were no forecast transactions for which hedge accounting had previously been used but are no longer expected to occur.

The number of non-margin exchange traded contracts held by the Bank as at 31 December 2012 was nil (2011: nil).

In line with industry standards, credit valuation adjustments (CVAs) are applied to non-collateralised swaps representing the fair value measurement of counterparty risk. This is a conservative approach to valuation and reduces the fair value of derivative assets. The credit adjustment across the portfolio was £2.8m as at the end of 2012. We do not apply CVA for derivatives that are fully cash collateralised.

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

18. Equity shares

	Group and Bank	
	2012	2011
Investment securities – unlisted	**5.7**	5.7
Included above are the following trade investments:		
Vocalink Limited – 4,416,165 ordinary shares of £1 each (2011: 4,416,165)	**5.6**	5.6

Equity shares are classified as available for sale.

19. Goodwill

	Group and Bank	
	2012	2011
Net book amount		
At the beginning of the year	**0.6**	0.6
Impairment charge	**(0.6)**	–
At the end of the year	**–**	0.6

The Bank's goodwill was recognised in 2009 and related to the transfer of engagements of Britannia Building Society.

Each year the Group tests the asset for impairment by comparing its recoverable amount, determined in accordance with IAS 36, with its carrying amount. The directors have concluded that the carrying value should be written down to nil. The amount has been charged to operating expenses.

20. Intangible fixed assets

	Group 2012			Group 2011		
	Internally generated intangible assets	**Other intangible assets**	**Total**	Internally generated intangible assets	Other intangible assets	Total
Cost						
At the beginning of the year	**13.5**	**46.0**	**59.5**	13.9	46.0	59.9
Additions	**0.4**	**–**	**0.4**	2.0	–	2.0
Disposals	**(2.3)**	**–**	**(2.3)**	(2.4)	–	(2.4)
At the end of the year	**11.6**	**46.0**	**57.6**	13.5	46.0	59.5
Accumulated amortisation						
At the beginning of the year	**8.0**	**10.8**	**18.8**	8.5	6.3	14.8
Charge for the year	**1.5**	**4.7**	**6.2**	1.9	4.5	6.4
Disposals	**(2.3)**	**–**	**(2.3)**	(2.4)	–	(2.4)
At the end of the year	**7.2**	**15.5**	**22.7**	8.0	10.8	18.8
Net book value						
At the end of the year	**4.4**	**30.5**	**34.9**	5.5	35.2	40.7
At the beginning of the year	5.5	35.2	40.7	5.4	39.7	45.1

20. Intangible fixed assets continued

	Bank 2012			Bank 2011		
	Internally generated intangible assets	**Other intangible assets**	**Total**	Internally generated intangible assets	Other intangible assets	Total
Cost						
At the beginning of the year	**12.1**	**46.0**	**58.1**	13.1	46.0	59.1
Additions	**0.2**	**–**	**0.2**	1.4	–	1.4
Disposals	**(2.3)**	**–**	**(2.3)**	(2.4)	–	(2.4)
At the end of the year	**10.0**	**46.0**	**56.0**	12.1	46.0	58.1
Accumulated amortisation						
At the beginning of the year	**8.0**	**10.8**	**18.8**	9.0	6.3	15.3
Charge for the year	**1.0**	**4.7**	**5.7**	1.4	4.5	5.9
Disposals	**(2.3)**	**–**	**(2.3)**	(2.4)	–	(2.4)
At the end of the year	**6.7**	**15.5**	**22.2**	8.0	10.8	18.8
Net book value						
At the end of the year	**3.3**	**30.5**	**33.8**	4.1	35.2	39.3
At the beginning of the year	4.1	35.2	39.3	4.1	39.7	43.8

Internally generated intangible assets consist of software development costs.

Other intangible assets consist of a core deposit intangible of £44.0m and a brand intangible of £2.0m. The brand intangible has an indefinite useful life and is not amortised but is subject to an annual impairment review. On the basis of this review the brand is considered to be unimpaired.

21. Investment properties

	Group		Bank	
	2012	2011	**2012**	2011
Fair value				
At the beginning of the year	**172.7**	162.3	**–**	–
Additions – acquisitions	**–**	9.2	**–**	–
Additions – other expenditure	**1.0**	2.1	**0.9**	–
Disposals	**(0.9)**	(0.8)	**–**	–
Changes in fair value (note 7)	**0.2**	(0.1)	**0.9**	–
At the end of the year	**173.0**	172.7	**1.8**	–

During the year £0.9m of properties, previously carried at historical cost, were transferred to investment properties from other assets. The carrying value of these properties has been assessed for fair value resulting in a £0.9m gain in the year.

All investment properties are held to generate rental income until such time that the Group considers it appropriate to realise its investment. Investment properties are carried at fair value.

The range of yields applied to the net annual rental income to determine the fair value of property is 3% to 8%.

The Group lets investment properties on assured shorthold tenancy agreements, most of which are for contract periods of no more than 12 months. The future minimum lease receipts under non-cancellable operating leases are £1.1m (2011: £3.0m). The Group has not recognised any contingent rent in the year (2011: £nil). None of the lease agreements are individually significant.

Included in Group other operating income for the year is £8.4m (2011: £7.9m) of rental income relating to investment properties (note 7).

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

22. Property, plant and equipment

2012 Group	**Land and buildings**	**Leasehold improvements**	**Computers and other equipment**	**Total**
Cost				
At the beginning of the year	**55.7**	**25.0**	**115.3**	**196.0**
Additions	**–**	**–**	**0.5**	**0.5**
Disposals	**(0.3)**	**(0.1)**	**(12.9)**	**(13.3)**
At the end of the year	**55.4**	**24.9**	**102.9**	**183.2**
Accumulated depreciation				
At the beginning of the year	**6.6**	**13.4**	**95.9**	**115.9**
Charge for the year	**1.2**	**5.0**	**8.6**	**14.8**
Disposals	**–**	**(0.1)**	**(11.5)**	**(11.6)**
At the end of the year	**7.8**	**18.3**	**93.0**	**119.1**
Net book value				
At the end of the year	**47.6**	**6.6**	**9.9**	**64.1**
At the beginning of the year	49.1	11.6	19.4	80.1

2011 Group	Land and buildings	Leasehold improvements	Computers and other equipment	Total
Cost				
At the beginning of the year	55.7	24.9	125.1	205.7
Additions	–	0.1	1.4	1.5
Disposals	–	–	(11.2)	(11.2)
At the end of the year	55.7	25.0	115.3	196.0
Accumulated depreciation				
At the beginning of the year	5.4	8.0	93.8	107.2
Charge for the year	1.2	5.4	13.0	19.6
Disposals	–	–	(10.9)	(10.9)
At the end of the year	6.6	13.4	95.9	115.9
Net book value				
At the end of the year	49.1	11.6	19.4	80.1
At the beginning of the year	50.3	16.9	31.3	98.5

22. Property, plant and equipment continued

2012 Bank	**Land and buildings**	**Leasehold improvements**	**Computers and other equipment**	**Total**
Cost				
At the beginning of the year	**34.8**	**24.9**	**111.1**	**170.8**
Additions	**–**	**–**	**0.1**	**0.1**
Disposals	**(0.3)**	**(0.1)**	**(12.8)**	**(13.2)**
At the end of the year	**34.5**	**24.8**	**98.4**	**157.7**
Accumulated depreciation				
At the beginning of the year	**3.0**	**13.3**	**93.0**	**109.3**
Charge for the year	**0.8**	**5.0**	**8.0**	**13.8**
Disposals	**–**	**(0.1)**	**(11.5)**	**(11.6)**
At the end of the year	**3.8**	**18.2**	**89.5**	**111.5**
Net book value				
At the end of the year	**30.7**	**6.6**	**8.9**	**46.2**
At the beginning of the year	31.8	11.6	18.1	61.5

2011 Bank	Land and buildings	Leasehold improvements	Computers and other equipment	Total
Cost				
At the beginning of the year	34.8	24.8	121.0	180.6
Additions	–	0.1	0.9	1.0
Disposals	–	–	(10.8)	(10.8)
At the end of the year	34.8	24.9	111.1	170.8
Accumulated depreciation				
At the beginning of the year	2.2	7.9	91.4	101.5
Charge for the year	0.8	5.4	12.2	18.4
Disposals	–	–	(10.6)	(10.6)
At the end of the year	3.0	13.3	93.0	109.3
Net book value				
At the end of the year	31.8	11.6	18.1	61.5
At the beginning of the year	32.6	16.9	29.6	79.1

	Group		**Bank**	
	2012	2011	**2012**	2011
The net book value of land and buildings comprises:				
Freehold	**47.1**	48.6	**30.2**	31.3
Leasehold	**0.5**	0.5	**0.5**	0.5
	47.6	49.1	**30.7**	31.8

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

23. Other assets

	Group		Bank	
	2012	2011	**2012**	2011
Amounts recoverable within one year:				
Trade debtors	**59.9**	23.2	**59.9**	23.2
Other assets	**10.4**	9.8	**7.4**	6.1
	70.3	33.0	**67.3**	29.3

24. Prepayments and accrued income

	Group		Bank	
	2012	2011	**2012**	2011
Amounts recoverable within one year:				
Other	**14.9**	18.7	**14.0**	17.7

25. Deposits by banks

	Group		Bank	
	2012	2011	**2012**	2011
Items in course of collection	**49.1**	48.7	**49.1**	48.7
Deposits from other banks	**3,562.9**	3,254.0	**3,503.8**	3,191.1
	3,612.0	3,302.7	**3,552.9**	3,239.8

Included within deposits from other banks are liabilities of £1,880.6m (2011: £1,703.2m) secured on investment securities with a carrying value of £1,983.6m (2011: £2,114.4m) which have been sold under sale and repurchase agreements (note 39).

26. Customer accounts

	Group		Bank	
	2012	2011	**2012**	2011
Customer accounts	**35,884.4**	34,990.6	**33,750.3**	32,670.1

The Group has entered into interest rate swaps that protect it from changes in interest rates on the floating rate assets that are funded by its fixed rate customer accounts. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed rate customer accounts. Included within customer accounts are 'fair value hedged' fixed rate accounts with a total nominal value of £nil (2011: £3.0m) against which there are fair value adjustments for hedged risk of £nil (2011: £(0.4)m), giving a total carrying value of £nil (2011: £2.6m).

27. Customer accounts – capital bonds

	Group		Bank	
	2012	2011	**2012**	2011
Customer accounts – capital bonds	**888.1**	1,429.8	**867.2**	1,397.3

Capital bonds are fixed term customer accounts with returns based on the movement in an index (eg FTSE100) over the term of the bond.

The capital bonds have been designated on initial recognition at fair value through income and expense and are carried at fair value.

The fair values for the capital bonds are obtained on a monthly basis from the swap counterparties. These external valuations are reviewed independently using valuation software to ensure the fair values are priced on a consistent basis.

None of the change in the fair value of the capital bonds is attributable to changes in the liability's credit risk.

The maximum amount the Group would contractually be required to pay at maturity for all the capital bonds is £888.7m (2011: £1,429.6m).

The Group uses swaps to create economic hedges against all of its capital bonds. The gain on capital bonds in the income statement for the year is £33.0m (2011: £24.8m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the year is a gain of £0.1m (2011: £0.6m).

28. Debt securities in issue

	Group		Bank	
	2012	2011	**2012**	2011
Certificates of deposit	**157.8**	252.1	**157.8**	252.1
Commercial paper	**8.2**	–	**8.2**	–
Fixed and floating rate notes	**4,547.7**	3,912.7	**1,586.2**	1,178.9
	4,713.7	4,164.8	**1,752.2**	1,431.0

The Group has entered into cross currency interest rate swaps that protect it from changes in exchange rates and interest rates on its debt securities in issue. Changes in the fair values of these swaps are largely offset by changes in the sterling equivalent carrying value of the debt securities in issue.

Debt securities in issue include fixed and floating rate notes, the majority of which are secured on portfolios of variable and fixed rate mortgages. The notes are redeemable in part from time to time, such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets. There is no requirement for the Group to make good any shortfall out of general funds. The maturity date of the notes matches the maturity date of the underlying assets.

29. Other borrowed funds

	Group and Bank	
	2012	2011
Step up callable subordinated notes 2019	**37.8**	150.0
60,000,000 9.25% non-cumulative irredeemable preference shares of £1 each	**60.0**	60.0
Floating rate subordinated notes 2016	**21.7**	20.6
5.625% fixed rate subordinated notes 2021	**8.7**	150.0
9.25% fixed rate subordinated notes 2021	**275.0**	275.0
7.875% fixed rate subordinated notes 2022	**235.4**	–
Fixed rate subordinated notes 2024	**173.7**	167.1
Fixed rate subordinated notes 2033	**125.4**	122.2
Perpetual subordinated bonds	**292.1**	282.9
Issue costs, discounts and accrued interest	**28.8**	31.0
	1,258.6	1,258.8

Step up callable subordinated notes 2019

The notes were issued on 1 April 2004 at a discount of 0.946%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an interest rate of 5.875% per annum to (but excluding) 2 April 2014, and thereafter the interest rate will be determined by reference to the gross redemption yield on the five year benchmark gilt, and a margin of 2.25%. Interest is payable annually in arrears on 2 April.

The Bank may redeem all, but not less than all, of the notes at their principal amount on 2 April 2014.

On 19 December 2012 the Bank invited investors to exchange their holdings in the above instrument for a new subordinated note, which resulted in the redemption of £112.2m of the notes (representing 74.8% of the amount outstanding), leaving £37.8m outstanding.

60,000,000 9.25% non-cumulative irredeemable preference shares of £1 each

The preference shares carry the right to a fixed non-cumulative preferential dividend on the capital for the time being paid up, at the rate of 9.25% per annum exclusive of any associated tax credit. The dividends are payable on 31 May and 30 November each year and take priority over dividends to any other class of share in the capital of the Bank.

On a return of capital on winding up, the assets of the Bank shall be applied in repaying the preference share capital in priority to any payments to the holders of any other class of shares in the capital of the Bank. The amount receivable by the holders of the preference shares shall be the greater of the capital paid up or the average quoted price during the three months immediately preceding the date of the notice convening the meeting to consider the resolution to wind up.

The holders of the preference shares shall have the right to vote at a general meeting of the Bank only if and when, at the date of the notice convening the meeting, the dividend due to them has been in arrears for six months or more or if a resolution is to be proposed at the meeting abrogating or varying their rights or privileges or for the winding up of the Bank or other return of capital and then only on that resolution.

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

29. Other borrowed funds continued

Floating rate subordinated notes 2016

The notes were issued on 18 May 2006 at a discount of 0.14%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes are denominated in euros and interest is calculated at three months EURIBOR plus a margin of 0.28%. From 18 May 2011 interest has been calculated at three months EURIBOR plus a margin of 0.78%. The first interest coupon was paid in August 2006.

The notes were hedged with a cross currency swap converting the exposure into sterling which paid a floating rate of three months LIBOR with a margin on interest coupon of 0.34125% and received a floating rate of three months EURIBOR plus a margin on interest coupon of 0.28%. The cross currency swap matured on 18 May 2011.

On 28 April 2011 the Bank redeemed €149.2m of the notes (representing 81% of the amount outstanding) leaving €34.9m outstanding. The Bank had the option to call the outstanding notes in whole but not in part on the interest payment date falling on or nearest to May 2011, and now at any interest payment date thereafter subject to prior consent of the Financial Services Authority.

5.625% fixed rate subordinated notes 2021

The notes were issued on 16 November 2006 at a discount of 0.189%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.625% up to and including the interest payment date on 16 November 2016, when the interest basis changes to floating rate. During the fixed rate period, interest is payable semi-annually in arrears on 16 May and 16 November.

From 17 November 2016, the notes carry a floating interest rate of three months LIBOR plus a margin of 1.75%. Interest is payable quarterly in arrears on 16 February, 16 May, 16 August and 16 November, commencing on the interest payment date falling in February 2017 up to and including the maturity date.

The Bank may redeem all, but not less than all, of the notes at the principal amount on 16 November 2016, and on any quarterly interest payment date thereafter.

On 19 December 2012 the Bank invited investors to exchange their holdings in the above instrument for a new subordinated note, which resulted in the redemption of £141.3m of the notes (representing 94.2% of the amount outstanding) leaving £8.7m outstanding.

9.25% fixed rate subordinated notes 2021

On 28 April 2011 the Bank issued £275.0m fixed rate subordinated notes due 2021, issued at par.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 9.25% up to (but excluding) 28 April 2021. Interest is payable annually in April.

There is no option to redeem the notes early.

7.875% fixed rate subordinated notes 2022

On 19 December 2012 the Bank issued £235.4m fixed rate subordinated notes due 2022, issued at par.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 7.875% up to 18 December 2022. Interest is payable annually in arrears in December.

There is no option to redeem the notes early.

29. Other borrowed funds continued

Fixed rate subordinated notes 2024
The notes were issued on 17 March 2004 at a discount of 1.148%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.75% to 2 December 2019 (reset date). During this period the notes are hedged with interest rate swaps that convert the interest rate payable into floating rates at six months LIBOR plus a margin of 0.72%. The fixed receipt leg of the swap is received annually to match the payment to the noteholders. The floating payment leg of the swap is payable semi-annually in June and December. The interest rate swaps mature on 2 December 2019.

From the reset date the interest rate will be calculated based on the Five Year Benchmark Gilt rate plus a margin of 1.94%. The Five Year Benchmark Gilt rate being the Gross Redemption Yield determined by the UK government security having a maturity date falling on or nearest the fifth anniversary of the determination date (the determination date being two days prior to the reset date), converted to an annualised yield. The Gross Redemption Yield being calculated on the basis set out by the UK Debt Management Office in the publication 'Formulae for Calculating Gilt Prices from Yields'. From the reset date the interest will be paid annually in arrears until maturity or redemption.

The notes are callable in whole but not in part, at the principal amount, on 2 December 2019, subject to the prior consent of the Financial Services Authority.

Fixed rate subordinated notes 2033
The notes were issued on 28 March 2002 at a discount of 0.93%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.875% to maturity. Interest is payable semi-annually in March and September.

Of the notes, £100m are hedged with interest rate swaps that have a floating payment leg at six months LIBOR payable in March and September. The fixed interest rate receivable legs on the swaps are £25m at 5.405% and £75m at 5.225%. The semi-annual interest receivable leg on the swap is matched to the dates on the notes.

Perpetual subordinated bonds
Perpetual subordinated bonds (PSBs) with a par value of £110m were issued in 1992 at a discount of 0%. PSBs with a par value of £200m were issued in 2005 at a discount of 0%.

Both the £110m and £200m PSBs are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of the bondholders will be subordinated in right of payment of all creditors (including subordinated creditors) of the Bank.

The PSBs with a par value of £110m carry an annual interest rate of 13%. Interest is payable semi-annually in January and July.

The PSBs with a par value of £200m carry an annual interest rate of 5.5555% up until the reset date. This coupon is payable semi-annually in June and December. From the reset date of 14 December 2015 the interest rate will be amended to the rate for three month deposits in sterling plus a margin of 2.05% per annum. The interest payments will then be made quarterly in arrears in March, June, September and December, with the interest resetting at each interest payment date.

During the period up until the reset date the PSBs are hedged with an interest rate swap that converts the interest rate payable into floating rates at six months LIBOR plus a margin of 1.175%. The semi-annual interest receivable and payable on the swap is aligned to the interest payment dates of the notes. The interest rate swap matures on 14 December 2015.

Given prior relevant supervisory consent, the Bank may elect to repay all, but not less than all, of these PSBs on 14 December 2015 or on any interest payment date thereafter at their principal amount.

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

30. Other liabilities

	Group		Bank	
	2012	2011	**2012**	2011
Amounts falling due within one year:				
ATM creditor	**61.5**	122.4	**61.5**	122.4
Other creditors	**37.7**	46.5	**33.5**	42.2
Amounts falling due after one year:				
Other creditors	**4.8**	4.8	**4.5**	4.5
	104.0	173.7	**99.5**	169.1

Other creditors of the Group and Bank include finance lease obligations as follows:

	Present value of lease payments		Future minimum lease payments	
	2012	2011	**2012**	2011
Due within one year	**–**	–	**–**	–
Due between one year and five years	**0.1**	0.1	**0.1**	0.1
Due after five years	**1.2**	1.0	**1.6**	1.7
	1.3	1.1	**1.7**	1.8

The future minimum lease payments have been discounted at LIBOR over the term of the lease to give the present value of these payments.

31. Accruals and deferred income

	Group		Bank	
	2012	2011	**2012**	2011
Amounts falling due within one year:				
Other	**19.5**	34.6	**15.0**	27.9
Amounts falling due after one year:				
Other	**0.6**	5.3	**0.5**	5.2
	20.1	39.9	**15.5**	33.1

32. Provisions for liabilities and charges

2012 Group	**Property**	**FSCS levies**	**PPI**	**Other**	**Total**
At the beginning of the year	**6.9**	**25.0**	**61.7**	**8.4**	**102.0**
Income statement movements:					
Provided in the year – operating expense	**0.8**	**24.8**	**–**	**0.5**	**26.1**
Provided in the year – net fee and commission income	**–**	**–**	**149.7**	**–**	**149.7**
Released in the year – operating expense	**(0.3)**	**–**	**–**	**(0.6)**	**(0.9)**
Released in the year – net fee and commission income	**–**	**–**	**–**	**–**	**–**
Utilised during the year	**(0.1)**	**(11.2)**	**(95.4)**	**(7.5)**	**(114.2)**
At the end of the year	**7.3**	**38.6**	**116.0**	**0.8**	**162.7**
Provisions were analysed as follows:					
Amounts falling due within one year	**3.2**	**24.9**	**77.2**	**0.8**	**106.1**
Amounts falling due after one year	**4.1**	**13.7**	**38.8**	**–**	**56.6**
	7.3	**38.6**	**116.0**	**0.8**	**162.7**

2011 Group	Property	FSCS levies	PPI	Other	Total
At the beginning of the year	8.8	20.9	4.3	21.8	55.8
Income statement movements:					
Provided in the year – operating expense	0.4	14.5	–	0.1	15.0
Provided in the year – net fee and commission income	–	–	90.0	1.0	91.0
Released in the year – operating expense	(0.3)	–	–	(0.1)	(0.4)
Released in the year – net fee and commission income	–	–	–	(0.9)	(0.9)
Utilised during the year	(2.0)	(10.4)	(32.6)	(13.5)	(58.5)
At the end of the year	6.9	25.0	61.7	8.4	102.0
Provisions were analysed as follows:					
Amounts falling due within one year	3.0	10.9	51.3	8.4	73.6
Amounts falling due after one year	3.9	14.1	10.4	–	28.4
	6.9	25.0	61.7	8.4	102.0

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

32. Provisions for liabilities and charges continued

2012 Bank	**Property**	**FSCS levies**	**PPI**	**Other**	**Total**
At the beginning of the year	**6.8**	**24.9**	**61.7**	**–**	**93.4**
Income statement movements:					
Provided in the year – operating expense	**0.8**	**24.7**	**–**	**–**	**25.5**
Provided in the year – net fee and commission income	**–**	**–**	**149.7**	**–**	**149.7**
Released in the year – operating expense	**(0.3)**	**–**	**–**	**–**	**(0.3)**
Utilised during the year	**(0.1)**	**(11.2)**	**(95.4)**	**–**	**(106.7)**
At the end of the year	**7.2**	**38.4**	**116.0**	**–**	**161.6**
Provisions were analysed as follows:					
Amounts falling due within one year	**3.1**	**24.8**	**77.2**	**–**	**105.1**
Amounts falling due after one year	**4.1**	**13.6**	**38.8**	**–**	**56.5**
	7.2	**38.4**	**116.0**	**–**	**161.6**

2011 Bank	Property	FSCS levies	PPI	Other	Total
At the beginning of the year	7.4	20.3	4.3	7.3	39.3
Income statement movements:					
Provided in the year – operating expense	0.4	14.5	–	–	14.9
Provided in the year – net fee and commission income	–	–	90.0	–	90.0
Released in the year – operating expense	(0.2)	–	–	–	(0.2)
Released in the year – net fee and commission income	–	–	–	(0.1)	(0.1)
Utilised during the year	(0.8)	(9.9)	(32.6)	(7.2)	(50.5)
At the end of the year	6.8	24.9	61.7	–	93.4
Provisions were analysed as follows:					
Amounts falling due within one year	2.9	10.8	51.3	–	65.0
Amounts falling due after one year	3.9	14.1	10.4	–	28.4
	6.8	24.9	61.7	–	93.4

Property

The Group has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases using a discount rate of 11%.

Financial Services Compensation Scheme (FSCS) levies

The FSCS has provided compensation to customers of financial institutions following the collapse of deposit takers in 2008. The compensation paid out to consumers is currently funded through loans from HM Treasury. The Group will be liable to pay a proportion of the outstanding borrowings that the FSCS has borrowed from HM Treasury. Additionally the Group is obliged to pay its share of management expenses and compensation based upon the Group's proportion of the total market protected deposits at 31 December of each year.

The ultimate FSCS levy to the industry as a result of the 2008 collapses cannot currently be estimated reliably as it is dependent on other factors that may affect amounts payable and the timing of amounts payable, including changes in interest rates, potential recoveries of assets by the FSCS and the level of protected deposits.

The Group has provided £38.6m (2011: £25.0m) for its share of the levies raised by the FSCS including the interest on the loan from HM Treasury in respect of the levy years to 31 March 2014. The provision includes £27.7m in respect of the interest levy (2011: £25.0m). The Group's interest levy provision calculation includes estimates of the total FSCS levy in each levy year and estimates of the Group's market participation in each levy year. During 2012, the FSCS indicated that it expected to raise a capital levy to cover an estimated shortfall in excess of £800m in the amounts recovered from the failed banks to repay HM Treasury loans made to the FSCS. The Group's share of such a levy is estimated at £24.0m and the Group has provided £10.9m in the current year in respect of this.

32. Provisions for liabilities and charges continued

PPI

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

The FSA issued a policy statement in August 2010 which amended the 'Disputes Resolution: Complaints' section of the FSA Handbook, setting out new rules for handling complaints, including complaints of PPI mis-selling. The Bank must comply with the policy statement which requires complainants to receive adequate redress and the Bank to complete a proactive review of all past business to identify mis-sold policies where no complaint has been made. An additional provision of £149.7m (2011: £90.0m) has been recognised in the year (note 5), in respect of the total expected cost to the Bank of carrying out this work and paying compensation, making total provisions raised of £244.0m (2011: £94.3m).

33. Deferred tax

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 23% (2011: 25%).

The movements on the deferred tax accounts are as follows:

	Group		Bank	
	2012	2011	**2012**	2011
Net deferred tax at the beginning of the year	**26.4**	87.0	**110.3**	154.0
Income statement credit/(charge)	**8.8**	(61.7)	**14.1**	(44.5)
Prior year adjustments	**6.9**	9.7	**9.4**	9.4
Charged to equity:				
Fair value unwinds	**–**	–	**8.9**	–
Unrealised appreciation on investments	**–**	0.4	**–**	0.4
Pensions and other post-retirement benefits	**–**	(0.1)	**–**	(0.1)
Cashflow hedges	**3.5**	(8.9)	**3.5**	(8.9)
Available for sale	**(7.4)**	–	**(7.4)**	–
Net deferred tax at the end of the year	**38.2**	26.4	**138.8**	110.3
Components of net deferred tax:				
Deferred tax asset	**165.9**	137.5	**138.8**	110.3
Deferred tax liability	**(127.7)**	(111.1)	**–**	–
	38.2	26.4	**138.8**	110.3
Net deferred tax comprises:				
Cashflow hedges	**(18.9)**	(22.4)	**(18.9)**	(22.4)
Unrealised appreciation on investments	**(0.7)**	(0.7)	**(0.7)**	(0.7)
Capital allowances on fixed assets	**33.4**	28.5	**37.0**	29.4
Capital allowances on assets leased to customers	**1.3**	(2.7)	**1.3**	0.6
Pensions and other post-retirement benefits	**0.9**	0.9	**0.9**	0.9
Fair value adjustments	**(55.8)**	(3.4)	**65.6**	98.9
Other temporary differences	**26.1**	26.2	**1.7**	3.6
Tax losses carried forward	**51.9**	–	**51.9**	–
	38.2	26.4	**138.8**	110.3

Other temporary differences for the Group of £26.1m (2011: £26.2m) include deferred tax assets/liabilities as a result of loss provisions on mortgage assets held by Special Purpose Entities (SPEs), taxation of SPEs under the securitisation regime and spreading of the tax effect of IFRS transitional adjustments.

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

33. Deferred tax continued

The deferred tax (credit)/charge in the income statement comprises the following temporary differences:

	Group		Bank	
	2012	2011	**2012**	2011
Capital allowances on fixed assets	**(8.1)**	4.0	**(7.6)**	4.1
Capital allowances on assets leased to customers	**(0.7)**	(0.7)	**(0.7)**	(0.2)
Fair value adjustments	**42.0**	35.7	**33.3**	27.8
Other temporary differences	**1.5**	13.0	**1.9**	3.4
Tax losses carried forward	**(50.4)**	–	**(50.4)**	–
	(15.7)	52.0	**(23.5)**	35.1

Deferred tax assets expected to be recoverable after one year are £38.2m (2011: £26.4m). The deferred tax asset is considered to be recoverable as, after preparing forecasts and projections for the Banking Group, the directors are satisfied that the Group will be profitable in the foreseeable future.

The 2012 Autumn Statement on 5 December 2012 announced that the UK corporation tax rate will reduce to 21% by 2014. A reduction in the rate from 26% to 25% (effective from 1 April 2012) was substantively enacted on 5 July 2011, and further reductions to 24% (effective from 1 April 2012) and 23% (effective from 1 April 2013) were substantively enacted on 26 March 2012 and 3 July 2012 respectively. This will reduce the Group's future current tax charge accordingly. The deferred tax asset at 31 December 2012 has been calculated based on the rate of 23% substantively enacted at the balance sheet date. It has not yet been possible to quantify the full anticipated effect of the announced further 2% rate reduction, although this will further reduce the Group's future current tax charge and reduce the Group's deferred tax asset accordingly.

34. Pensions

Defined contribution basis

The Group participates in The Co-operative Group Pension (average career earnings) Scheme (Pace). Pace is a defined benefit scheme, the assets of which are held in a separate fund administered by trustees. As a group wide pension scheme, Pace exposes the participating businesses to actuarial risks associated with the current and former employees of other Group companies, with the result that there is no consistent and reliable basis for allocating liabilities, assets and costs to individual companies participating in the scheme. Therefore, pension costs in respect of the scheme are accounted for on a defined contribution basis and recognised as an expense in the income statement as incurred, based on a fixed percentage as agreed with the trustees.

Key assumptions of the Group pension scheme

The key aspects of The Co-operative Group's Pace scheme are as follows:

	2012	2011
The principal assumptions used to determine the liabilities of the Pace scheme are:		
Discount rate	**4.60%**	4.60%
Rate of increase in salaries	**4.80%**	4.80%
Future pension increases where capped at 5.0% per annum	**3.30%**	3.30%
Future pension increases where capped at 2.5% per annum	**2.50%**	2.50%
Assumptions used to determine net pension cost for the Pace scheme are:		
Discount rate	**4.60%**	5.20%
Expected long term return on scheme assets	**5.10%**	6.20%
Rate of increase in salaries	**4.80%**	5.20%

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the Pace scheme at the 2012 year end is:

	Male	**Female**
Life expectancy:		
Member currently aged 65 (current life expectancy)	**22.4**	**24.0**
Member currently aged 40 (life expectancy at age 65)	**24.2**	**25.9**

The amounts recognised in the balance sheet of The Co-operative Group are as follows:

	2012	2011
Fair value of plan assets	**6,919.4**	6,610.5
Present value of funded obligations	**(6,532.1)**	(6,242.6)
	387.3	367.9
Present value of unfunded obligations	**(4.5)**	(4.4)
	382.8	363.5

34. Pensions continued

The weighted average asset allocations at the year end were as follows:

	2012	2011
Equities	**31%**	29%
Liability driven investments	**49%**	51%
Alternative growth	**14%**	14%
Property	**4%**	5%
Cash	**2%**	1%

To develop the expected long term rate of return on assets assumption, The Co-operative Group considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long term rate of return on assets assumption for the portfolio. This resulted in the selection of the 5.1% assumption for the year ended 31 December 2012 (2011: 6.2%).

Former Britannia Building Society pension scheme

Following the transfer of engagements of Britannia Building Society, the Britannia pension scheme transferred to the Co-operative Financial Services Management Services Limited (CFSMS). The pension cost shown in these accounts in respect of the Britannia defined benefit scheme for the period after 31 July 2009 is the actual contribution paid by the Bank. The scheme closed on 6 October 2012 with active members at the date of closure being transferred to the Co-operative Pension Scheme (Pace).

The key aspects of the Britannia defined benefit scheme are as follows:

	2012	2011
The principal assumptions used to determine the liabilities of the Britannia defined benefit scheme are:		
Discount rate	**4.60%**	4.60%
Rate of increase in salaries	**4.80%**	4.80%
Future pension increases where capped at 5.0% per annum	**3.30%**	3.30%
Future pension increases where capped at 2.5% per annum	**2.50%**	2.50%
Assumptions used to determine net pension cost for the Britannia defined benefit scheme are:		
Discount rate	**4.60%**	5.20%
Expected long term return on scheme assets	**5.00%**	6.00%
Rate of increase in salaries	**4.80%**	5.20%

The average life expectancy (in years) for mortality tables used to determine defined benefit scheme liabilities for the former Britannia Building Society scheme at the 2012 year end is:

	Male	**Female**
Life expectancy:		
Member currently aged 65 (current life expectancy)	22.4	24.6
Member currently aged 40 (life expectancy at age 60)	24.2	26.5

The amounts recognised in the balance sheet of The Co-operative Group are as follows:

	2012	2011
Fair value of plan assets	**602.7**	569.9
Present value of funded obligations	**(586.8)**	(608.4)
	15.9	(38.5)
Pension surplus not recognised under IAS 19	**(15.9)**	–
Present value of unfunded obligations	**(2.9)**	(2.9)
	(2.9)	(41.4)

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

34. Pensions continued

The weighted average asset allocations at the year end were as follows:

	2012	2011
Equities	**25%**	25%
Diversified growth	**14%**	15%
Liability driven investments	**48%**	57%
Property	**13%**	3%

To develop the expected long term rate of return on assets assumption, The Co-operative Group considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long term rate of return on assets assumption for the portfolio. This resulted in the selection of the 5.0% assumption for the year ended 31 December 2012 (2011: 6.0%).

Bank (unfunded) pension scheme

The Bank also operates a small unfunded pension scheme.

	2012	2011	2010	2009	2008
Expected return on scheme assets	**n/a**	n/a	n/a	n/a	n/a
Rate of increase of pensions in payment	**3.3%**	3.3%	3.7%	3.8%	3.3%
Rate of increase in salaries	**4.8%**	4.8%	5.2%	5.3%	4.8%
Discount rate	**4.6%**	4.6%	5.2%	5.6%	5.7%

The assumptions used by the actuary were the best estimates chosen from a range of possible actuarial assumptions which, due to the timescales covered, may not necessarily be borne out in practice.

The values of the assets and liabilities of the unfunded pension scheme were:

	Group and Bank	
	2012	2011
Present value of unfunded obligations	**(4.0)**	(3.9)
Deficit in scheme	**(4.0)**	(3.9)
Related deferred tax asset	**0.9**	0.9
Net pension liability	**(3.1)**	(3.0)

Analysis of amount charged to income statement:

Current service cost	**–**	–
Interest on pension scheme liabilities	**0.2**	0.2
	0.2	0.2

Changes in the present value of the scheme liabilities are as follows:

	Group and Bank	
	2012	2011
Opening defined benefit liabilities	**3.9**	3.8
Current service cost	**–**	–
Interest on liabilities	**0.2**	0.2
Actuarial losses	**–**	–
Benefits paid	**(0.1)**	(0.1)
Closing defined benefit liabilities	**4.0**	3.9

Amounts recognised in the statement of comprehensive income:

	Group and Bank	
	2012	2011
Actuarial losses on scheme liabilities during the year	**–**	–
Actuarial gains on scheme assets during the year	**–**	–
Total scheme losses during the year	**–**	–

34. Pensions continued

The amounts for the current year are as follows:

	Group and Bank	
	2012	2011
Defined benefit obligation	**(4.0)**	(3.9)
Scheme assets	**–**	–
Deficit in scheme	**(4.0)**	(3.9)
Experience adjustment on scheme liabilities	**–**	–
Experience adjustment on scheme assets	**–**	–

35. Contingent liabilities and commitments

The tables below give, for the Group and the Bank, the contract amounts and risk weighted amounts of contingent liabilities and commitments. The contract amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The risk weighted amounts have been calculated in accordance with the FSA rules.

The contingent liabilities of the Group and the Bank as detailed below arise in the normal course of banking business and it is not practical to quantify their future financial effect.

	Contract amount 2012	**Risk weighted amount 2012**	Contract amount 2011	Risk weighted amount 2011
Group				
Contingent liabilities:				
Guarantees and irrevocable letters of credit	**168.8**	**120.6**	167.6	131.8
Bank				
Contingent liabilities:				
Guarantees and irrevocable letters of credit	**168.2**	**120.3**	166.6	131.3
Group				
Other commitments:				
Documentary credits and short term trade related transactions	**3.7**	**0.7**	7.7	1.5
Forward asset purchases and forward deposits placed	**53.2**	**0.1**	44.9	0.9
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments) (i)	**4,713.4**	**1,065.0**	4,700.1	1,148.1
	4,770.3	**1,065.8**	4,752.7	1,150.5
Bank				
Other commitments:				
Documentary credits and short term trade related transactions	**3.7**	**0.7**	7.7	1.5
Forward asset purchases and forward deposits placed	**53.2**	**0.1**	44.9	0.9
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments) (i)	**4,565.5**	**1,061.0**	4,504.2	1,138.7
	4,622.4	**1,061.8**	4,556.8	1,141.1

Notes
(i) Undrawn loan commitments include revocable commitments which are unused credit card limits of £2,048.1m (2011: £2,181.6m).

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Group's day to day operations. Mandatory reserve deposits are also held with the Bank of England in accordance with statutory requirements.

See note 39.d for further details of assets pledged.

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

35. Contingent liabilities and commitments continued

Commitments under operating leases

The Group leases various properties and equipment under non-cancellable operating lease arrangements. The leases have various terms, ranging from six months to 999 years. None of these leases are individually material and none have any material clauses. The table below discloses the minimum operating lease payments the Group and the Bank will be required to make over the remaining lives of the leases.

	Land and buildings 2012	**Equipment 2012**	Land and buildings 2011	Equipment 2011
Group				
Falling due:				
Within one year	**21.9**	**0.3**	26.1	0.3
Between one and five years	**63.9**	**0.5**	76.5	0.4
In five years or more	**79.6**	**–**	87.3	0.1
	165.4	**0.8**	189.9	0.8
Bank				
Falling due:				
Within one year	**22.6**	**0.3**	25.4	0.3
Between one and five years	**65.3**	**0.5**	78.7	0.4
In five years or more	**66.0**	**–**	73.7	0.1
	153.9	**0.8**	177.8	0.8

The Group leases a number of branch and office premises under operating leases. The leases typically run for a period of up to 25 years, with an option to renew the lease after that period. Lease payments are generally reviewed every three to five years to reflect market rentals.

The total value of future minimum sub-lease payments expected to be received under non-cancellable sub-leases for the Group and for the Bank was £9.1m (2011: £12.8m).

Former Britannia Building Society pension scheme guarantee

Following the transfer of engagements of Britannia Building Society, the Britannia pension scheme transferred to CFSMS. Under the terms of this transfer the Bank entered into a deed of guarantee to provide assurance to the trustees of the pension scheme to support CFSMS in meeting its funding obligations to the scheme should CFSMS be unable to pay its obligations as they fall due.

Intra-group guarantee

The Bank has an indemnification agreement, accounted for as an intra-group guarantee under IFRS 4, with CFSMS in which the Bank has agreed to indemnify CFSMS against all and any liability, loss, damage, costs and expense arising from the agreement.

Interest rate hedging products

The Bank has sold circa 100 interest rate hedging products to small businesses. It has participated in the FSA pilot review of such sales, though the full review has not yet been completed. The Bank expects any redress payments would not be material and no provision has been made in the annual results.

36. Investments in Group undertakings

Investments in equity shares and loans of subsidiary undertakings are financial assets.

	2012			2011		
	Ordinary shares	**Capital contributions**	**Total**	Ordinary shares	Capital contributions	Total
At the beginning of the year	**569.7**	**1,003.7**	**1,573.4**	569.0	889.9	1,458.9
Additions	**–**	**1,185.0**	**1,185.0**	1.0	1,057.8	1,058.8
Repayments	**(0.2)**	**(949.7)**	**(949.9)**	(0.3)	(944.0)	(944.3)
At the end of the year	**569.5**	**1,239.0**	**1,808.5**	569.7	1,003.7	1,573.4

Subsidiary undertakings
The Bank has, except in the case of Unity Trust Bank plc, a direct interest in the ordinary share capital of the following principal subsidiary undertakings trading in the businesses indicated. All subsidiary undertakings are included in the consolidated Group results.

Principal subsidiary undertakings which are registered in England and operating in the UK:

		Group interest 2012	Group interest 2011
Unity Trust Bank plc (held through subsidiary undertaking)	Banking	**27%**	27%
Co-operative Commercial Limited	Investment company	**100%**	100%
First Roodhill Leasing Limited	Leasing	**100%**	100%
Second Roodhill Leasing Limited	Leasing	**100%**	100%
Third Roodhill Leasing Limited	Leasing	**100%**	100%
Fourth Roodhill Leasing Limited	Leasing	**100%**	100%
Britannia Treasury Services Limited	Holding company	**100%**	100%
Britannia Asset Management Limited	Holding company	**100%**	100%
Britannia Development and Management Company Limited	Property investment	**100%**	100%
Illius Properties Limited	Property investment	**100%**	100%
Moorland Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	**100%**	100%

See note 39.d for further details of the covered bond transactions.

The accounting policy for Special Purpose Entities (SPEs) is disclosed on page 42.

Unity Trust Bank plc is considered to be a subsidiary undertaking of The Co-operative Bank plc as The Co-operative Bank plc elects a majority of the directors and appoints the chair and managing director. This provides the power to control.

Investments in equity shares and loans with subsidiary undertakings are shown net of impairments.

Britannia Treasury Services Limited has the following principal wholly owned subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Mortgage Agency Services Number One Limited	Mortgage and syndicated lending
Mortgage Agency Services Number Two Limited	Mortgage lending
Mortgage Agency Services Number Four Limited	Mortgage lending
Mortgage Agency Services Number Five Limited	Mortgage lending
Mortgage Agency Services Number Six Limited	Mortgage lending
Western Mortgage Services Limited	Mortgage book administration
Platform Group Holdings Limited	Holding company

Platform Group Holdings Limited has the following principal wholly owned subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Platform Consumer Services Limited	Mortgage lending
Platform Funding Limited	Mortgage origination
Platform Home Loans Limited	Mortgage origination and servicing

Platform Consumer Services Limited is the only direct subsidiary of Platform Group Holdings Limited.

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

36. Investments in Group undertakings continued

Registered in the Isle of Man and operating overseas:

Britannia International Limited	Deposit taking

Registered in Scotland and operating in the UK:

Britannia Life Direct Limited	Direct sales of financial services

Securitisation vehicles

The results of the following principal securitisation vehicles are consolidated into the results of the Group under SIC 12 (Consolidation: Special Purpose Entities):

Leek Finance Number Seventeen plc	Securitisation company
Leek Finance Number Eighteen plc	Securitisation company
Leek Finance Number Nineteen plc	Securitisation company
Leek Finance Number Twenty plc	Securitisation company
Leek Finance Number Twenty One plc	Securitisation company
Leek Finance Number Twenty Two plc	Securitisation company
Meerbrook Finance Number One Limited	Securitisation company
Meerbrook Finance Number Two Limited	Securitisation company
Meerbrook Finance Number Three Limited	Securitisation company
Meerbrook Finance Number Four Limited	Securitisation company
Meerbrook Finance Number Six Limited	Securitisation company
Silk Road Finance Number One plc	Securitisation company
Silk Road Finance Number Two plc	Securitisation company
Silk Road Finance Number Three plc	Securitisation company
Cambric Finance Number One plc	Securitisation company

All securitisation vehicles are registered in England and operate in the UK.

All of the above companies are related parties to the Group. See note 37 for the related party disclosures.

See note 39.d for further details of securitisation vehicles.

Joint ventures

The Group's investment in joint ventures is £3.9m (2011: £2.7m).

The Bank owns 49% of the ordinary shares in Britannia Personal Lending Limited, a company registered in England and operating in the UK. The company trades in the business of unsecured personal lending.

The Group's interest in Britannia Personal Lending Limited is as follows:

	2012	2011
Current assets	**6.5**	17.5
Long term assets	**11.8**	13.0
	18.3	30.5
Current liabilities	**10.7**	20.2
Long term liabilities	**7.6**	10.3
	18.3	30.5
Income	**1.5**	1.3
Expenses	**0.1**	(1.1)
Profit before tax	**1.6**	0.2
Taxation	**(0.4)**	–
Profit after tax	**1.2**	0.2

Joint ventures are accounted for using the equity method.

37. Related party transactions

Parent, subsidiary and ultimate controlling party

The Co-operative Banking Group Limited owns 100% of the issued ordinary share capital of the Bank and is the Bank's immediate holding company. The Co-operative Banking Group Limited is incorporated in England and is registered under the Industrial and Provident Societies Acts. The ultimate holding organisation is The Co-operative Group Limited, which is incorporated in England and registered under the Industrial and Provident Societies Acts. The financial statements of the immediate and ultimate holding organisations are available from 1 Angel Square, Manchester M60 0AG.

Further details of subsidiary undertakings and joint ventures are disclosed in note 36.

A number of banking transactions are entered into with related parties in the normal course of business on normal commercial terms. These include loans and deposits. Key management, as defined by IAS 24 (Related Party Disclosures), are considered to be Board and executive members of the Group, and Board and executive members of the Group's immediate and ultimate holding organisations. The volume of related party transactions, outstanding balances at the year end, and related income and expense for the year are as follows:

Directors, key management personnel and close family

	Group and Bank	
	2012	2011
Loans outstanding at the beginning of the year	**2.2**	2.3
Net movement	**0.4**	(0.1)
Loans outstanding at the end of the year	**2.6**	2.2
Deposits and investments at the beginning of the year	**1.9**	2.0
Net movement	**0.5**	(0.1)
Deposits and investments at the end of the year	**2.4**	1.9

Directors' loans

	Mortgages 2012	**Personal loans 2012**	**Credit cards 2012**	Mortgages 2011	Personal loans 2011	Credit cards 2011
Number of directors with loan type	**5**	**2**	**4**	6	1	9
Total value of directors' loans	**1.0**	**–**	**–**	1.8	–	–

The Bank undertook the following transactions with Group companies during the year:

	Interest paid to Bank	**Interest received from Bank**	**Staff recharges paid to Bank**	**Rent received from Bank**	**Administration recharge paid to Bank**
2012					
Transactions with subsidiary undertakings	**84.3**	**66.6**	**14.5**	**0.6**	**8.3**
2011					
Transactions with subsidiary undertakings	93.8	94.3	9.4	0.6	–

Interest accrues on outstanding balances at a transfer price rate agreed between the Bank and its subsidiaries.

	Interest and fees received from other Co-operative Group undertakings 2012	**Interest and fees paid to other Co-operative Group undertakings 2012**	Interest and fees received from other Co-operative Group undertakings 2011	Interest and fees paid to other Co-operative Group undertakings 2011
Parent undertakings	**4.3**	**0.2**	4.6	1.0
Fellow subsidiary undertakings	**1.0**	**–**	1.1	–
	5.3	**0.2**	5.7	1.0

At the year end the following unsecured balances were outstanding:

	Loans owed to Bank 2012	**Loans owed by Bank 2012**	Loans owed to Bank 2011	Loans owed by Bank 2011
Amounts outstanding with subsidiary undertakings	**4,638.6**	**3,854.0**	6,558.0	3,674.3

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

37. Related party transactions continued

	Loans owed by other Co-operative Group undertakings 2012	Loans owed to other Co-operative Group undertakings 2012	Loans owed by other Co-operative Group undertakings 2011	Loans owed to other Co-operative Group undertakings 2011
Group				
Parent undertakings	**56.4**	**29.4**	1.6	74.0
Fellow subsidiary undertakings	**200.0**	**82.6**	177.6	58.3
	256.4	**112.0**	179.2	132.3

	Loans owed by other Co-operative Group undertakings 2012	Loans owed to other Co-operative Group undertakings 2012	Loans owed by other Co-operative Group undertakings 2011	Loans owed to other Co-operative Group undertakings 2011
Bank				
Parent undertakings	**56.4**	**29.4**	1.6	74.0
Fellow subsidiary undertakings	**199.6**	**82.6**	180.5	58.3
	256.0	**112.0**	182.1	132.3

There are no formal repayment terms with subsidiary companies.

Recharges from CFSMS

During the year, operating costs of £779.7m (2011: £488.6m) incurred on its behalf were charged at cost to the Bank by CFSMS, a fellow subsidiary of the Co-operative Banking Group Limited. £150.0m (2011: £nil) of these recharges related to the impairment of intangible assets relating to the development of new banking systems. At 31 December 2012, the Bank was owed £199.6m (2011: £180.5m) by CFSMS.

Transactions with SPEs

The Bank undertook the following transactions with SPEs during the year:

	Interest paid to Bank 2012	Interest received from Bank 2012	Interest paid to Bank 2011	Interest received from Bank 2011
Transactions with SPEs	**108.4**	**118.0**	103.1	121.0

	Fees paid to Bank 2012	Fees received from Bank 2012	Fees paid to Bank 2011	Fees received from Bank 2011
Transactions with SPEs	**2.9**	**–**	2.4	–

The 2011 figure for interest received from Bank has been amended to include deemed loan interest paid to SPEs.

At the year end the following balances were outstanding with SPEs:

	Loans owed to Bank 2012	Loans owed by Bank 2012	Loans owed to Bank 2011	Loans owed by Bank 2011
Amounts outstanding with SPEs	**7,718.4**	**3,843.0**	6,221.1	3,654.6

In addition to the above, the Bank holds floating rate notes in Leek Finance Number Seventeen plc of £14.3m (2011: £18.5m), in Leek Finance Number Eighteen plc of £19.8m (2011: £23.3m) and in Leek Finance Number Nineteen plc of £25.2m (2011: £28.7m) included within investment securities – available for sale.

The loans owed to the SPEs comprise cash balances deposited with the Bank.

Key management compensation

	Group and Bank	
	2012	2011
Salaries and short term benefits	**3.0**	4.6
Termination benefits	**1.4**	2.5
	4.4	7.1

Directors' remuneration

A list of the members of the Board of directors is shown on page 12. The total remuneration of directors was £0.6m (2011: £3.7m).

Further details of directors' remuneration are provided in the remuneration report on pages 20 to 28.

38. Share capital

	Group and Bank			
	No. of shares (millions) 2012	Share capital 2012	No. of shares (millions) 2011	Share capital 2011
Authorised capital (ordinary shares of 5p each)				
At the beginning and end of the year	**8,200**	**410.0**	8,200	410.0
Allotted, called up and fully paid (ordinary shares of 5p each)				
At the beginning and end of the year	**8,200**	**410.0**	8,200	410.0
Share premium account at the beginning and the end of the year		**8.8**		8.8

The shareholders have one vote for every share held.

39. Fair values of financial assets and liabilities

The tables below analyse the balance sheet carrying values of financial assets and liabilities by classification.

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Cashflow hedges	Total
2012							
Group							
Assets							
Cash and balances at central banks	**–**	**–**	**5,433.0**	**–**	**–**	**–**	**5,433.0**
Loans and advances to banks	**–**	**–**	**1,904.1**	**–**	**–**	**–**	**1,904.1**
Loans and advances to customers	**–**	**153.6**	**33,185.9**	**–**	**–**	**–**	**33,339.5**
Fair value adjustments for hedged risk	**–**	**–**	**354.2**	**–**	**–**	**–**	**354.2**
Investment securities	**960.2**	**1,845.2**	**295.0**	**3,789.4**	**–**	**–**	**6,889.8**
Derivative financial instruments	**197.3**	**501.2**	**–**	**–**	**–**	**120.3**	**818.8**
Equity shares	**–**	**–**	**–**	**5.7**	**–**	**–**	**5.7**
Amounts owed by other Co-operative Group undertakings	**–**	**–**	**256.4**	**–**	**–**	**–**	**256.4**
Total financial assets	**1,157.5**	**2,500.0**	**41,428.6**	**3,795.1**	**–**	**120.3**	**49,001.5**
Non-financial assets							**571.9**
Total assets							**49,573.4**
Liabilities							
Deposits by banks	**–**	**–**	**–**	**–**	**3,612.0**	**–**	**3,612.0**
Customer accounts	**–**	**–**	**–**	**–**	**35,884.4**	**–**	**35,884.4**
Customer accounts – capital bonds	**–**	**888.1**	**–**	**–**	**–**	**–**	**888.1**
Debt securities in issue	**–**	**–**	**–**	**–**	**4,713.7**	**–**	**4,713.7**
Derivative financial instruments	**168.3**	**747.0**	**–**	**–**	**–**	**52.3**	**967.6**
Other borrowed funds	**–**	**–**	**–**	**–**	**1,258.6**	**–**	**1,258.6**
Amounts owed to other Co-operative Group undertakings	**–**	**–**	**–**	**–**	**112.0**	**–**	**112.0**
Total financial liabilities	**168.3**	**1,635.1**	**–**	**–**	**45,580.7**	**52.3**	**47,436.4**
Non-financial liabilities							**286.8**
Total liabilities							**47,723.2**
Capital and reserves							**1,850.2**
Total liabilities and equity							**49,573.4**

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Cashflow hedges	Total
2011							
Group							
Assets							
Cash and balances at central banks	–	–	6,696.6	–	–	–	6,696.6
Loans and advances to banks	–	–	2,006.5	–	–	–	2,006.5
Loans and advances to customers	–	114.1	33,651.9	–	–	–	33,766.0
Fair value adjustments for hedged risk	–	–	366.3	–	–	–	366.3
Investment securities	–	343.1	804.9	3,423.0	–	–	4,571.0
Derivative financial instruments	163.7	593.6	–	–	–	218.5	975.8
Equity shares	–	–	–	5.7	–	–	5.7
Amounts owed by other Co-operative Group undertakings	–	–	179.2	–	–	–	179.2
Total financial assets	163.7	1,050.8	43,705.4	3,428.7	–	218.5	48,567.1
Non-financial assets							388.5
Total assets							48,955.6
Liabilities							
Deposits by banks	–	–	–	–	3,302.7	–	3,302.7
Customer accounts	–	–	–	–	34,990.6	–	34,990.6
Customer accounts – capital bonds	–	1,429.8	–	–	–	–	1,429.8
Debt securities in issue	–	–	–	–	4,164.8	–	4,164.8
Derivative financial instruments	143.5	838.2	–	–	–	106.2	1,087.9
Other borrowed funds	–	–	–	–	1,258.8	–	1,258.8
Amounts owed to other Co-operative Group undertakings	–	–	–	–	132.3	–	132.3
Total financial liabilities	143.5	2,268.0	–	–	43,849.2	106.2	46,366.9
Non-financial liabilities							315.6
Total liabilities							46,682.5
Capital and reserves							2,273.1
Total liabilities and equity							48,955.6

39. Fair values of financial assets and liabilities continued

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Cashflow hedges	Total
2012							
Bank							
Assets							
Cash and balances at central banks	**–**	**–**	**5,433.0**	**–**	**–**	**–**	**5,433.0**
Loans and advances to banks	**–**	**–**	**1,047.2**	**–**	**–**	**–**	**1,047.2**
Loans and advances to customers	**–**	**153.6**	**22,631.9**	**–**	**–**	**–**	**22,785.5**
Fair value adjustments for hedged risk	**–**	**–**	**354.1**	**–**	**–**	**–**	**354.1**
Investment securities	**960.2**	**1,845.2**	**355.4**	**3,563.9**	**–**	**–**	**6,724.7**
Derivative financial instruments	**198.8**	**271.8**	**–**	**–**	**–**	**120.3**	**590.9**
Equity shares	**–**	**–**	**–**	**5.7**	**–**	**–**	**5.7**
Amounts owed by other Co-operative Group undertakings	**–**	**–**	**12,613.0**	**–**	**–**	**–**	**12,613.0**
Total financial assets	**1,159.0**	**2,270.6**	**42,434.6**	**3,569.6**	**–**	**120.3**	**49,554.1**
Non-financial assets							**2,264.4**
Total assets							**51,818.5**
Liabilities							
Deposits by banks	**–**	**–**	**–**	**–**	**3,552.9**	**–**	**3,552.9**
Customer accounts	**–**	**–**	**–**	**–**	**33,750.3**	**–**	**33,750.3**
Customer accounts – capital bonds	**–**	**867.2**	**–**	**–**	**–**	**–**	**867.2**
Debt securities in issue	**–**	**–**	**–**	**–**	**1,752.2**	**–**	**1,752.2**
Derivative financial instruments	**169.7**	**700.7**	**–**	**–**	**–**	**52.2**	**922.6**
Other borrowed funds	**–**	**–**	**–**	**–**	**1,258.6**	**–**	**1,258.6**
Amounts owed to other Co-operative Group undertakings	**–**	**1,764.4**	**–**	**–**	**6,044.6**	**–**	**7,809.0**
Total financial liabilities	**169.7**	**3,332.3**	**–**	**–**	**46,358.6**	**52.2**	**49,912.8**
Non-financial liabilities							**276.6**
Total liabilities							**50,189.4**
Capital and reserves							**1,629.1**
Total liabilities and equity							**51,818.5**

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Cashflow hedges	Total
2011							
Bank							
Assets							
Cash and balances at central banks	–	–	6,696.6	–	–	–	6,696.6
Loans and advances to banks	–	–	1,300.1	–	–	–	1,300.1
Loans and advances to customers	–	114.1	22,620.9	–	–	–	22,735.0
Fair value adjustments for hedged risk	–	–	365.8	–	–	–	365.8
Investment securities	–	343.1	866.1	3,107.4	–	–	4,316.6
Derivative financial instruments	166.4	319.5	–	–	–	218.5	704.4
Equity shares	–	–	–	5.7	–	–	5.7
Amounts owed by other Co-operative Group undertakings	–	–	12,961.2	–	–	–	12,961.2
Total financial assets	166.4	776.7	44,810.7	3,113.1	–	218.5	49,085.4
Non-financial assets							1,880.3
Total assets							50,965.7
Liabilities							
Deposits by banks	–	–	–	–	3,239.8	–	3,239.8
Customer accounts	–	–	–	–	32,670.1	–	32,670.1
Customer accounts – capital bonds	–	1,397.3	–	–	–	–	1,397.3
Debt securities in issue	–	–	–	–	1,431.0	–	1,431.0
Derivative financial instruments	146.0	799.3	–	–	–	106.2	1,051.5
Other borrowed funds	–	–	–	–	1,258.8	–	1,258.8
Amounts owed to other Co-operative Group undertakings	–	2,130.6	–	–	5,330.6	–	7,461.2
Total financial liabilities	146.0	4,327.2	–	–	43,930.3	106.2	48,509.7
Non-financial liabilities							295.6
Total liabilities							48,805.3
Capital and reserves							2,160.4
Total liabilities and equity							50,965.7

The 2011 Bank amounts owed to other Co-operative Group undertakings have been amended to include intercompany balances designated at fair value.

a. Use of financial instruments

The use of financial instruments is essential to the Bank's business activities, and financial instruments constitute a significant proportion of the Bank's assets and liabilities. The main financial instruments used by the Group, and the purposes for which they are held, are outlined below:

Loans and advances to customers and customer accounts

The provision of banking facilities to customers is the prime activity of the Bank, and loans and advances to customers and customer accounts are major constituents of the balance sheet. Loans and advances to customers include retail mortgages, corporate loans, credit cards, unsecured retail lending and overdrafts. Customer accounts include retail and corporate current and savings accounts. The Bank has detailed policies and procedures to manage risks. Retail mortgage lending and much of the lending to corporate and business banking customers is secured.

Loans and advances to banks and investment securities

Loans and advances to banks and investment securities underpin the Bank's liquidity requirements and generate incremental net interest and trading income. Held for trading investments are traded solely for short term profit.

Deposits by banks and debt securities in issue

The Bank issues medium term notes within an established euro medium term note programme and also issues certificates of deposit and commercial paper as part of its normal treasury activities. These sources of funds, alongside other borrowed funds, are invested in marketable investment grade debt securities and short term wholesale market placements and are used to fund customer loans.

Other borrowed funds

The Bank utilises a broad spread of capital funds. In addition to ordinary share capital and retained earnings, when appropriate, the Bank issues preference shares and perpetual and fixed term subordinated notes.

39. Fair values of financial assets and liabilities continued

Derivatives

A derivative is a financial instrument that derives its value from an underlying rate or price such as interest rates, exchange rates and other market prices. Derivatives are an efficient means of managing market risk and limiting counterparty exposure. The Bank uses them mainly for hedging purposes and to meet the needs of customers.

The most frequently used derivative contracts are interest rate swaps, exchange traded futures and options, caps and floors, forward rate agreements, currency swaps and forward currency transactions. Terms and conditions are determined by using standard industry documentation. Derivatives are subject to the same market and credit risk control procedures as are applied to other wholesale market instruments and are aggregated with other exposures to monitor total counterparty exposure which is managed within approved limits for each counterparty.

Foreign exchange

The Bank undertakes foreign exchange dealing to facilitate customer requirements and to generate incremental income from short term trading in the major currencies. Structured risk and trading related risk are managed formally within position limits approved by the Board.

b. Valuation of financial instruments carried at fair value

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

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

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
2012				
Group				
Non-derivative financial assets				
Held for trading:				
Investment securities	**960.2**	**–**	**–**	**960.2**
Designated at fair value:				
Loans and advances to customers	**–**	**142.4**	**11.2**	**153.6**
Investment securities	**1,845.2**	**–**	**–**	**1,845.2**
Available for sale financial assets:				
Investment securities	**2,184.9**	**1,604.5**	**–**	**3,789.4**
Equity shares	**–**	**–**	**5.7**	**5.7**
Derivative financial instruments	**–**	**783.4**	**35.4**	**818.8**
Total assets carried at fair value	**4,990.3**	**2,530.3**	**52.3**	**7,572.9**
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	**–**	**888.1**	**–**	**888.1**
Derivative financial instruments	**–**	**955.2**	**12.4**	**967.6**
Total liabilities carried at fair value	**–**	**1,843.3**	**12.4**	**1,855.7**

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
2011				
Group				
Non-derivative financial assets				
Held for trading:				
Investment securities	–	–	–	–
Designated at fair value:				
Loans and advances to customers	–	101.7	12.4	114.1
Investment securities	343.1	–	–	343.1
Available for sale financial assets:				
Investment securities	1,836.9	1,586.1	–	3,423.0
Equity shares	–	–	5.7	5.7
Derivative financial instruments	–	950.4	25.4	975.8
Total assets carried at fair value	2,180.0	2,638.2	43.5	4,861.7
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	–	1,429.8	–	1,429.8
Derivative financial instruments	–	1,074.6	13.3	1,087.9
Total liabilities carried at fair value	–	2,504.4	13.3	2,517.7

	Fair value at end of the reporting period using:			
	Level 1	**Level 2**	**Level 3**	**Total**
2012				
Bank				
Non-derivative financial assets				
Held for trading:				
Investment securities	**960.2**	**–**	**–**	**960.2**
Designated at fair value:				
Loans and advances to customers	**–**	**142.4**	**11.2**	**153.6**
Investment securities	**1,845.2**	**–**	**–**	**1,845.2**
Available for sale financial assets:				
Investment securities	**2,184.9**	**1,379.0**	**–**	**3,563.9**
Equity shares	**–**	**–**	**5.7**	**5.7**
Derivative financial instruments	**–**	**580.0**	**10.9**	**590.9**
Total assets carried at fair value	**4,990.3**	**2,101.4**	**27.8**	**7,119.5**
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	**–**	**867.2**	**–**	**867.2**
Amounts owed to other Co-operative Group undertakings	**–**	**–**	**1,764.4**	**1,764.4**
Derivative financial instruments	**–**	**909.7**	**12.9**	**922.6**
Total liabilities carried at fair value	**–**	**1,776.9**	**1,777.3**	**3,554.2**

39. Fair values of financial assets and liabilities continued

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
2011				
Bank				
Non-derivative financial assets				
Held for trading:				
Investment securities	–	–	–	–
Designated at fair value:				
Loans and advances to customers	–	101.7	12.4	114.1
Investment securities	343.1	–	–	343.1
Available for sale financial assets:				
Investment securities	1,836.9	1,270.5	–	3,107.4
Equity shares	–	–	5.7	5.7
Derivative financial instruments	–	694.9	9.5	704.4
Total assets carried at fair value	2,180.0	2,067.1	27.6	4,274.7
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	–	1,397.3	–	1,397.3
Amounts owed to other Co-operative Group undertakings	–	–	2,130.6	2,130.6
Derivative financial instruments	–	1,041.6	9.9	1,051.5
Total liabilities carried at fair value	–	2,438.9	2,140.5	4,579.4

The 2011 Bank amounts owed to other Co-operative Group undertakings (level 3) have been amended to include intercompany balances designated at fair value.

The carrying values of financial instruments measured at fair value are determined in compliance with the accounting policies on pages 40 to 50 and according to the following hierarchy:

Level 1 – Quoted market prices in active markets
Financial instruments with quoted prices for identical instruments in active markets. The best evidence of fair value is a quoted market price in an actively traded market.

Level 2 – Valuation techniques using observable inputs
Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

The valuation techniques used to value these instruments employ only observable market data and relate to the following assets and liabilities:

Loans and advances to customers
Loans and advances to customers include corporate loans of £142.4m (2011: £101.7m) which are fair valued through income or expense using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

Investment securities – available for sale
Fair value is based on available market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

Derivative financial instruments
OTC (ie non-exchange traded) derivatives are valued using valuation models which are based on observable market data. Valuation models calculate the present value of expected future cash flows, based upon 'no arbitrage' principles. The Bank enters into vanilla foreign exchange and interest rate swap derivatives, for which modelling techniques are standard across the industry. Examples of inputs that are generally observable include foreign exchange spot and forward rates, and benchmark interest rate curves.

Customer accounts – capital bonds
The estimated fair value of customer accounts – capital bonds is based on independent third party valuations using forecast future movements in the appropriate indices.

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

Level 3 – Valuation techniques using unobservable inputs

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

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

Loans and advances to customers

Loans and advances to customers include 25 year fixed rate mortgages of £11.2m (2011: £12.4m) which are fair valued through income or expense using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has increased the valuation by £0.5m in 2012 (2011: £0.5m decrease). A reasonable change in the assumptions would not result in any material change in the valuation.

Equity shares

Equity shares primarily relate to investments held in Vocalink Limited which are unquoted shares. The valuation of these shares is based on the Group's percentage shareholding and the net asset value of the company according to its most recently published financial statements.

Amounts owed to other Co-operative Group undertakings

Amounts owed to other Co-operative Group undertakings are to the Silk Road Finance Number One plc (Silk Rd 1) subsidiary, relating to the legal transfer of loans and advances on securitisation. The amounts are fair valued to eliminate an accounting mismatch of the swap derivative as discussed above.

Revaluation of the £1,764.4m (2011: £2,130.6m) mortgage pool from carrying to fair value is based on assumed timing of future mortgage capital and revenue receipts, discounted to present value using a credit adjusted discount rate.

During 2012, the Bank's amounts owed to other Co-operative Group undertakings decreased due to reanalysis of intercompany balances.

The amortisation profile is as per the swap's valuation methodology, assuming some annual prepayment, but is extended beyond any bond maturity, until all the mortgages themselves mature, which is circa 25 years. Similarly, the revenue receipts are calculated as per the swap valuation methodology, but extended until all the mortgages mature. For fixed rate mortgages, revenue receipts are based on fixed customer rates within the assumed amortisation profile. For tracker, SVR and discount products, revenue receipts are assumed to be based on forward LIBOR rates plus the product margins. Fixed and tracker mortgages are assumed to revert to SVR at the end of any offer period. All mortgages in the covered bond pool were originated pre 31 December 2007.

The fair value of the swap is based on a valuation model that reflects the mortgage cash flows over a three year period using a discount rate based on LIBOR spreads. This derivative eliminates on consolidation.

Derivative financial instruments

Derivative financial instruments including internal interest rate swaps have been entered into between the Bank and Silk Rd 1.

The purpose of the swaps is to convert the fixed and base rate linked revenue receipts of the pool of mortgage assets to the same LIBOR linked basis as the intercompany loan. Under this swap arrangement Silk Rd 1 pays to the swap counterparty, the monthly mortgage revenue receipts of the pool of assets and receives from the swap counterparty LIBOR plus a contractual spread on the same notional balance; the spread being sufficient to cover the intercompany loan and any expenses.

The swaps are valued based on an assumed amortisation profile of the pool of assets to the bond maturity date (assuming some annual prepayment), an assumed profile of customer receipts over this period, and LIBOR prediction using forward rates. Swap cash flows are discounted to present value using mid-yield curve zero coupon rates, ie no adjustment is made for credit losses, nor for transaction or any other costs.

The fair value of the swaps is based on a valuation model that reflects the mortgage cash flows over a three year period using a discount rate based on LIBOR spreads. These derivatives eliminate on consolidation.

39. Fair values of financial assets and liabilities continued

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

	Fair value at the beginning of the year	Purchases and transfers in	Sales and transfers out	Income or expense including impairment	Fair value at the end of the year
Group					
2012					
Loans and advances to customers	**12.4**	**–**	**–**	**(1.2)**	**11.2**
Derivative assets	**25.4**	**–**	**–**	**10.0**	**35.4**
Equity shares	**5.7**	**–**	**–**	**–**	**5.7**
Derivative liabilities	**(13.3)**	**–**	**–**	**0.9**	**(12.4)**
	30.2	**–**	**–**	**9.7**	**39.9**
2011					
Loans and advances to customers	11.8	–	–	0.6	12.4
Derivative assets	17.5	–	–	7.9	25.4
Equity shares	7.2	–	–	(1.5)	5.7
Derivative liabilities	(27.2)	–	–	13.9	(13.3)
	9.3	–	–	20.9	30.2

	Fair value at the beginning of the year	Purchases and transfers in	Sales and transfers out	Income or expense including impairment	Fair value at the end of the year
Bank					
2012					
Loans and advances to customers	**12.4**	**–**	**–**	**(1.2)**	**11.2**
Derivative assets	**9.5**	**–**	**–**	**1.4**	**10.9**
Equity shares	**5.7**	**–**	**–**	**–**	**5.7**
Derivative liabilities	**(9.9)**	**–**	**–**	**(3.0)**	**(12.9)**
Amounts owed to other Co-operative Group undertakings	**(2,130.6)**	**–**	**361.8**	**4.4**	**(1,764.4)**
	(2,112.9)	**–**	**361.8**	**1.6**	**(1,749.5)**
2011					
Loans and advances to customers	11.8	–	–	0.6	12.4
Derivative assets	20.1	–	–	(10.6)	9.5
Equity shares	7.2	–	–	(1.5)	5.7
Derivative liabilities	(17.5)	–	–	7.6	(9.9)
Amounts owed to other Co-operative Group undertakings	(2,585.8)	–	448.2	7.0	(2,130.6)
	(2,564.2)	–	448.2	3.1	(2,112.9)

The 2011 Bank amounts owed to other Co-operative Group undertakings (level 3) have been amended to include intercompany balances designated at fair value.

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

c. Fair values of financial instruments not carried at fair value

The carrying values of financial instruments measured at amortised cost are determined in compliance with the accounting policies on pages 40 to 50.

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

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

unless there is no significant difference between carrying and fair values.

	Group		**Bank**	
	Carrying value	**Fair value**	**Carrying value**	**Fair value**
2012				
Financial assets				
Loans and receivables				
Loans and advances to banks	**1,904.1**	**1,902.9**	**1,047.2**	**1,046.0**
Loans and advances to customers	**33,185.9**	**33,222.7**	**22,631.9**	**22,487.6**
Fair value adjustments for hedged risk	**354.2**	**354.2**	**354.1**	**354.1**
Investment securities	**295.0**	**302.3**	**355.4**	**380.2**
Amounts owed by other Co-operative Group undertakings	**256.4**	**256.4**	**12,613.0**	**12,575.0**
Financial liabilities				
Financial liabilities at amortised cost				
Deposits by banks	**3,612.0**	**3,626.8**	**3,552.9**	**3,567.7**
Customer accounts	**35,884.4**	**36,108.4**	**33,750.3**	**33,969.4**
Debt securities in issue	**4,713.7**	**4,939.7**	**1,752.2**	**1,799.8**
Other borrowed funds	**1,258.6**	**1,161.3**	**1,258.6**	**1,161.3**
Amounts owed to other Co-operative Group undertakings	**112.0**	**112.0**	**6,044.6**	**6,115.6**

	Group		Bank	
	Carrying value	Fair value	Carrying value	Fair value
2011				
Financial assets				
Loans and receivables				
Loans and advances to banks	2,006.5	2,004.2	1,300.1	1,297.8
Loans and advances to customers	33,651.9	33,870.1	22,620.9	22,622.6
Fair value adjustments for hedged risk	366.3	366.3	365.8	365.8
Investment securities	804.9	798.5	866.1	859.7
Amounts owed by other Co-operative Group undertakings	179.2	179.2	12,961.2	12,373.3
Financial liabilities				
Financial liabilities at amortised cost				
Deposits by banks	3,302.7	3,305.1	3,239.8	3,242.2
Customer accounts	34,990.6	35,138.9	32,670.1	32,812.2
Debt securities in issue	4,164.8	4,008.1	1,431.0	1,434.5
Other borrowed funds	1,258.8	1,092.6	1,258.8	1,092.6
Amounts owed to other Co-operative Group undertakings	132.3	132.3	5,330.6	5,425.1

39. Fair values of financial assets and liabilities continued

Key considerations in the calculation of fair values for loans and receivables and financial liabilities at amortised cost are as follows:

Loans and advances to banks/deposits by banks
Loans and advances to banks include interbank placements and items in the course of collection

The fair value of floating rate placements and overnight deposits is their carrying amount. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity. A credit loss adjustment has been applied based on expected loss amounts derived from the Bank's regulatory capital calculations.

Loans and advances to customers
Fixed rate loans and advances to customers are revalued to fair value based on future interest cash flows (at funding rates) and principal cash flows discounted using an appropriate market rate. Forecast principal repayments are based on redemption at the earlier of maturity or repricing date with some overlay for historical behavioural experience where relevant. The eventual timing of future cash flows may be different from the forecast due to unpredictable customer behaviour. It is assumed there is no fair value adjustment required in respect of interest rate movement on variable rate assets. A credit loss adjustment has been applied based on expected loss amounts derived from the Bank's regulatory capital calculations. The fair value of Group assets are higher than carrying value primarily because the current levels of interest rates are lower in comparison to the fixed levels of interest originated, and are reduced by the increased expectation of losses as the economy is expected to remain fragile for longer. In the Bank the expectation of losses outweighs the impact of interest rates and fair value is lower than carrying value. However in the Group, the fair value is higher because included within the carrying value are assets acquired through the merger with Britannia Building Society that were at a significant discount to their exposure amount.

Investment securities
Fair value is based on available market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

Customer accounts
The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

Debt securities in issue and other borrowed funds
The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

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

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

The Group retains substantially all of the risks and rewards of ownership. The Group benefits to the extent to which surplus income generated by the transferred mortgage portfolios exceeds the administration costs of those mortgages. The Group continues to bear the credit risk of these mortgage assets.

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

The results of the following principal securitisation vehicles are consolidated into the results of the Group. The table below shows the carrying values and fair values of the assets transferred to principal securitisation vehicles and their associated liabilities:

	Carrying amount of transferred assets not derecognised	Carrying amount of associated liabilities	Fair value of transferred assets not derecognised	Fair value of associated liabilities	Net position
2012					
Leek Finance Number Seventeen plc	**618.3**	**648.9**	**614.6**	**636.8**	**(22.2)**
Leek Finance Number Eighteen plc	**735.0**	**794.0**	**730.9**	**770.0**	**(39.1)**
Leek Finance Number Nineteen plc	**713.9**	**787.0**	**708.8**	**774.4**	**(65.6)**
Leek Finance Number Twenty plc	**1,514.8**	**1,488.6**	**1,498.4**	**1,491.8**	**6.6**
Leek Finance Number Twenty One plc	**926.1**	**944.0**	**916.9**	**928.3**	**(11.4)**
Leek Finance Number Twenty Two plc	**394.2**	**411.4**	**391.5**	**406.4**	**(14.9)**
Meerbrook Finance Number Six Limited	**77.3**	**58.3**	**76.8**	**58.3**	**18.5**
Silk Road Finance Number One plc	**1,764.4**	**1,778.9**	**1,764.4**	**1,794.2**	**(29.8)**
Silk Road Finance Number Two plc	**697.1**	**675.3**	**696.9**	**685.2**	**11.7**
Silk Road Finance Number Three plc	**689.1**	**699.5**	**684.1**	**712.9**	**(28.8)**
Cambric Finance Number One plc	**1,644.5**	**1,684.3**	**1,637.5**	**1,679.9**	**(42.4)**
	9,774.7	**9,970.2**	**9,720.8**	**9,938.2**	**(217.4)**

Transferred assets include securitised gilts and loans and advances to customers that have not been derecognised by the seller. The associated liabilities include the fixed and floating rate notes, bank loans and intercompany loans that specifically relate to the funding for the assets securitised.

In 2012, the market value of many of the fixed and floating rate notes has increased, with many of the AAA notes now trading above par, therefore uplifting the fair value. However, the repayment of the notes will be at par.

The securitisation vehicles receive cash daily in relation to the transferred loans and advances and semi-annually for the transferred gilts. These amounts will be held within loans and advances to banks until the associated liabilities' payments are due. Payments are made quarterly for all associated liabilities except for the variable funding notes associated with the transferred gilts, which are paid semi-annually. The amounts held within loans and advances to banks are not included in the table above but will be used in part to cover the repayments made on the associated liabilities.

	Carrying amount of transferred assets not derecognised	Carrying amount of associated liabilities	Fair value of transferred assets not derecognised	Fair value of associated liabilities	Net position
2011					
Leek Finance Number Seventeen plc	638.4	699.2	632.0	576.7	55.3
Leek Finance Number Eighteen plc	758.6	855.5	751.4	677.8	73.6
Leek Finance Number Nineteen plc	740.8	854.4	732.5	661.3	71.2
Leek Finance Number Twenty plc	1,581.7	1,556.8	1,555.6	1,450.5	105.1
Leek Finance Number Twenty One plc	998.0	1,011.3	983.3	915.1	68.2
Leek Finance Number Twenty Two plc	418.5	431.9	413.6	393.3	20.3
Meerbrook Finance Number Six Limited	82.4	61.9	81.4	61.9	19.5
Silk Road Finance Number One plc	2,130.6	2,151.5	2,130.6	2,124.7	5.9
Silk Road Finance Number Two plc	823.6	804.1	827.3	799.2	28.1
	8,172.6	8,426.6	8,107.7	7,660.5	447.2

Covered Bond Limited Liability Partnership

Moorland Covered Bonds LLP was established as a result of a £1.4bn covered bond retained issuance. Loans and advances to customers of £1.9bn were transferred to Moorland Covered Bonds LLP. The transfer was funded by a loan of £1.4bn and capital contribution of £0.5bn. During October 2011 the £1.4bn loan was repaid. Following additional capital contribution repayment and on achieving Regulated Covered Bond status there was a public issuance of notes in November 2011 totalling £0.6bn. As a result of these changes, at the year end the Bank held a loan of £0.6bn (2011: £0.6bn) and a capital contribution of £1.2bn (2011: £1.0bn) with Moorland Covered Bonds LLP.

The loans issued by the Bank are included within amounts owed by other Co-operative Group undertakings. The associated capital contribution invested by the Bank is included within investments in Group undertakings. The notes issued by the Bank in November 2011 are included within debt securities in issue.

39. Fair values of financial assets and liabilities continued

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

	Carrying amount of transferred loans and advances to customers	Carrying amount of fixed and floating rate notes	Fair value of transferred loans and advances to customers	Fair value of fixed and floating rate notes	Net position
2012					
Moorland Covered Bonds LLP	**1,808.4**	**600.0**	**1,835.8**	**693.8**	**1,142.0**

	Carrying amount of transferred loans and advances to customers	Carrying amount of fixed and floating rate notes	Fair value of transferred loans and advances to customers	Fair value of fixed and floating rate notes	Net position
2011					
Moorland Covered Bonds LLP	1,559.5	600.0	1,602.4	602.8	999.6

39. Fair values of financial assets and liabilities continued

Assets pledged

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

	Carrying amount of assets not derecognised	Carrying amount of associated liabilities	Fair value of assets not derecognised	Fair value of associated liabilities	Net position
2012					
Group					
Investment securities sold under repurchase agreements	**1,907.4**	**1,830.9**	**1,907.7**	**1,827.5**	**80.2**
Bank					
Investment securities sold under repurchase agreements	**1,907.4**	**1,830.9**	**1,907.7**	**1,827.5**	**80.2**
Amounts owed by other Co-operative Group undertakings sold under repurchase agreements	**1,324.6**	**896.7**	**1,301.6**	**911.7**	**389.9**

	Carrying amount of assets not derecognised	Carrying amount of associated liabilities	Fair value of assets not derecognised	Fair value of associated liabilities	Net position
2011					
Group					
Investment securities sold under repurchase agreements	2,114.4	1,703.2	2,114.9	1,869.1	245.8
Bank					
Investment securities sold under repurchase agreements	2,114.4	1,703.2	2,114.9	1,869.1	245.8
Amounts owed by other Co-operative Group undertakings sold under repurchase agreements	777.1	613.9	767.4	614.3	153.1

Associated liabilities are included within deposits by banks.

The Group and Bank have loans and advances to banks of £250.0m (2011: £255.7m) under reverse sale and repurchase agreements and against gilts are held with a fair value of £250.4m (2011: £267.8m). These transactions are conducted under terms that are usual and customary to standard stock lending, securities borrowing and reverse purchase agreements. The Group is permitted to sell or repledge the assets received as collateral in the absence of their default. The Group is obliged to return equivalent securities. At 31 December 2012 the fair value of collateral repledged amounted to £250.4m (2011: £267.8m). The Group and Bank do not adjust for the fair value of securities received under reverse sale and repurchase agreements.

Notes to the financial statements continued

For the year ended 31 December 2012

All amounts are stated in £m unless otherwise indicated

40. Bank only analysis of credit risk exposure

2012	Loans and advances to banks	Loans and advances to customers	Investment securities				Derivative financial instruments	Total
			Loans and receivables	Available for sale	Fair value through income or expense	Held for trading		
Analysis of balance in note	14	15	16	16	16	16	17	
Gross balance	**1,047.2**	**23,203.7**	**355.4**	**3,602.9**	**1,845.2**	**960.2**	**590.9**	**31,605.5**
Less: allowance for losses	**–**	**(418.2)**	**–**	**(39.0)**	**–**	**–**	**–**	**(457.2)**
	1,047.2	**22,785.5**	**355.4**	**3,563.9**	**1,845.2**	**960.2**	**590.9**	**31,148.3**
Analysis of credit risk exposure								
Not impaired	**1,047.2**	**21,932.0**	**366.4**	**3,563.9**	**1,845.2**	**960.2**	**590.9**	**30,305.8**
Impaired	**–**	**1,311.6**	**–**	**39.0**	**–**	**–**	**–**	**1,350.6**
	1,047.2	**23,243.6**	**366.4**	**3,602.9**	**1,845.2**	**960.2**	**590.9**	**31,656.4**
Credit commitments	**54.1**	**4,736.5**	**–**	**–**	**–**	**–**	**–**	**4,790.6**
Gross credit risk exposure	**1,101.3**	**27,980.1**	**366.4**	**3,602.9**	**1,845.2**	**960.2**	**590.9**	**36,447.0**
Less:								
Fair value adjustments	**–**	**(39.9)**	**(11.0)**	**–**	**–**	**–**	**–**	**(50.9)**
Allowance for losses	**–**	**(418.2)**	**–**	**(39.0)**	**–**	**–**	**–**	**(457.2)**
Net credit risk exposure	**1,101.3**	**27,522.0**	**355.4**	**3,563.9**	**1,845.2**	**960.2**	**590.9**	**35,938.9**

2011	Loans and advances to banks	Loans and advances to customers	Investment securities				Derivative financial instruments	Total
			Loans and receivables	Available for sale	Fair value through income or expense	Held for trading		
Analysis of balance in note	14	15	16	16	16	16	17	
Gross balance	1,300.1	22,993.1	868.8	3,149.9	343.1	–	704.4	29,359.4
Less: allowance for losses	–	(258.1)	(2.7)	(42.5)	–	–	–	(303.3)
	1,300.1	22,735.0	866.1	3,107.4	343.1	–	704.4	29,056.1
Analysis of credit risk exposure								
Not impaired	1,295.5	22,240.0	884.7	3,107.4	343.1	–	704.0	28,574.7
Impaired	21.0	795.9	3.9	42.5	–	–	0.4	863.7
	1,316.5	23,035.9	888.6	3,149.9	343.1	–	704.4	29,438.4
Credit commitments	40.6	4,661.8	–	–	–	–	–	4,702.4
Gross credit risk exposure	1,357.1	27,697.7	888.6	3,149.9	343.1	–	704.4	34,140.8
Less:								
Fair value adjustments	(16.4)	(42.8)	(19.8)	–	–	–	–	(79.0)
Allowance for losses	–	(258.1)	(2.7)	(42.5)	–	–	–	(303.3)
Net credit risk exposure	1,340.7	27,396.8	866.1	3,107.4	343.1	–	704.4	33,758.5

The comparative figures for loans and advances to customers have been updated to include the changes made to impairment definitions.

Responsibility statement

for the year ended 31 December 2012

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Directors' report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By Order of the Board
Barry Tootell, Chief Executive

20 March 2013

Notice of Annual General Meeting 2013

NOTICE IS HEREBY GIVEN that the Annual General Meeting of The Co-operative Bank plc will be held on the 9th Floor, 1 Angel Square, Manchester M60 0AG at 9am on Wednesday 15 May 2013 for the following purposes:

Ordinary Business

1. To receive the notice convening the meeting.

2. To receive the annual reports and adopt the financial statements for the year ended 31 December 2012, together with the auditors' report.

3. To approve the remuneration report for the year ended 31 December 2012.

4. To accept the following recommendations of the Board in respect of the non-cumulative irredeemable preference shares:

i) that the payment of the dividend of 4.625p per £1 share on 30 November 2012 be confirmed.

ii) that a dividend of 4.625p per £1 share be declared and paid on 31 May 2013 to the registered holders as at 3 May 2013 providing a dividend rate of 9.25 per cent per annum and making a total distribution of £5,550,000.

5. To re-elect the following directors who retire by rotation, in accordance with the provisions of Article 105:

i) Duncan Bowdler, Non-Executive Director

ii) Peter Harvey, Non-Executive Director

iii) Bob Newton, Non-Executive Director

6. To re-appoint the following directors who were appointed to the Board since the last Annual General Meeting of the Company:

i) Richard Coates, Non-Executive Director

7. To re-appoint KPMG Audit Plc as auditor of the Company, to hold office from the conclusion of this meeting until the conclusion of the next General Meeting at which accounts are laid before the Company, at a remuneration to be fixed by the Directors:

Registered Office:
1 Balloon Street
Manchester M60 4EP
Reg. No. 990937 (England)
Tel: 0161 832 3456
Fax: 0161 829 4475
Tel: 0870 702 0003

Registrar:
Computershare Investor Services PLC
P.O. Box 82
The Pavilions
Bridgwater Road
Bristol BS99 7NH

By Order of the Board
Moira Lees, Secretary

20 March 2013

A member entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote on his/her behalf. A proxy need not also be a member. Further information on preference shareholders' voting rights is given below.

Members should note that to attend the meeting their shareholding must be registered on the register of the Company not later than 9am on 13 May 2013. This applies to shares held in uncertified forms in CREST and to shares held in certified form.

Notes:

1. Director information

The biographies of the directors up for re-election and re-appointment at the Annual General Meeting can be found on page 12 of the financial statements.

2. Preference shareholders – Extract from Articles of Association 4 (B)(c)

Voting and General Meetings

i) The holders of the preference shares shall be entitled to receive notice of and attend (either in person or by proxy) all General Meetings of the Company. The holders of the preference shares shall have a right to speak and vote at a General Meeting of the Company only if and when, at the date of the notice convening such meeting, the fixed preferential dividend payable to them respectively has been in arrears for six months or more after any date fixed for payment thereof, or if a resolution is to be proposed at such meeting abrogating or varying any of the respective rights or privileges attaching to their shareholding or for the winding-up of the Company or other return of capital and then on such resolution only.

ii) Whenever the holders of the preference shares are entitled to vote at a General Meeting of the Company upon any resolution proposed at such meeting, on a show of hands every holder who (being an individual) is present in person or (being a corporation) is present by a representative or by proxy shall have one vote and, on a poll, shall have one vote in respect of each preference share registered in the name of such holder.

Glossary

For the year ended 31 December 2012

The following glossary defines terminology used within the Group's Annual Report and Accounts to assist the reader and to facilitate comparison with publications by other financial institutions:

Terminology	Definition
Almost prime	Almost prime lending is lending to borrowers with very low levels of adverse credit history.
Arrears	Customers are said to be in arrears or non-performing when they are behind in fulfilling their obligations with the result that an outstanding loan is unpaid or overdue. Corporate customers may also be considered non-performing prior to being behind in fulfilling their obligations. This can happen when a significant restructuring exercise begins.
Asset & Liability Committee (ALCO)	This committee is chaired by the Chief Executive Officer and is primarily responsible for overseeing the management of market, liquidity and funding risks. Its responsibilities include ensuring that the capital and solvency position is managed in line with policy and that adequate capital is maintained at all times overseeing and monitoring relevant risk control frameworks and recommending to CEO and ERC relevant risk policies and detailed risk appetite limits for approval.
Asset-backed securities (ABS)	Securities that represent an interest in an underlying pool of referenced assets. The referenced pool can comprise any assets which attract a set of associated cash flows but are commonly pools of residential or commercial mortgages but could also include leases, credit card receivables, motor vehicles, student loans.
Audit Committee (AC)	The committee which provides oversight in relation to financial reporting, internal control, regulatory compliance, external and internal audit across the Banking Group.
Automated Valuation Model (AVM)	A valuation model used specifically for low loan to value (LTV) remortgages. Performance of AVMs is monitored on a regular basis to ensure their ongoing accuracy.
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 was implemented in the UK by the FSA.
Basel III	A strengthening of the requirements laid out in Basel II, to be phased into the Bank gradually between 2013 and 2019 ahead of full implementation by 2023. This phased implementation is now expected to commence in the UK in 2014.
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.
BIPRU	The prudential sourcebook for banks, building societies and investment firms which sets out the FSA's capital requirements.
Board Risk Committee (BRC)	This committee provides oversight and advice to the Banking Group Board on current and potential risks and the overall risk framework, including risk appetite, risk tolerance and management strategies.
Buy to let	A commercial practice of buying a property to let to tenants, rather than to live in.
Capital bonds	Fixed term customer accounts with returns based on the movement in an index (eg FTSE 100) over the term of the bond.
Capital Management Committee (CMC)	This committee reviews, challenges and monitors the capital adequacy of the Banking Group, in line with capital policy and within risk appetite.
Capital ratio	Total of Tier 1 capital plus Tier 2 capital, all divided by risk weighted assets.
Capital resources	Capital held, allowable under regulatory rules, less certain regulatory adjustments and deductions that are required to be made. Capital includes the general reserve, revaluation reserve, collectively assessed impairment allowances for products measured on a standardised basis and subordinated debt.
Carrying value	The value of an asset or liability as it appears in the balance sheet. For each asset or liability, the value is based on either of the amortised cost or fair value principles.
Certificates of deposit (CDs)	Debt issued by banks, savings and loan associations to individual investors with terms ranging from a few months to several years. Longer term CDs tend to bear a higher interest rate. At the expiration of the term, investors may (subject to penalties) withdraw both the principal and the accrued interest.
CFS Management Services Ltd (CFSMS)	CFS Management Services Ltd (CFSMS) provides supplies and services on behalf of fellow subsidiary undertakings within The Co-operative Banking Group.
Charged off	When all economical avenues to recover an unsecured debt have been exhausted, the Bank permanently closes the loan account, ie it is charged off. This final step sits at the end of a time frame within which the Bank attempts to manage the debt's recovery and differs from a 'write down' in terms of its fixed position in time (see 'Write down').
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').
Colleague engagement	An internal survey, measuring the level of the Bank's employees' engagement.
Collectively assessed for impairment	Impairment is measured collectively where a portfolio comprises assets with a homogenous risk and where appropriate statistical techniques are available.
Commercial Paper	An unsecured promissory note issued to finance short term credit needs. It specifies the face amount paid to investors on the maturity date.

Glossary continued
For the year ended 31 December 2012

Terminology	Definition
Commercial real estate	Commercial real estate includes office buildings, industrial property, malls, retail stores, shopping centres, multifamily housing buildings, warehouses, and industrial properties.
Conduct risk	The risk that the Banking Group's behaviours, offerings or interactions will result in unfair outcomes for customers.
Contagion risk	An international financial market term which describes a corrupting or harmful influence, spreading effects of shocks from one counterparty to another.
Core business	Lines of business that are consistent with the Bank's strategy and risk appetite.
Corporate and Business Banking (CABB)	The Group's operating segment which includes Corporate, Optimum and Illius. This includes lending to large corporate and commercial entities, acquired mortgage books and a specialist mortgage team dealing with intermediary lending.
Corporate core segment	The segment that comprises corporate banking, business banking and business services in line with the Bank's strategy and risk appetite.
Cost to income ratio	Operating expenses divided by operating income.
Counterparty	In any financial contract, the person or institution entering the contract on the opposite side of the transaction is called a counterparty.
Covered bonds	Debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Bank issues covered bonds as part of its funding activities.
Credit Approvals Committee	The Credit Approvals Committee supports the Chief Executive Officer carrying out his responsibilities including, but not limited to, sanctioning large counterparty transactions and managing large exposure positions.
Credit default swap	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 impairment	Impairment charges on loans and advances to customers.
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 Committee (CRMC)	This committee advises and supports the Credit Risk Director. It designs the credit risk control implementation approach and risk control framework. It reviews the CBG credit risk policy and credit measurement methodologies, defines and recommends the credit risk appetite and limits and reviews and challenges the CBG credit risk processes and procedures.
Currency swap	An arrangement in which two parties exchange specific principal amounts of different currencies at inception and subsequently interest payments on the principal amounts. Often one party will pay a fixed rate of interest, while the other will pay a floating rate (though there are also fixed-fixed and floating-floating arrangements). At the maturity of the swap, the principal amounts are usually re-exchanged.
Credit valuation adjustments (CVAs)	Adjustments to the fair values of derivative assets to reflect the creditworthiness of the counterparty.
Customer advocacy	An external survey, measuring the level of the Bank's customers who would personally recommend the Bank to other potential new customers as their primary financial services provider.
Customer deposits	Money deposited by all individuals and companies that are not credit institutions. Such funds are recorded as liabilities in the Bank's balance sheet under customer accounts or financial liabilities designated at fair value.
Customer funding ratio	Customer deposits divided by customer loans. This is the reverse equation of the customer loan to deposit ratio (see 'Customer loan to deposit ratio').
Customer loan to deposit ratio	Customer loans divided by customer deposits. This is the reverse equation of the customer funding ratio (see 'Customer funding ratio').
Debt for equity swaps	The act whereby a creditor exchanges a loan asset for a stake in its relevant debtor company's equity share capital.
Debt securities in issue	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit, commercial paper and fixed and floating rate notes.
Default	Circumstances in which the probability of default is taken at 100% for the purposes of the calculation of regulatory capital and compliance with Basel II. This is defined as when a borrower reaches a predefined arrears status where a borrower is considered unlikely to repay the credit obligation in full without the lender taking action.
Deleverage the balance sheet	Strategic reduction of the Bank's risk asset base leading to improved capital management.
Delinquency	A customer in arrears is also said to be in a state of delinquency. When a customer is in arrears, his entire outstanding balance is said to be delinquent, meaning that delinquent balances are the total outstanding loans on which payments are overdue (see 'Arrears').
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.

Terminology	Definition
Effective interest rate method (EIR)	The method used to measure the carrying value of certain financial assets or liabilities and to allocate associated interest income or expense over the relevant period.
Eurozone	The geographical area containing countries whose economies function using the European single currency.
Executive Risk Committee (ERC)	The committee is chaired by the Chief Risk Officer (CRO). Its purpose is to provide a mechanism to ensure that the Banking Group's risk management is reviewed, challenged and approved (with escalation to Board Risk Committee where required) and embedded within the Banking Group.
Executive Committee	This committee manages the business in line with the Board risk appetite statement. It also maintains oversight of risk management processes and management information.
Expected charge off rate	The expected level of a portfolio's loans that may be written off as bad debt.
Expected loss	A measure of anticipated loss for exposures captured under an internal ratings based credit risk approach. The expected loss amount is the exposure from a potential default of a counterparty or dilution over a one year period to the amount outstanding at default.
Exposure at default (EAD)	A Basel II parameter used in internal ratings based approaches to estimate the amount outstanding at the time of default.
External audit	The independent review by an external firm of the Company's financial statements.
External credit rating	A financial indicator of risk, assigned by credit rating agencies, to potential investors in the Group.
Fair value adjustments	Fair value adjustments are the remaining balance sheet adjustments for the assets/liabilities acquired on the merger of the Bank and Britannia Building Society on 1 August 2009.
Fair value amortisation	The amortisation of the remaining interest risk related fair value adjustments for the assets/liabilities acquired on the merger of the Bank and Britannia Building Society on 1 August 2009 (see 'Interest rate risk').
Financial instruments	Any document with monetary value. Examples include cash and cash equivalents, but also securities such as bonds and stocks which have value and may be traded in exchange for money.
Financial Services Authority (FSA)	An independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000, which regulates the financial services industry in the best interests of its stakeholders. It is a company limited by guarantee and financed by the financial services industry.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FSA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Floating rate notes (FRNs)	Investments with a variable interest rate. The adjustments to the interest rate are usually made every six months and are tied (or 'float') to a certain money market index.
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.
Foreclosure	The legal process by which a lender, eg the Bank, obtains a court order in order to terminate a borrower's equitable right of redemption. This legal action is required when a borrower has materially failed to comply with the agreed terms and conditions of the loan, eg by defaulting (see 'Forbearance').
Forward rate agreement	A legal contract, governing the terms and conditions of a forward or future, in which the buyer pays a fixed rate of interest to the seller in return for the seller's floating rate (see 'Forwards', 'Futures' and 'Swaps').
Forwards	Non-standardised contracts, traded over the counter, between two parties to buy or sell financial instruments at a specified future time at a price agreed today (see 'Over The Counter').
Funding for Lending	The Bank of England and HM Treasury launched the Funding for Lending Scheme (FLS) on 13 July 2012. It is designed to boost lending to households and businesses. It works by allowing participating banks and building societies to borrow from the Bank of England for up to four years. As security against that lending, participating banks will provide assets, such as business or mortgage loans, to the Bank of England. Banks will be able to borrow during the 18 months from 1 August 2012 until 31 January 2014.
Futures	Standardised contracts, traded on an exchange, between two parties to buy or sell financial instruments at a specified future time at a price agreed today.
Gap	The Bank's net exposure to variable elements being managed within its market risk, eg interest rate movements (see 'Market risk').
Hedging	A technique used by the Bank to offset risks on one instrument by purchasing a second instrument that is expected to perform in the opposite way.
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.

Glossary continued
For the year ended 31 December 2012

Terminology	Definition
Impairment allowance	A loss allowance held on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. An impairment loss allowance may be either individual or collective.
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 FSA (see 'Liquidity risk').
Individual Liquidity Guidance (ILG)	A FSA 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.
Individually assessed for impairment	Impairment is measured individually for assets that are individually significant.
Integration and Transformation Committee	This committee provides oversight by in depth review of transformation activity within the Group in order to give assurance on progress.
Interest rate risk	The variability in value borne by an interest bearing asset, such as a loan or a bond, due to variability of interest rates. In general, as rates rise, the price of a fixed rate bond will fall, and vice versa.
Internal audit	The examination of the Company's records and reports by its employees. Internal audits are usually intended to prevent fraud and to ensure compliance with Board directives and management policies.
Internal Capital Adequacy Assessment Process (ICAAP)	The Bank's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events.
Internal rating grade (IRG)	The grading of credit risk resulting from the internal ratings based approach (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 FSA permission.
Investment grade	A debt security, treasury bill or similar instrument with a credit rating measured by external agencies of AAA to BBB.
Legacy insurance products	Insurance products which are no longer sold to customers by the Group.
LIBOR (London Interbank Offered Rate)	The interest rate participating banks offer to other banks for loans on the London market.
Lifetime expected loss	The losses that the Bank expects to incur over the lifetime of portfolios of mortgage assets which were acquired on merger with Britannia Building Society. This is different from expected loss (see 'Expected loss') which is based on assets expected to default in the next 12 months.
Limited Liability Partnership (LLP)	An LLP provides each of its individual partners protection against personal liability for certain partnership liabilities.
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 Committee (LMC)	This committee 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)).
Loss given default	An estimate of the actual loss that would occur in the event of default expressed as a percentage of the Exposure at Default (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.
Low to medium credit risk	Within not impaired, low to medium credit risk has been defined as exposures where the probability of default (PD) is 1% or below over a one year time horizon for exposures on an internal ratings based (IRB) approach under Basel II, and slotting category strong/good for specialised lending exposures under the slotting approach (see 'Slotting').
Lower Tier 2	Lower Tier 2 capital comprises the Bank's long term subordinated debt.
Malus	A facility whereby the Remuneration and Appointments Committee may reduce the amount of any deferred bonus payable in the event that any of the underpins to the incentive plans are not met or where business and/or individual performance otherwise requires.
Management expenses and compensation cost	The specific elements of both operating and financing cost which form the basis of the Financial Services Compensation Scheme (see 'Financial Services Compensation Scheme (FSCS)').
Mandatory reserve deposits	Mandatory reserve deposits are deposited with the Bank of England and are not available for use in the Group's day to day operations. They are non-interest bearing and are not included in cash and cash equivalents.
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.

Terminology	Definition
Medium term notes (MTN)	Flexible medium term corporate debt instruments, offered by the Bank to investors through a dealer. Investors can choose from differing maturities, ranging from nine months to 30 years.
Medium to high credit risk	Within not impaired, medium to high credit risk has been defined as a probability of default (PD) of greater than 1% over a one year time horizon for exposure on internal ratings based (IRB) approach under Basel II, and slotting category weak/satisfactory for specialised lending exposures under the slotting approach (see 'Slotting').
Member	A person who holds and retains one share in The Co-operative Group. The share is paid for by a £1 deduction from the member's first profits payment. The member, by a result of the deduction, becomes a shareholder of the Co-operative Group Limited.
Merger	Any combination of two or more business enterprises into a single enterprise. In the Group, this specifically refers to the merger of the Bank with Britannia Building Society on 1 August 2009 (see 'Transfer of engagements').
Mobile banking service	A service allowing customers to access their account information and locate branches and ATMs via iPhone, BlackBerry and Android handsets.
Model Review Committee (MRC)	This committee provides oversight and challenge of model governance across the Banking Group in support of the Enterprise Risk Director.
Mortgage backed securities	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 interest income	The difference between interest received on assets and interest paid on liabilities after taking into account the effect of derivatives.
Net present value (NPV)	The present value of the expected future cash in and out flows on an asset or liability.
Non-conforming	Loans originated by Platform prior to 2009 and those acquired by Britannia Treasury Services, with similar risk profiles to 'Almost prime' (see 'Almost prime').
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 Committee (ORC)	This committee reports into the Executive Risk Committee and 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.
Optimum	A sub-segment within Corporate and Business Banking which is a closed book of residential mortgages originated through intermediaries and previously purchased mortgage portfolios.
Options	Instruments which convey the rights, but not the obligations, to engage in future transactions.
Over The Counter (OTC)	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.
Overnight Indexed Swap (OIS)	A rate reflecting the overnight interest typically earned or paid on the Bank's collateralised swaps. The OIS rate is used for valuing the discounted cash flows of collateralised swaps.
Past due	When a counterparty has failed to make a payment when contractually due.
Pension risk	The risk to Banking Group capital and company funds from exposure to pension scheme liabilities and risks inherent in the valuation of scheme liabilities and assets.
Preference shares	The preference shares are fixed interest shares and are non-cumulative and irredeemable. On a return of capital on winding up, the assets of the Bank shall be applied in repaying the preference share capital in priority to any payments to the holders of any other class of shares in the capital of the Bank.
Prime	Prime mortgages are mainstream residential loans, which typically have a higher credit quality and fit standard underwriting processes. As such, they are likely to have a good credit history and pass a standard affordability assessment at the point of origination.
Probability of default (PD)	The likelihood that a loan will not be repaid and will fall into default. PD may be calculated for each customer who has a loan (normally applicable to wholesale customers) or for a portfolio of customers with similar attributes (normally applicable to retail customers). To calculate PD, the Bank assesses the credit quality of borrowers and other counterparties and assigns them an internal risk rating.
Project Verde	The bid to purchase the Verde business from the Lloyds Banking Group. Also referred to as project Mars.

Glossary continued
For the year ended 31 December 2012

Terminology	Definition
Recovery and Resolution Plan	The FSA required all UK deposit takers and large investment firms to draw up a Recovery and Resolution Plan by 31 December 2012. The Recovery Plan assesses and documents the recovery options available in situations of financial stress or negative financial shocks, either market-wide or idiosyncratic. The Resolution Plan will provide authorities with sufficient information to enable them to determine a detailed roadmap to resolve a failed financial institution, without resorting to government (effectively taxpayer) support.
Regulatory Risk Committee (RRC)	This committee supports the Regulatory Risk Director. It ensures maintenance of appropriate authorisations for the regulated entities within CBG, adherence to regulatory reporting requirements and any ongoing regulatory engagement.
Remuneration and Appointments Committee	This committee determines the policy on remuneration and other terms and conditions of employment of senior executives. It makes recommendations on senior executive appointments and the related terms and conditions. It reviews and agrees remuneration policy for staff under the FSA remuneration code (see 'Remuneration Code'). In addition, it reviews and approves incentive schemes and decides on issues surrounding the retirement benefit schemes.
Remuneration Code	The Remuneration Code, issued by the Financial Services Authority, sets out the standards that banks, building societies and other financial institutions have to meet when setting pay and bonus awards for their staff. It aims to ensure that firms' remuneration practices are consistent with effective risk management.
Repo/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.
Reputational risk	The risk associated with an issue which could in some way be damaging to the brand of The Co-operative Banking Group either through its strategic decisions, business performance, an operational failure or external perception.
Retail segment	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.
Return on Risk Weighted Exposure Amount (RRWEA)	The return on Bank's assets and exposures weighted according to risk. The measure is one of the performance metrics set by the Remuneration and Appointments Committee when assessing targets in the long term incentive plan.
Risk appetite	The articulation of the level of risk that the Group is willing to accept (or not accept) in order to safeguard the interests of the members whilst achieving its business objectives.
Risk Management Forums	A framework of sector specific management forums supporting risk and capital management, optimising performance and monitoring adherence to policy.
Risk weighted amount	Risk weightings are established in accordance with Basel II as implemented by the FSA. Risk weighted amounts are the carrying value of the Bank's assets, adjusted by the risk weightings, to reflect the degrees of risk they represent.
Risk weighted assets	A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with Basel II.
Roll up mortgage	A mortgage, whose accrued interest is added to its principal amount and settled at the end of its repayment term.
Sale and purchase agreement (SPA)	A legal contract which obliges the buyer to buy and seller to sell products or services.
Secondary sovereign exposure	Direct exposure to something other than sovereign debt that has itself a direct exposure to sovereign debt.
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.
Securitisation	A process by which a portfolio of retail mortgages is used to back the issuance of new securities by an SPE. The Group has established securitisation structures as part of its funding and capital management activities (see 'Special purpose entities (SPEs)').
Senior unsecured debt	Debt that has priority ahead of all other unsecured or subordinated debt for payment in the event of default.
Significant items	Items which are material by both size and nature (ie outside of the normal operating activities of the Group) are treated as significant items and disclosed separately on the face of the income statement.

Terminology	Definition
Slotting	The regulatory defined approach used for rating the risk level of Corporate lending using a broad scope of financial, political and transactional factors. The regulatory slotting categories are listed as follows: – 'Standardised' businesses lack sufficient information upon which detailed credit analysis can be undertaken for which models have yet to be developed; – 'Strong' businesses have little competition, high demand, significant governmental support and enforceable collateral; – 'Good' businesses have limited competition, stable demand, good governmental support and enforceable collateral; – 'Satisfactory' businesses have a broad competition base with limited levels of demand, governmental support and collateral; – 'Weak' businesses operate at a disadvantage to competition, display a declining trend of demand, with no governmental support and no clear collateral; and – 'Default' businesses are considered unlikely to repay their credit obligations (see 'Impaired loans').
Sovereign debt	Bonds issued by and loans given to central banks and local governments, governmental bodies and other government-related bodies.
Sovereign exposure	The Bank's exposure to the total financial obligations incurred by all governmental bodies of any nation.
Special purpose entities (SPEs)	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; and – Covered Bond Limited Liability Partnerships created in order to act as guarantors for issues of covered bonds.
Specialised lending	Lending in which 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 category	Customers who have not defaulted, and for the purposes of the capital calculations are not rated with the regulatory approved rating model.
Standard Variable Rate (SVR)	A variable and basic rate of interest charged on a mortgage. This may change in reaction to market conditions resulting in monthly repayments going up or down.
Statutory loss	The loss stated in accordance with the requirements of the UK Companies Act 2006, which incorporates the requirements of International Financial Reporting Standards (IFRS).
Strategic and business risk	Risk arising from changes to the Banking Group's business and the environment in which it operates, specifically the risk of not being able to carry out the Bank's business plan and desired strategy.
Subordinated debt/liabilities	Liabilities which, in the event of insolvency or liquidation of the Group, are subordinated to the claims of depositors and other creditors of the Group.
Sub-sovereign	Any level of government below the national or central government. This includes regions, provinces, states, municipalities.
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.
Tenor	The length of time until a loan is due. For example, a loan is taken out with a two year tenor. After one year passes, the tenor of the loan is one year.
Term deposit	A deposit balance that cannot be withdrawn before a date specified at the time of deposit.
the Bank	The Co-operative Bank as a standalone entity.
the Banking Group	See 'The Co-operative Banking Group'.
the Board	The Board of Directors. They manage the Banking Group's business performance in line with its purpose, givens, vision and values.
The Co-operative Banking Group	An internal brand, which is a consolidation of the following entities: CFS Management Services Ltd, CFS Services Ltd, CIS General Insurance Ltd, Co-operative Insurance Society Ltd, Co-operative Asset Management Ltd and Co-operative Bank plc.
The Co-operative Group	The ultimate holding company.
the Group	The Co-operative Bank consolidated with its subsidiaries.
Tier 1	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 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 ratio	Tier 1 capital divided by risk weighted assets.

Glossary continued
For the year ended 31 December 2012

Terminology	Definition
Tier 2	Tier 2 capital comprises the Bank's property valuation reserve, preference shares, 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 (see 'Upper Tier 2' and 'Lower Tier 2').
Transfer of engagements	On 1 August 2009, Britannia Building Society merged with The Co-operative Bank plc by a transfer of engagements between the building society and the Bank under the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 (see 'Merger').
Treasury Market Risk Committee (TMRC)	This committee reviews, challenges and monitors the market risk profile for the Banking Group, in line with policy and within the risk appetite.
Treasury segment	The treasury segment's responsibilities usually include capital management, risk management, strategic planning and investor relations.
Unaudited	Financial information that has not been subjected to the audit procedures undertaken by the Group's external auditor.
Unfunded pension scheme	Pension scheme which has liabilities and no assets. The Group will pay the liabilities of the scheme as they fall due.
Unsecured lending	Lending for which there is no collateral for the loan.
Upper Tier 2	Upper Tier 2 capital comprises the Group's preference shares, perpetual subordinated bonds and revaluation reserves.
Verde business	Separated part of the retail business of the Lloyds Banking Group.
Value at risk (VaR)	VaR measures the daily maximum potential gain or loss due to market volatility within a statistical confidence level of 95% and a one day holding period. The VaR methodology employed is historical simulation using a time series of one year to latest day.
Watchlist	A list of counterparties, drawn up by the Bank once it has elected to closely monitor the performance of loans subject to significant credit risk.
Wholesale	Wholesale banking is the provision of loans to corporate customers and institutional customers and services to other banks and financial institutions.
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 debt's life (see 'Charge off').

Notes

Notes

Design by Radley Yeldar

Printed at APS Group, an ISO 14001 and
FSC certified company.

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PART (B)

AUDITED FINANCIAL STATEMENTS OF THE COMPANY FOR THE FINANCIAL YEAR ENDING 31 DECEMBER 2011

The Co-operative Bank plc

Building the compelling co-operative alternative

Financial statements 2011

Part of The **co-operative** banking group

The **co-operative**
good with money

Contents

1 About us
3 Chair's statement
4 Chief Executive's overview
5 Business and financial review
8 Social goals
10 The Board
11 Report of the Board of Directors
19 Remuneration report
29 Independent auditor's report
30 Consolidated income statement
31 Consolidated statement of comprehensive income
32 Consolidated balance sheet
33 Bank balance sheet
34 Consolidated statement of cash flows
35 Bank statement of cash flows
36 Consolidated and Bank statements of changes in equity
37 Basis of preparation and significant accounting policies
46 Risk management
71 Capital management
73 Critical judgments and estimates
75 Notes to the financial statements
123 Responsibility statement
124 Notice of Annual General Meeting 2012
125 Glossary

About us: a guide to The Co-operative Bank

What is The Co-operative Bank?

The Co-operative Bank is part of The Co-operative Banking Group, providing a range of financial services to personal and business customers across the UK. The Banking Group's parent company, The Co-operative Group, is the world's largest consumer co-operative.

The Co-operative Bank operates under its own brand as well as those of **smile**, Platform and Britannia. We offer our services through 342 branches and 22 corporate banking centres as well as telephony and online channels.

We are a leader in the field of ethical investment and corporate social responsibility. Our customer driven ethical strategy was the first of its kind in our industry and we pursue an active strategy of community involvement.

What services do we provide?

We offer a broad range of financial services to both personal and corporate customers, including high street and internet banking; current accounts and credit cards; mortgages and loans; savings; a range of personal and commercial insurances; corporate finance and financial advice. In partnership with AXA Wealth we also offer a range of savings and investment services to our branch customers.

How do we provide them?

We believe that our customers should be able to access our services in the way and at the time that best suits their needs, so we offer our services via a number of channels including:

- face to face (via our Britannia and Co-operative Bank branch networks)
- over the telephone (via our customer contact centres)
- online

How do we do business?

We are renowned as a member owned, customer led and ethically guided business. In contrast with many shareholder owned competitors, we exist solely for the benefit of our members and customers. In 2011 our 'co-operative difference' was recognised by the Financial Times in naming us Europe's most sustainable bank for the second year running.

Our business strategy is driven by our **purpose**, **vision**, **values** and **givens**.

Our **purpose** represents who we are and why we are different from other financial services providers. The Co-operative Bank's purpose is to be a pioneering business delivering sustainable financial services for members and society.

Our **vision** is to become a compelling co-operative alternative in the markets in which we compete.

Our **values** describe what we stand for and ensure we are consistent in how we treat customers, members and colleagues.

As a co-operative:

- We put **members and customers first** in all we do
- We take **personal and social responsibility**
- Together we will create **a great place to work, grow and develop**
- We strive relentlessly to be **faster, better, more successful**
- We are open and fair and committed to **excellent communication**

Our **givens** are the building blocks that underpin our business:

- We champion **co-operative values, principles and ethics**
- We are **financially prudent and strong**
- We **share profits** with members
- We only do business **consistent with our values and principles**

About us: a guide to The Co-operative Bank continued

How do we measure our success?

The Co-operative Bank business strategy measures success in four key areas: financial, customer, people and process. This 'balanced scorecard' approach is a key reflection of our co-operative difference and helps us ensure that in all decisions we make as a business we focus on all implications of the decision. It also helps us to take a broad view of our progress towards our strategic vision.

The following table summarises our performance in 2011 against our key performance indicators.

The Board reviews performance evidence against each key performance indicator on a regular basis, and considers 2011's performance satisfactory in all areas. Details (except where commercially sensitive) are shown below.

Financial

Financial measures focus on profitability and underlying financial strength:

- **Profit**
  This is our measure of operating result for the business as a whole.
  Operating result: £141.1m
  Progress: ●
- **Liquidity**
  Our liquidity measure sets out our minimum liquidity target for the year in line with the financial plan, and taking into account our regulatory obligations.
  Minimum liquidity level: 107%
  Progress: ●
- **Surplus capital**
  Similarly our surplus capital measure sets out the minimum amount of capital we need to retain, to meet our regulatory obligations and underpin our operational requirements. This minimum is set in line with the financial plan, with due regard for our regulatory requirements.
  Amount of surplus capital: [satisfactory]
  Progress: ●

Customer

Customer measures address the key relationships through which we sustain and grow our business:

- **Customer advocacy**
  We use an external survey to monitor advocacy of customers across the Retail businesses relative to appropriate peers. This gives us our customer advocacy measure.
  Customer advocacy: +10.3%
  Progress: ●
- **Primary current account customers**
  Primary current account customers are defined as those who:
  – Hold one of our standard current accounts.
  – Credit their account with at least £800 per month.
  Primary account customers: 552,000
  Progress: ●
- **Products held per primary current account customer**
  This measure monitors how well we are meeting the needs of our relationship customers (as defined above) by calculating the average number of active products they hold with us.
  Accounts per primary account holder: 2.59
  Progress: ●

To be the UK's most admired Financial Services Business

People

People measures reflect the importance of internal engagement:

- **Colleague engagement**
  Our colleague engagement assessment is derived from our twice yearly internal colleague survey.
  Colleague engagement: 81%
  Progress: ●

Process

Process measures focus on the efficiency of our business in delivering services to our customers:

- **Cost**
  This measure focuses on the cost base for the combined Banking Group as a percentage of its income.
  Cost income ratio: 66.2%
  Progress: ●
- **Compliance with risk appetite**
  We track this measure using key risk criteria across the business. Success means no material breaches against any of these criteria.
  Compliance with risk appetite: 100%
  Progress: ●

● On target
○ Good progress
○ Below target

Visit us online
To find out more about us, visit our website – **www.co-operativebank.co.uk**

Chair's statement

A year ago, in my first statement as Chair of The Co-operative Bank, I described this as one of the most exciting times in our history, and the last 12 months have certainly been eventful. As the UK economy continues to struggle, our member led ownership model has attracted supporters beyond our loyal customer base, while the Financial Times has recognised us as Europe's most sustainable bank for the second year running.

As a co-operative business it is our goal to present customers with a 'compelling co-operative alternative' to the dominance of the shareholder owned banks. The International Year of the Co-operative is a real opportunity to present the co-operative business model to a wider consumer public. But what does the phrase 'compelling co-operative alternative' actually mean?

As a 'co-operative' we are member led rather than shareholder led. This model allows us to focus on the 'bigger picture' rather than react to short term trends. It encourages prudent stewardship, customer focus and a responsible approach to growth.

Our co-operative model also means that we are grounded in our communities. Customers can choose to share in our profits and play a part in how we are governed. This places power in the hands of real people, sitting on area committees, regional and business boards and the Group board itself. What is more, we judge our success by what we put back into local communities, not simply what we earn from them.

As consumers look increasingly to their financial service providers for support, our member led, community focused approach is an increasingly attractive alternative to the shareholder banks. We have supported small and medium businesses through these testing times as part of our overall £1.2bn loans to business during 2011; and we have also reached out to communities who have felt abandoned by other banks.

A particular example of this presented itself in the town of Horbury. Early in 2011, Horbury lost its last remaining bank branch. Co-operative members in the town wrote to us to ask if we could step in and provide a vital service to the community. In June 2011 we opened a new branch in the local Co-operative food store, and the feedback from customers, townspeople and local politicians alike has been positive and customers have voted with their feet. Business is brisk and the Horbury branch is already operating beyond expectations as well as supporting the local community.

One thing our customers most definitely expect from us is a willingness to accept when we have got it wrong. Our figures for 2011 include a provision of £90.0m for historic mis-selling of Payment Protection Insurance (PPI). Although this was an industry wide issue (and our provision is low by comparison with the market leaders) we are committed to identifying where our customers have been disadvantaged and putting things right. We will deal with their complaints in a fair, personal, easy and responsible manner; and we will make sure that we learn from past mistakes.

So does that make us a compelling prospect? We enjoy excellent customer satisfaction and have attracted a steady flow of customers switching to us over the past two years. However we recognise that to become a compelling alternative to the 'Big Five', we need to continue to grow further and increase our scale and presence.

The need to become a compelling co-operative alternative was a driving force behind our merger with Britannia Building Society, and is the basis for our interest in the 632 branches being sold by Lloyds Banking Group. We will not, however, sacrifice our members' interests on the altar of ambition, but continue to examine cautiously the opportunity for us to enhance our reach, grow our customer base and become a truly compelling alternative for the UK consumer.

Another exciting opportunity to increase our reach is through the existing membership and customer base of The Co-operative Group. Last year the Group launched Project Unity to rationalise its operating structure and deliver a more integrated service proposition to its members and its significant customer base. For us, as for the other Co-operative businesses, the opportunities offered by Unity are significant.

In the short term, Unity means restructuring and eliminating duplication, reducing unnecessary cost while reinvigorating the way we work. In the longer term, a truly unified Group offers the advantages of scale, diversity and brand strength, that our strategy demands.

2011 has seen some changes to the leadership of the Bank. Our Chief Executive Officer, Neville Richardson, left the business in July. I would like to thank Neville for his leadership, both at Britannia and during the process of integration with The Co-operative Bank.

Barry Tootell, Chief Financial Officer, has been appointed acting CEO. Barry was an integral part of the executive team that created our vision and is ideally qualified to step seamlessly into the role of guiding the business forward. James Mack, formerly Director of Financial Control, has been appointed acting CFO.

Meanwhile Project Unity has seen a rationalisation of both the executive structure and board composition. Tim Franklin, Chief Operating Officer, and Karen Moir, Director of Organisational Development, have left the business, and I would like to thank both Tim and Karen for their support and commitment in helping to merge two businesses into a single strategic, cultural and operational entity.

In line with the Group structure, we have also slimmed down our board. I would like to express my thanks to the following board members who stepped down in 2011; Chris Jones, Stephen Kingsley, Steve Watts and Piers Williamson. We also reduced the number of executive directors on the Board with Phil Lee, Rod Bulmer and Tim Franklin stepping down.

At the same time, we welcomed two new non-executive directors to the Board, Anne Gunther and Merlyn Lowther. As Chief Executive of the Norwich and Peterborough Building Society, Anne guided the business through its merger with the Yorkshire Building Society. Merlyn is a non-executive director of Schroders plc and a former Chief Cashier of the Bank of England.

In my role as Chair I am responsible for ensuring that the Board operates effectively. This involves putting in place a sound framework in which the Board can make strategic decisions, within a governance structure appropriate to the business of The Co-operative Bank plc. More details on the governance structure and arrangement can be found at page 11.

The phrase 'change is a constant' has become a cliché, but one look at the economy as it stands demonstrates the need for change. It is impossible to grow and develop, to stay in touch with one's customers and markets, without embracing the challenge of change, and we have shown ourselves more than ready to do so. However, the compelling co-operative alternative is built on the same values that inspired the Rochdale Pioneers 168 years ago – voluntary and open membership; democratic control; economic participation; autonomy and independence; education and development; and concern for our community. It is the resonance of those values with customers and investors alike that underpins our ambition to become a real force in UK financial services.

Paul Flowers, Chair

Chief Executive's overview

Welcome to The Co-operative Bank report and accounts for 2011, my first as Chief Executive Officer. It is with pride that I present our results for what has been a successful year in a challenging market.

While the UK economy has shown some signs of stabilisation, commentators and customers alike are anxious about the future. Growth estimates have been downgraded, sovereign debt remains a major issue and the ongoing eurozone crisis continues to suppress market confidence.

As families cope with rising costs, low pay and the government's austerity measures, the Institute for Fiscal Studies reports that living standards have gone into their most significant fall in 25 years. Now more than ever, UK consumers are looking to financial services providers for understanding and support.

As we continue to build the 'compelling co-operative alternative' we continued to invest heavily throughout 2011 in making life easier for our customers and their communities, while maintaining the underlying financial strength to safeguard their investment in us. In supporting UK customers and businesses alike, we have lent £1.2bn to UK businesses and £0.9bn to mortgage customers. Yet continuing our prudent approach to banking, and not over-committing ourselves, we have strengthened still further our loans to deposits ratio which is now 94% (compared with 102% in 2010).

We have taken a significant step forward in the integration of our banking proposition with the extension of full personal banking facilities to our Britannia branch network, which has in effect opened up 245 new bank branches. In doing the right thing for our customers, we aim to build long term relationships, and these in turn will lay the foundations for sustainable success.

This year's results in context

Despite the gloom and uncertainty of the market, our operating profit of £141.1m has remained stable compared with 2010, while the statutory profit of £54.2m (2010: £48.9m) represents a solid performance by the business.

Underpinning these figures is a healthy balance sheet with our core tier one capital ratio robust and stable at 9.6% (unchanged on 2010). Our underlying capital position continues to be a source of strength, and reflects our prudent approach to the stewardship of our customers' money, while our commitment to liquidity has been reflected in the high liability balances retained, including healthy levels of term deposits.

We have successfully raised term funding this year, in residential mortgage backed securities and covered bonds, to support our plans for long term growth. In each case important funds were secured at competitive rates, having been significantly over subscribed. In a year when the Financial Times named us Europe's most sustainable bank for the second year running, our successful dealings in the City underline the confidence of the financial markets in our sustainable business model.

Customers and commentators have again endorsed The Co-operative Bank with numerous awards, including 'best packaged current account' at the Moneynet Personal Finances awards, and 'best longer term fixed rate mortgage provider' according to Moneyfacts. The Bank was also successful in multiple categories at the Moneywise Customer Service Awards.

Our corporate and business banking arm has experienced increases in impairment on corporate lending in line with the market, but the business has shown encouraging growth, laying the groundwork for future success.

A model for sustainable growth

These results reflect the excellent relationships we have with our customers, with customer advocacy levels for 2011 on average 10.3% ahead of our target peer group. They also reflect our determination to challenge ourselves and build for sustainable success. Even as we continue to challenge the cost base throughout the business, we are investing significantly in infrastructure for the future. Our transformation programme is designed to enhance our customer centred banking operations and provide the infrastructure for future growth. The launch of a new bancassurance proposition, in partnership with AXA Wealth, enables us to offer our customers a simplified savings and investments portfolio, while a pilot to offer legal services through 30 branches has been successful. With negotiations at an advanced stage to buy 632 Lloyds TSB branches, the opportunities for growth are exciting, but even without this boost we are confident we have the capacity to increase our scale, reach and presence in the coming years.

Opportunities and challenges in the next 12 months

The year ahead presents a number of significant opportunities and challenges, which will shape the long term future of The Co-operative Bank and its parent company The Co-operative Banking Group.

One of the principal challenges remains the economic climate, which will continue to put pressure on UK businesses and consumers alike. Interest margins are likely to remain low while customer behaviour, in the wake of falling real living standards, will continue to be cautious. Against this background The Co-operative Bank aims to drive down cost in the business, but we will also be taking proactive steps to develop our customer relationship model, focusing on attracting, engaging, deepening and retaining customer relationships.

Within the business, our transformation programme remains a significant investment in the future. At the same time the focus for our customer facing colleagues will be to continue to deliver market leading customer satisfaction.

The decision by Lloyds Banking Group to enter into exclusive negotiations with The Co-operative Bank, over the sale of their 632 branches, reinforces our credentials as a genuine challenger in the UK market. This opportunity complements our strategic vision while offering an excellent chance to achieve real scale on the high street.

We continue to assess the complex nature of this transaction and are diligently assessing the risks and the steps to mitigate them. We are clear that we will only make the acquisition on terms that make sense for our customers and our members.

Project Unity offers a significant opportunity during the coming year and beyond, opening up greater synergies and product development opportunities across The Co-operative Group's family of businesses. The project began to roll out in Quarter 4, 2011 and is due for completion by the end of 2012. Unity offers huge potential, both for customers and for the business itself.

Outlook for the future

If ever there was a time for realism in banking, this is that time. Our industry, and more importantly our customers, face challenges not seen for decades. At The Co-operative Bank we have benefited from sensible, customer centred stewardship during the 'good times' and as a result we are in a position to invest for a better future, while continuing to deliver much needed support to our customers today.

We believe the Co-operative model has never been more relevant, and we believe it is a model for the future. With the increasingly close support of our colleagues across The Co-operative Group, we aim to build on our customer relationships to add value, both to customers and to members. It is this added value that will make us the compelling co-operative alternative.

Barry Tootell, Acting Chief Executive

Business and financial review

Overview

2011 has been a difficult year for the financial sector. Markets remain challenging and unpredictable, while the ongoing eurozone crisis continues to dampen confidence and inhibit growth. The industry continues to suffer from constrained capital markets, squeezed margins and a lack of customer confidence. Meanwhile the long term outlook remains unclear.

Against such a background, the continued resilience of The Co-operative Bank ('the Bank') is a positive endorsement for the Co-operative model. The Bank has provided a safe haven for our customers, fostering long term relationships and building a compelling co-operative alternative within the financial services industry. The steady operating result of £141.1m (2010: £144.5m) for the year reflected a strong performance in the Retail sector, partly offset by a difficult year for the Corporate sector. The income statement also benefited from gains on the sale of Treasury assets of £37.2m (2010: £11.4m) (a result of reshaping our liquidity portfolio), and a reduction in total credit risk expected over the life of the Optimum mortgage book of £20m (2010: £15m). These offset the cost of funding significantly higher levels of liquidity than experienced in 2010, as we continued to strengthen our liquidity, a core element of our financial strength. Statutory profit before tax of £54.2m was generated for 2011 (2010: £48.9m), which was adversely impacted by a provision for payment protection insurance (PPI) mis-selling of £90.0m (2010: £4.3m). Despite the difficulties within the UK economy, asset quality has been maintained with our levels of late residential mortgage arrears (>2.5% of balance) now standing at 1.18%, 0.24% better than the CML industry average for the fourth quarter of 2011.

The foundation of our balance sheet is our sound liquidity position, with an improved loans to deposits ratio of 93.9% (2010: 102.5%), now our primary measure of liquidity and replacing the customer funding ratio, which was 117.6% at the end of 2011 (2010: 106.7%). The Bank has remained active in the wholesale funding markets during the year, raising funding through the securitisation of mortgages and issuance of a covered bond. Furthermore, we have been proactive in managing exposure to the eurozone counterparties. The capital position remains robust, with a core tier one ratio of 9.6%.

Our balanced scorecard approach takes a holistic view of performance, taking into account not just profit generation but effective risk and process management, and our impact on colleagues and customers.

As a member owned bank, our customers trust us to put them at the heart of our business and, by really understanding their needs, we offer products and services tailored to them. As a result, our levels of customer advocacy continue to be strong – for 2011, advocacy for The Co-operative Banking Group was 10.3 percentage points above the average of our top five competitors.

Integration and transformation

Over two years have now passed since the merger with Britannia Building Society. During this time we have integrated the merged operations and are making good progress in transforming the business and realising the benefits of the merger.

Within months of the merger, customers were able to open current accounts in the 245 Britannia branded branches – to date, over 62,000 current accounts have been opened via these branches (nearly 45,000 during 2011). August 2011 saw the introduction of the capability for customers to service current accounts in Britannia branded branches. This effectively extended our banking network from around 90 to over 340 sites and enabled us to rebrand our Britannia branches as part of The Co-operative Bank. We have also continued to attract customers switching their main current account, with a 10.8% year on year increase in 2011 of customers making us their main bank.

To bring colleagues together, we have completed our organisational design and introduced a single set of terms and conditions of employment across The Co-operative Banking Group, with the full support of our recognised trades unions. Despite the pace of change in the business, colleague engagement has increased during 2011, rising to 81% in November 2011 for The Co-operative Banking Group (November 2010: 78%).

Full transformation will be achieved when we have enabled our customer relationship model and provided a platform for growth, through the replacement of our legacy banking systems and infrastructure with modern, flexible solutions. 2011 has seen investment in some very large elements of this programme:

- a new Financial Crime Management system
- an upgrade to our banking mainframe
- a new flexible and functionally rich telephony system
- a new platform for our credit card system
- the first phase of our new payments hub
- the first stage in the re-platforming of our core banking systems

This is just part of our transformation plan, under which we are making a significant investment in our people, processes and systems in order to transform our business for our customers. Other examples of this transformation include the in-store banking programme, which has created new in-store pilot facilities in our food stores in 2011 and aims to increase this still further during 2012.

Project Unity is a Co-operative Group programme seeking to maximise the customer and commercial benefits of belonging to the world's largest consumer co-operative, and The Co-operative Banking Group is a key participant in the project. At the beginning of this year, a new group senior management structure was announced, reinforcing the common culture, purpose and strategic goals that unite our family of businesses and the project began to roll out in depth in 2011. The Co-operative Banking Group now benefits from the economies of scale arising from a single procurement function, with further efficiency gains to be delivered as more enterprise functions are managed on a group basis.

Highlights

Operating result and profit before taxation and distributions	**2011 £m**	2010 £m	Change £m	Change %
Income	**817.6**	821.8	(4.2)	(0.5)
Operating costs – steady state	**(548.2)**	(555.5)	7.3	1.3
Operating costs – strategic initiatives	**(13.4)**	(26.0)	12.6	48.5
Impairment losses	**(114.9)**	(95.8)	(19.1)	(19.9)
Operating result	**141.1**	144.5	(3.4)	(2.4)
Significant items	**(53.3)**	(55.5)	2.2	4.0
Payment protection insurance (PPI) provision	**(90.0)**	(4.3)	(85.7)	n/a
Share of post-tax profits/(losses) from joint ventures	**0.2**	0.7	(0.5)	(71.4)
Financial Services Compensation Scheme (FSCS) levies	**(14.5)**	(11.5)	(3.0)	(26.1)
Fair value amortisation	**86.3**	(14.2)	100.5	707.7
Profit before taxation and distributions	**69.8**	59.7	10.1	16.9
Membership dividend	**(15.6)**	(10.8)	(4.8)	(44.4)
Profit before taxation	**54.2**	48.9	5.3	10.8

Business and financial review continued

The operating result was slightly below 2010, a resilient performance given the difficult market conditions. The profit before tax and distributions of £69.8m was adversely impacted by a provision for PPI mis-selling of £90.0m (2010: £4.3m). Although this is an industry wide issue, as a member owned organisation, we are committed to doing the right thing for our customers, especially if we get things wrong. We will deal with their complaints in a fair, personal, easy and responsible manner.

Profit before tax and distributions of £69.8m (2010: £59.7m) was also after a credit of £86.3m (2010: charge of £14.2m) for the amortisation of fair values. These fair value adjustments principally relate to the amortisation through net interest income of interest rate related adjustments required to be made to the carrying value of assets and liabilities at the time of merger. The credit for the year was adversely impacted by £75m amortisation on various funding instruments caused by an acceleration in their expected redemption. This was offset by the release of contingent merger consideration through operating expenses of £37m no longer expected to be paid.

Profit before tax increased by 10.8% to £54.2m for 2011.

2011 income levels (excluding fair value adjustments) were marginally down on 2010, and reflected the impact of additional funding raised within the past 12 months, lower asset yields and lower investment income, although this was partly mitigated by gains on Treasury asset sales during the year. Income benefited from the reduction in total credit risk expected over the life of the Optimum mortgage book of £20m (2010: £15m).

Operating costs (excluding fair value adjustments and strategic investment costs) have reduced from £555.5m in 2010 to £548.2m in 2011, despite inflationary pressures on the cost base. However, there is further work to do in this area and we remain committed to further improving the cost position over the medium term.

Impairment losses have reflected the difficult economic conditions in 2011, rising by 19.9% compared with 2010 levels, predominantly due to a higher corporate impairment charge. The total charge benefited from the mitigating impact of prudent credit fair value adjustments taken at the time of merger. The residential mortgage book (both Retail and Optimum) continued to perform well and arrears reduced further during 2011, with late mortgage arrears (>2.5% of balance) down from 1.67% at December 2010 to 1.18% at December 2011.

Significant items of £53.3m (2010: £55.5m) were incurred during the year, primarily associated with the investment in our transformation and integration programme.

The 2011 charge for profit distributions to individual members of The Co-operative Group, which are based on their account holdings with the Bank, totalled £15.6m.

Given the economic backdrop and regulatory requirements to hold higher levels of capital and liquidity, as well as consumer behaviour in respect of unsecured lending, the size of the Retail loan book reduced from £17.3bn to £16.2bn over the year, partially compensated for by growth in the Corporate and Platform loan books.

The loans to deposits ratio of 93.9% improved by 8% from the equivalent position at the end of December 2010 (102.5%). The Bank has remained active in the capital markets, completing its second prime mortgage securitisation since the merger and issuing a covered bond. We also undertook a lower tier two exchange into new securities at an on-market rate.

Capital has been carefully managed to maintain the Bank core tier one capital ratio at 2010 levels (9.6%), despite the impact of the PPI provision. The total capital ratio was 14.7% (2010: 14.0%), with a tier one ratio of 9.9% (2010: 9.9%). During the year, a capital injection was made to the Bank of £87m, from The Co-operative Banking Group.

Our businesses

Operating result	**2011 £m**	2010 £m	Change £m	Change %
Retail	**94.6**	47.4	47.2	99.6
CABB	**14.5**	54.7	(40.2)	(73.5)
Other	**32.0**	42.4	(10.4)	(24.5)
Operating result	**141.1**	144.5	(3.4)	(2.4)

The Bank consists of two primary operating segments – Retail, and Corporate and Business Banking (CABB).

The Retail business (trading as The Co-operative Bank, Britannia and **smile**) offers a range of financial products and services to individuals and households throughout the UK.

CABB includes corporate banking, business banking, business services, Platform (the intermediary mortgage business) and Optimum (the closed book of pre-merger intermediary and acquired loan book assets). CABB effectively incorporates all the key business to business elements of the Bank.

Included in the Other segment are the results of the Treasury activities of the business. Also included are the results of Unity Trust Bank.

During 2011 the Bank's internal reporting structure was revised, to include Optimum within CABB; this was previously reported separately. The 2010 results reported above have been revised to reflect this change.

Retail

Retail operating result	**2011 £m**	2010 £m	Change £m	Change %
Net interest income	**387.4**	389.1	(1.7)	(0.4)
Non-interest income	**150.2**	147.2	3.0	2.0
Net income	**537.6**	536.3	1.3	0.2
Operating costs – steady state	**(399.3)**	(406.2)	6.9	1.7
Operating costs – strategic initiatives	**(9.4)**	(19.9)	10.5	52.8
Impairment losses	**(34.3)**	(62.8)	28.5	45.4
Operating result	**94.6**	47.4	47.2	99.6

The Retail operating result for 2011 of £94.6m was nearly double that of 2010 (£47.4m).

Mortgage income has improved largely as a result of new business and retention of maturing balances at higher margins. However, this has been offset by lower net interest income both on deposit balances and credit cards. The cost of maintaining high liability balances reflects our commitment to maintaining a sound liquidity position. Lower credit card balances and yields reflect the change in customer behaviour to pay down unsecured debt due to the difficult economic conditions.

Non-interest income was better than last year due to higher current account balances, and the rollout of 280 additional ATM installations in Co-operative food stores.

Building the compelling co-operative alternative

Impairment losses were significantly lower in 2011 than in 2010, by 45.4%. Key drivers include declining credit card balances and improvements in the collection of arrears. Mortgage quality has been maintained with continued low rates of impairment.

Our focus continues to be on delivering high quality assets with the average loan to value remaining at below 50% across the Retail business, in line with 2010.

The strength of the Retail customer proposition continues to be recognised by a range of awards. In 2011 the Bank won Moneysupermarket's 'Best Current Account Provider 2011', received the 'Best Longer Term Fixed Rate Mortgage Product' award from Moneyfacts, and was successful in several categories at the Moneywise Customer Service Awards. The Bank's credibility amongst customers and commentators alike was underscored by a second year of being shortlisted for 'Best Financial Services Provider' at the 2011 Which? Awards.

Corporate and Business Banking

CABB operating result	**2011 £m**	2010 £m	Change £m	Change %
Net interest income	**161.5**	146.4	15.1	10.3
Non-interest income	**68.2**	66.2	2.0	3.0
Net income	**229.7**	212.6	17.1	8.0
Operating costs – steady state	**(127.4)**	(123.1)	(4.3)	(3.5)
Operating costs – strategic initiatives	**(3.2)**	(4.8)	1.6	33.3
Impairment losses	**(84.6)**	(30.0)	(54.6)	(182.0)
Operating result	**14.5**	54.7	(40.2)	(73.5)

The CABB operating result for 2011 was £14.5m (2010: £54.7m).

Corporate banking

Corporate banking has delivered an operating loss of £36.4m during 2011 (2010: profit of £2.5m). This reflects another difficult year for the industry, with impairment losses rising from £31.4m to £87.4m, including a collective provision against potential losses of £10.4m. There has been measured growth of Corporate banking assets through selected high quality new business, combined with continued significant liability growth through term deposits (c. 43% growth in corporate deposits during 2011, evidencing the appeal of our proposition to the market), leading to higher net interest income.

Corporate banking rolled out a further two Corporate banking centres during 2011, taking the total number to 22. Alongside our specialist sector and customer deposits teams, these will be used to drive measured balance sheet growth.

Platform

The Platform intermediary mortgage business, focusing on the prime mortgage and buy to let markets, has continued to grow in the marketplace throughout 2011. The focus for Platform remains on good quality prudent lending and advances of £0.6bn have been extended during 2011 with strong margins achieved and late arrears (>2.5% of balance) on only 0.30% of accounts (2010: 0.71%).

Optimum

In 2011 the Optimum portfolio, a closed book of intermediary and acquired mortgage book assets, reduced in size, as planned, by 5.5% to £7.7bn, and delivered a profit of £52.7m (2010: £61.2m).

Throughout the year, the business has continued to deliver improvements in its management of arrears, with a focus both on existing and pre-arrears cases. As a result, arrears in Optimum have continued to improve steadily, and the business has been able to release £20m (2010: £15m) of its total provision for credit risk expected over the life of the Optimum mortgage book. The remaining merger related fair value provisions against the portfolio continue to provide a high degree of cover against credit losses.

Other businesses

The main component of the Other business segment, our Treasury operation, has continued to deliver on its core responsibilities of ensuring a stable liquidity base, providing diverse sources of wholesale funding to the Bank, managing market risk and delivering a favourable financial performance on the investment portfolio. The Treasury result benefited from gains on the sale of Treasury assets of £37.2m (2010: £11.4m) as part of reshaping the investment portfolio. However, it was impacted by a challenging funding environment driven by uncertainty in the financial markets, especially in the eurozone, with margins continuing to be under pressure during the year. Net interest income was negatively impacted by increased investment in highly liquid, low risk assets as well as the reduction in higher risk and higher earning investment assets together with increased structured funding transactions.

The Bank has no sovereign exposure to 'peripheral' eurozone countries (namely Portugal, Ireland, Italy, Greece and Spain), and no exposure to Greek financial institutions or any other Greek counterparties. Other peripheral eurozone country and counterparty limits have continued to be cautiously managed downwards, and exposure is primarily restricted to short dated money market lending. Investment assets in peripheral eurozone counterparts are in run-off, with associated counterparty and country limits reducing upon maturity or sale. The Treasury investment assets maturing over the coming year amount to £539m (16% of the investment portfolio). Further detail is included in the Risk Management section.

Outlook

The Bank has been granted preferred bidder status by Lloyds Banking Group in the process currently being run for the sale of its 632 branches. This is part of our ambition to build upon our strong foundations in banking, to ensure customers have a genuine alternative on the high street. The combination of the Lloyds Banking Group branches and our own branch network is consistent with our strategy to strengthen our position as a real challenger in relationship banking in the UK. Our current bid is non-binding and we would only proceed if we could reach an agreement that was in the interests of our members and other stakeholders. Any transaction would be subject to regulatory approval.

Given the considerable scale, reach and reputation of the wider Co-operative Group, Project Unity will open up many potential synergies and product development opportunities, which will considerably enhance both the financial strength of the business and the experience for our customers.

The outlook for the financial services industry remains difficult, and latest indications point to a continuation of these challenging circumstances, particularly in the Corporate sector. Together with increasing regulatory requirements, these will continue to weigh heavily on earnings. Our focus remains on ensuring our continued financial resilience, and means that we can look forward with optimism and confidence to the future.

Social goals

Introduction

In the midst of the current global economic challenges, and with increasing calls for more ethical and responsible forms of business, it is appropriate that the United Nations should herald 2012 as the International Year of Co-operatives. The Co-operative model is being seen as an increasingly relevant factor to a more balanced, sustainable economy.

The Co-operative Bank has been at the forefront of this renaissance. Our reputation amongst consumers (who consistently see us as the UK's most socially responsible bank), remains unparalleled. Also in 2011, the Financial Times and the International Finance Corporation recognised us as Europe's most sustainable bank – the second successive year that our commitment to social responsibility has been recognised in this way.

In 2011, our approach to sustainability was revitalised with the launch of The Co-operative Ethical Plan. The Plan, to be refreshed each year in consultation with our democratically elected member representatives, sets ambitious targets across issues of primary concern for members.

Whilst challenges remain, we believe our business model will thrive by delivering value to our members and customers in a responsible and sustainable manner.

Materiality, strategy and governance

The Co-operative Bank has always had a purpose beyond profit. As part of The Co-operative Group, we are owned by our members and accountable to them through our democratic structure. The Group Values and Principles Committee, made up of elected members, oversees our sustainability strategy and customers and members help shape our unique Ethical Policy.

The Group's Ethical Plan sets out targets across eight priority areas. We review these annually with our members through the Group Values and Principles Committee to ensure that we continue to show the way forward for corporate sustainable development in the UK. Performance is transparently reported in the award winning annual Sustainability Report of our parent company, The Co-operative Group.

Performance overview

Responsible finance

A longstanding focus on responsible finance is firmly embedded in our business. Over the last two decades our unique customer led ethical policy has led to our refusing over £1bn of finance to businesses or projects that failed to satisfy our social or environmental standards. At the same time we have seen our commercial lending grow to £9bn.

Throughout 2011 our Social Banking Unit provided a dedicated resource for social, co-operative and environmental businesses. Around a quarter of all bank lending is channelled into such businesses and has to date contributed £700m of a £1bn commitment to fund green energy and energy efficiency projects. A range of organisations with a social purpose received funding during 2011, including the Youth Hostel Association (£13m) and Social Investment Scotland (£1.5m), an organisation that provides loans for charities and social enterprises unable to secure bank loans. Since 2008, our charity business has doubled, with customer numbers increasing to over 4,800 in 2011.

We believe that responsible finance should mean accessible finance. For a decade, our lending to small businesses in deprived areas, as a proportion of equivalent bank activity, has consistently exceeded the industry average. Our provision of basic bank accounts is up 21% from 2010, and we maintain our support to the pioneering 'bank accounts for prisoners' project, providing those opening an account with a better opportunity to secure housing and employment, factors considered key to reducing reoffending.

Keeping communities thriving

In 2011, The Co-operative family of businesses invested £13.6m in communities at home and around the world, and we are aiming to invest 10% of monies available for distribution by 2013, building on our current support for 10,000 community initiatives each year – one new project every hour, every day.

Colleagues throughout The Co-operative Bank contributed to the £7m raised in 2011 for our Charity of the Year partners, Mencap and sister charity ENABLE in Scotland, to improve the lives of young people with a learning disability around the UK – well above our £5m target.

Our members helped over 2,400 local community groups by donating their share of the profits to The Co-operative Community Fund, and Co-operative Bank colleagues volunteered in a range of community projects.

Supporting co-operatives
We believe in 'co-operation amongst co-operatives', supporting the growth of responsible businesses and contributing to the development of a more diverse and sustainable economy. We continue to be the only bank to offer a current account for credit union members, in partnership with the Association of British Credit Unions Ltd and provide facilities to 60% of the credit union sector.

As part of The Co-operative Group, we are also investing £17m over the next three years to support the growth and development of co-operatives in the UK and overseas. The Co-operative Enterprise Hub continues to provide professional business advice and training to help new co-operatives get off the ground and help existing co-operatives to grow and become more sustainable. Over 700 co-operatives have benefited from the Hub's support to date, helping to contribute to the growth in the UK co-operative sector, which comprises more than 5,000 co-operatives nationwide.

Inspiring young people
The Co-operative Group's Inspiring Young People programme aims to bring about a cultural shift in the way that young people are viewed and treated in the UK, and to help them change their world. The programme aims to have benefited one million young people by 2014.

Our Skills for Schools programme, delivered by colleague volunteers, aims to improve the financial literacy, numeracy and employability of school children. Our Green Schools Revolution, launched in September 2011, is a new sustainability education programme for primary and secondary schools. So far, over 3,000 UK schools have registered to take part with a view to engaging 6,000 schools, or one in five across the UK by 2014.

In 2011, The Co-operative Group established a Co-operative Academy school in Leeds, the third Academy to be launched to date, and we aim to establish a total of six by the end of 2013, delivering an innovative curriculum within a values led ethos. This forms part of the Group's wider work supporting Co-operative Schools, which includes establishing a co-operative society, to which over 200 schools are currently enrolled.

Protecting the environment
Our longstanding commitment to the environment speaks for itself. In line with our customers' concerns, we have declined almost £500m of finance to businesses or projects that did not meet our environmental standards since the launch of our Ethical Policy, whilst providing £700m finance for projects with a positive environmental impact. During 2011, we continued to offset all our carbon dioxide emissions, together with an additional 10% to compensate for our carbon legacy. The Co-operative Group has cut greenhouse gas emissions by 35% since 2006, saving half a million tonnes of greenhouse gases each year and well ahead of its 2017 target. The Group is aiming for a 50% cut in emissions by 2020, and to generate the equivalent of 25% of all electricity used from its own renewable sources by 2017.

In 2011, The Co-operative Bank achieved recertification to the ISO 14001 standard and we are still the only financial services organisation in the world to achieve this leading standard across all business activities and products. Looking forward our state of the art head office, which opens in 2012, will set new standards for the UK in sustainable design, construction and operation.

Tackling global poverty
The Co-operative Group continues to strive for a fairer world, where basic human needs are met and rights respected. We support microfinance institutions in 27 countries across the globe with a $50m fund to provide small loans to people in the world's poorest countries. Our charity credit cards have enabled customers to raise a staggering £729,000 for organisations tackling global poverty and human rights issues, such as Oxfam and Amnesty International.

In 2011, The Co-operative Group entered into a partnership with CARE International UK to support 'lendwithcare.org'. The innovative scheme allows people in the UK to lend directly to entrepreneurs in the developing world, helping them to grow their businesses and ultimately to work their way out of poverty. Our aim is to facilitate 30,000 loans by the end of 2012. The Co-operative Bank is also spearheading The Global Development Co-operative – a new development fund intended to support co-operatives in the developing world.

2012 promises to be another challenging but rewarding year. The Co-operative business model will be brought to the fore through the UN International Year of Co-operatives, while our groundbreaking Ethical Plan will help us in our ambition to remain the UK's most socially responsible business and at the same time, inspire more people than ever to change their world.

The Board

Non-executive directors:

Paul Flowers (BA (Hons))
Age 61. Joined the Board in 2009 and appointed Chair in 2010. Deputy Chair of Co-operative Group Limited. Superintendent Methodist Minister. Member of The Co-operative Group North Regional Board. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Rodney Baker-Bates (MA, FCA, AIMC, FCIB)
Age 67. Joined the Board in 2009 and appointed Deputy Chair in 2010. Chair of Willis Limited. Directorships also held at Bedlam Asset Management plc, Dolphin Square Trust Limited, EG Solutions plc, G's Group Holding Limited and Stobart Group plc. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Duncan Bowdler (BSc (Hons) Biochemistry)
Age 53. Joined the Board in 2009. Trade and Legislation Manager. Member of The Co-operative Group North West and North Midlands Regional Board. Non-executive director of Co-operative Group Limited, Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

David Davies (BSc (Econ), FIA)
Age 64. Joined the Board in 2003, appointed Deputy Chair in 2010. Qualified actuary. Chair of Sun Life Assurance Company of Canada (UK), the PACE Pension Scheme and Nortel Networks Pension Scheme in the UK. Non-executive director of Interglobal Insurance Company Limited. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Anne Gunther (BSc (Hons), MBA, ACIB, FCIBS)
Age 57. Joined the Board in 2011. A career retail banker, most recently as Chief Executive of Standard Life Bank and then Chief Executive of Norwich and Peterborough Building Society to secure its merger with the Yorkshire Building Society. Chair of Warwick Business School. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Peter Harvey (ACIB, Dip FS)
Age 56. Joined the Board in 2009. Consultant to Berwin Leighton Paisner LLP and non-executive director of Marshalls Holdings Limited. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Paul Hewitt (MA, ACA, Dip German (Open))
Age 56. Joined the Board in 2003. Chair of RJ Kiln & Co Limited, The Good Care Group Limited and Four Times Enterprises Limited. Non-executive director of Shop Direct Financial Services Limited, trustee member of NEST (the National Employment Savings Trust) and Industrial partner with Lyceum Capital, a mid market private equity firm. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Merlyn Lowther (BSc (Hons), MBA, FCIB)
Age 58. Joined the Board in 2011. Chief Cashier of the Bank of England from 1999 to 2004. Non-executive director of Schroders plc. Trustee of the Winston Churchill Memorial Trust and The Henry Smith Charity. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Peter Marks
Age 62. Joined the Board in 2009. Group Chief Executive of Co-operative Group Limited. Named Orange Leader of the Year 2009 in the National Business Awards. Entire working life spent within the Co-operative Movement. Instrumental in bringing about a number of major co-operative mergers over the past decade, as well as the Group's acquisition of the Somerfield supermarket chain. Non-executive director of Thomas Cook Group plc. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Bob Newton (BSc, FIA, CDir)
Age 62. Joined the Board in 2007. Retired from the insurance industry in 2006 and has since built a portfolio of business and pro bono interests. Chair of Silentair Group Limited. Non-executive director of UIA (Insurance) Limited and Reclaim Fund Limited. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Ben Reid OBE (FCCA)
Age 57. Joined the Board in 2009. Chief Executive of The Midcounties Co-operative and also Chair of Walsall Healthcare NHS Trust. Non-executive director of Co-operative Group Limited, Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Len Wardle (BA)
Age 67. Joined the Board in 2002. Chair of Co-operative Group Limited and member of the South East Regional Board. Held management positions in local government and latterly was a Fellow at the University of Surrey in the School of Management. Director of Communicate Mutuality Limited. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Martyn Wates (ACA, ATII, BA (Hons))
Age 45. Joined the Board in 2007. Has held various senior finance positions within the co-operative movement. Director of various internal subsidiaries and non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Executive Director:

Barry Tootell (BA (Hons), FCA)
Age 50. Joined the Board in 2008. Acting Chief Executive Officer. Qualified accountant with over 20 years of banking experience and was previously Chief Financial Officer. Executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Report of the Board of Directors

Introduction
The Co-operative Bank plc (the Bank) is a subsidiary of The Co-operative Banking Group (the Banking Group) and its ultimate parent company is Co-operative Group Limited (Co-operative Group) which is an Industrial and Provident Society that is jointly owned and democratically controlled by its members.

During the year, a number of actions were undertaken to enhance further the governance structure of the Board and bring it in line with evolving best practice. These included changes to the composition of the Board with a reduction in numbers of members whilst at the same time increasing the diversity of the Board.

During the year, with the exception of the level of independent representation on the Board and Audit Committee, the Bank believes it has fully complied with the principles and provisions of the UK Corporate Governance Code (the Code) appropriate to the democratic structures of the Bank and its parent organisations; the Banking Group and Co-operative Group. The Bank has also continued to consider and address the final recommendations arising from the introduction of the Code. In particular, a detailed review of the risk management framework in which the Bank operates has taken place and the Board and Board committees have redefined membership, responsibilities and terms of reference.

The corporate governance section of the Directors' report describes the key governance mechanisms operating within the Bank and Banking Group.

Board composition and independence
The names of the current members of the Board, their biographies and details of length of service are set out on page 10.

The size and composition of the Board was reviewed in 2011 in light of an external evaluation of the Board's effectiveness in 2010 and introduction of the Code. The aim of the review was to increase both the independence of the Board and its effectiveness. The opportunity was also taken to introduce new talent into the Board (within the reduced Board size) and improve its diversity in line with the recommendations made in Lord Davies' review into Women on Boards. The review led to several directors stepping down from the Board with a reduction in overall numbers on the Board. The changes to the Board composition and independence which stem from the review have meant that by the end of the year the Board was compliant with the Code.

The Bank Board consists of 13 non-executive directors and two executive directors. Of the 13 non-executive directors four are members of The Co-operative Group Board, two are Co-operative Group Executives and seven are externally recruited for their specific financial services experience and expertise.

The two executive directorships are held by the Chief Executive and the Chief Financial Officer of the Bank who also hold the same role in the wider Banking Group. In July 2011 Neville Richardson stepped down from his position as Chief Executive of the Banking Group and its subsidiaries (including the Bank) and Barry Tootell (Chief Financial Officer and an executive director) was appointed as Acting Chief Executive. The position of Chief Executive has not, as yet, been appointed on a permanent basis and evaluation and interviews by the Board for this permanent appointment are ongoing. James Mack was appointed Acting Chief Financial Officer but is currently not an executive director and therefore there is a vacancy on the Board.

The Code requires at least half of the Board, excluding the Chair, to be independent non-executive directors. In accordance with the Code, it is for the Board to consider whether a director is independent in character and judgment and whether there are any relationships or circumstances which are likely to affect, or could appear to affect, the director's judgment.

The Board has concluded that, looking across the wider Co-operative Group, the individual members elected by and from The Co-operative Group's seven regions to stand as directors (unless employees within the last five years) should be defined as independent, while those appointed directors representing independent society members of The Co-operative Group could not be so categorised in the co-operative context. This is because the latter represent significant stakeholders with material business relationships with the Banking Group and Bank.

The Board believes it has sufficient independent representation having seven independent non-executive directors (excluding the Chair). There are six external independent professional non-executive directors: Rodney Baker-Bates, David Davies, Peter Harvey, Bob Newton, Anne Gunther and Merlyn Lowther. Len Wardle has been elected by and from the members of The Co-operative Group and the Board has determined him to be independent.

Ben Reid represents independent society members of The Co-operative Group. Peter Marks and Martyn Wates hold executive appointments in The Co-operative Group (Peter Marks is the Group Chief Executive and Martyn Wates is the Deputy Group Chief Executive). Duncan Bowdler is an employee of The Co-operative Group. Paul Hewitt is an external non-executive director and was, until 28 July 2007, Deputy Chief Executive of Co-operative Group. Barry Tootell is the Acting Chief Executive of the Bank. These directors cannot therefore be considered to be independent.

David Davies and Rodney Baker-Bates are the Deputy Chairs and together fulfil the role of a senior independent director.

All the non-executives have considerable experience and make valuable contributions to the operation of the Bank. The non-executive directors constructively challenge and help develop proposals on strategy and bring strong, independent judgment, knowledge and experience to the Board's deliberations. The non-executive directors are of sufficient calibre and number that their views carry significant weight in the Board's decision making.

Appointment and reappointment of directors
The directors that serve on the Banking Group Board also sit on the Bank Board to provide common leadership of the financial services business. Appointments to the Banking Group Board are made by The Co-operative Group Board. For the recruitment of external non-executive directors, external recruitment consultants are retained.

All non-executive directors are eligible for re-appointment at the end of each term of office. The Co-operative Group Board, being party to agreements with the independent professional non-executive directors for services to the Banking Group and its subsidiaries, including the Bank, may resolve to re-appoint at or before the date their contracts expire for a further three year term. It is the normal policy of the Board not to allow an independent professional non-executive director to serve for more than nine years in aggregate.

Under the Articles of Association, one third of the Board is required to retire by rotation at the conclusion of the Annual General Meeting (AGM). In accordance with the Articles of Association, therefore, three directors retire by rotation, Paul Flowers, Peter Marks and Paul Hewitt and all offer themselves for re-election at the 2012 AGM. Two directors have been appointed since the conclusion of the last AGM on 12 May 2011 (Anne Gunther and Merlyn Lowther) which makes them eligible for re-appointment at the 2012 AGM and both offer themselves for re-election at the 2012 AGM.

At its meeting on 21 April 2010, The Co-operative Group Board noted the Walker Review recommendations that the Chair should stand for re-election every year. The Banking Group and its subsidiaries including the Bank, considered that this

Report of the Board of Directors continued

course of action was more relevant to organisations where there are a number of shareholders, who had less direct influence on the process of selecting candidates for the Chair. For the Bank, the shareholders are the Banking Group and The Co-operative Group which directly controls the process of appointment. The Chair of the Bank is also the Chair of the Banking Group. As the Chair's performance is evaluated annually, The Co-operative Group Board will be asked to reconfirm the Chair's appointment annually. The Chair still stands for re-election by rotation every three years.

The notice of the AGM can be found on page 124. All directors due for re-election continue to demonstrate commitment to their roles (see schedule of attendance on page 14).

Changes to the Board

The directors of the Bank during the financial year are listed below. They were in office for the full period unless otherwise indicated:

Non-executive directors	Date of appointment	Date of resignation
Paul Flowers (Chair)		
Rodney Baker-Bates		
Duncan Bowdler		
David Davies		
Anne Gunther	6 September 2011	
Peter Harvey		
Paul Hewitt		
Chris Jones		31 August 2011
Stephen Kingsley		16 June 2011
Peter Marks		
Merlyn Lowther	7 September 2011	
Bob Newton		
Ben Reid		
Steve Watts		8 July 2011
Len Wardle		
Martyn Wates		
Piers Williamson		8 September 2011
Executive directors		
Neville Richardson (Chief Executive)		22 July 2011
Rod Bulmer		16 June 2011
Tim Franklin		16 June 2011
Phil Lee		16 June 2011
Barry Tootell (Acting Chief Executive)		

Board diversity

The Bank, as part of the Banking Group, welcomes diversity and actively promotes a policy and practice of equality of opportunity in employment for all colleagues, regardless of age, disability, ethnicity, gender, religion or belief, or sexual orientation.

Of the 13 non-executive directors of the Bank two of these are women. Anne Gunther and Merlyn Lowther were appointed to its Board in 2011 and women now represent 15% of the Board. Any further appointment of directors, will take into consideration the Board's policy on diversity in light of Lord Davies' independent review into Women on Boards and its recommended minimum percentages of women on Boards.

Role and responsibilities of the Board

The Board is responsible for the long term success of the Bank within a framework of controls which enables risk to be assessed and managed. It is responsible for setting strategy, maintaining the policy and decision making framework in which this strategy is implemented, ensuring that the necessary financial and human resources are in place to meet strategic aims, monitoring performance against key financial and non-financial indicators, overseeing the system of risk management and for setting values and standards in governance matters.

The responsibility of the Board is to direct the business of the Bank and in particular to:

- ensure that the Bank's affairs are conducted and managed in accordance with its Articles of Association, the best interests of its stakeholders and co-operative values and principles;
- agree objectives, policies and strategies, and monitor the performance of executive management;
- approve the annual budget and business plan;
- approve the annual report, financial statements and dividends;
- monitor, utilising various committees, the key significant risks facing the Bank;
- establish Board committees and agree their terms of reference; and
- approve the delegated financial authorities.

The role of the Chair

The Chair is a non-executive director and leads the Board in the determination of its strategy and in the achievement of its objectives. The Chair is responsible for organising the business of the Board, ensuring its effectiveness and setting its agenda. The Chair has no involvement in the running of the day to day business of the Bank. The Chair facilitates the effective contribution of directors, constructive relations between the executive and non-executive directors, ensures directors receive accurate, timely and clear information and ensures that there is effective communication with members. During 2011 the Chair undertook one to one discussions with all directors regarding the performance of the Board. There are two Deputy Chairs who support the Chair.

The division of responsibilities between the Chair and the Chief Executive is clearly defined and has been approved by the Board.

The current Chair is Paul Flowers and the two Deputy Chairs are David Davies and Rodney Baker-Bates. Details of the Chair's and Deputy Chairs' professional commitments are included in the biographies on page 10. The Board is satisfied that these responsibilities do not interfere with the performance of the Chair or Deputy Chairs' duties for the Bank.

The Secretary to the Board

The Secretary is professionally qualified and is responsible for advising the Board through the Chair on all governance matters. The directors have access to the advice and services of the Secretary. The Articles of Association and the schedule of matters reserved to the Board for decision provide that the appointment and removal of the Secretary is a matter for the full Board.

The role of the Chief Executive and the Executive

The Chief Executive has direct charge of the Bank on a day to day basis and is accountable to the Board for the financial and operational performance of the Bank.

It is the responsibility of the Executive to implement the strategic objectives as agreed by the Board. The Executive, under the leadership of the Chief Executive, is responsible for the management of the Bank.

How the Board operates

Meetings

The Board meets on a monthly basis and it met 11 times in 2011. There were also two strategy meetings, attended by senior executives, devoted to consideration of performance and longer term planning. The Board is scheduled to meet for 11 Board meetings and to hold two strategy meetings in 2012. In addition, the Board holds private sessions in the absence of executive directors, if appropriate. Details of attendance at Board meetings are noted on page 14.

Board and committee papers are distributed at least eight days in advance of meetings. This provides the opportunity for directors to prepare fully for meetings. The minutes of all meetings are circulated to all directors. As well as circulating papers as hard copies, the Board has access to its own secure website where papers are available together with additional supporting material (and which acts as a library of papers for directors).

In September 2011, The Co-operative Group Board approved the roll out of a secure software application supported via iPad technology to provide access to Board papers. The principal aims are to increase security and to provide a more environmentally friendly solution to the distribution of papers by eliminating hard copy production as far as possible. The intention is to eliminate hard copy distribution by the summer of 2012.

Board committees

With the agreement of the Financial Services Authority (FSA), the Board has delegated certain responsibilities to a number of committees, all of which have written terms of reference covering the authority delegated to it by the Board. Each of these committees has a role in ensuring the effectiveness of the Bank and its subsidiaries. A provision of the Code is that the terms of reference for the Remuneration and Appointments Committee and the Audit Committee are available on the Bank's website, and the Bank complies with this.

In 2011, the continuing review of the Banking Group Risk Management Framework progressed. The review made a number of recommendations in light of new regulations and evolving best practice, and these were implemented during 2011 alongside a detailed review of the terms of reference and composition of the committees. As a result of the review, the terms of reference for the key committees, being the Audit Committee, the Exposures Committee and the Risk Committee have been revised.

The revised terms of reference incorporate recommendations contained in the Walker Report, Solvency II, the 2010 external Board Effectiveness Review and the review undertaken by external consultants. All committees meet as a joint committee for the Banking Group, Co-operative Insurance Society Limited (CIS), CIS General Insurance Limited (CISGIL) and the Bank. The terms of reference for all the committees can be found at http://www.co-operativebankinggroup.co.uk.

Remuneration and Appointments Committee

Information on the Remuneration and Appointments Committee is found on page 19.

Audit Committee

The committee comprises five members and is chaired by Paul Hewitt. During the year the committee comprised:

Paul Hewitt	(Chair)
Duncan Bowdler	(appointed 23 November 2011)
Ben Reid	
Bob Newton	
Peter Harvey	(appointed 23 November 2011)
Chris Jones	(resigned 18 August 2011)
Martyn Wates	(resigned 8 September 2011)

Paul Hewitt and Ben Reid bring recent and relevant financial experience and in addition Ben Reid is Chair of The Co-operative Group's Audit and Risk Committee. Duncan Bowdler is also a member of The Co-operative Group's Audit and Risk Committee. Bob Newton and Peter Harvey are considered to be independent members of the committee. The committee's terms of reference and constitution were approved on 13 July 2011. Chris Jones stood down from the committee when he ceased to be a director.

The changes to the committee were to address the lack of independence on the committee and that it did not comply with its terms of reference. The make up of the committee will again be revisited in May 2012. The committee met four times during the financial year. The main responsibilities of the committee are set out in its terms of reference. In the year the committee reviewed its own effectiveness.

Risk Committee

The committee comprises five members and is chaired by Peter Harvey. During the year the committee comprised:

Peter Harvey	(Chair) (appointed 8 September 2011)
David Davies	
Paul Hewitt	
Merlyn Lowther	(appointed 8 September 2011)
Bob Newton	(appointed 8 September 2011)
Piers Williamson	(Chair) (resigned 8 September 2011)
Stephen Kingsley	(resigned 16 June 2011)
Barry Tootell	(resigned 22 July 2011)
Mike Fairbairn	(Chief Risk Officer) (resigned 8 September 2011)

Piers Williamson and Stephen Kingsley stood down from the committee following their resignation as Board members. The committee's terms of reference were approved on 13 July 2011. These stated that the members of the committee should be non-executives directors only, with the majority of these members being independent non-executive directors. For this reason Barry Tootell resigned from the committee in July and Mike Fairbairn resigned in September.

The committee met seven times during the financial year. The main responsibilities of the committee are set out in the terms of reference.

Report of the Board of Directors continued

Exposures Committee

The committee comprises four members and is chaired by Peter Harvey. During the year the committee comprised:

Peter Harvey	(Chair)
Anne Gunther	(appointed 8 September 2011)
Duncan Bowdler	(appointed 8 September 2011)
Len Wardle	(appointed 8 September 2011)
Kevin Blake	(resigned 8 September 2011)
Neville Richardson	(resigned 22 July 2011)
Steve Watts	(resigned 8 July 2011)
Piers Williamson	(resigned 8 September 2011)

The committee met eight times during the financial year. The committee's terms of reference were approved on 13 July 2011. These stated that the members of the committee should be non-executive directors only with the majority of these members being independent non-executive directors. For this reason Kevin Blake resigned from the committee in September. The main responsibilities of the committee are set out in the terms of reference. Steve Watts and Piers Williamson stood down from the committee following their resignations as Board members.

During the year the committee reviewed its own effectiveness.

Transformation Committee

The committee comprises three members and is chaired by Bob Newton. During the year the committee comprised:

Bob Newton	(Chair) (appointed 16 June 2011)
Stephen Kingsley	(resigned 16 June 2011)
Paul Flowers	(appointed 14 July 2011)
Paul Hewitt	

The main responsibilities of the committee are set out in its terms of reference. It looks at integration issues across the Bank and Banking Group.

Stephen Kingsley stood down from the committee at the same time he stood down as a Board director.

Attendance

The following table sets out the frequency of, and attendance at, the Board and Board committee meetings for the period under review by directors:

Directors	Bank Board	Audit	Risk	Exposures	Transformation	Remuneration
Number of meetings held	11	4	7	8	11	5
Paul Flowers	11 (11)				2 (3)	5 (5)
Rodney Baker-Bates	10 (11)					5 (5)
Duncan Bowdler	11 (11)			2 (2)		
David Davies	9 (11)		5 (7)			5 (5)
Anne Gunther	3 (3)			2 (2)		
Peter Harvey	10 (11)		2 (2)	7 (8)		
Paul Hewitt	11 (11)	4 (4)	6 (7)		11 (11)	
Stephen Kingsley	6 (6)		2 (3)		7 (7)	
Merlyn Lowther	1 (2)		1 (1)			
Peter Marks	8 (11)					5 (5)
Bob Newton	11 (11)	4 (4)	1 (2)		9 (11)	
Ben Reid	9 (11)	4 (4)				
Barry Tootell	11 (11)		3 (4)			
Len Wardle	11 (11)			2 (2)		5 (5)
Martyn Wates	10 (11)	3 (3)				
Former directors						
Rod Bulmer	6 (6)					
Tim Franklin	6 (6)					
Chris Jones	8 (8)	3 (4)				
Phil Lee	6 (6)					
Neville Richardson	7 (7)			5 (5)		
Steve Watts	7 (7)			4 (4)		
Piers Williamson	7 (7)		5 (5)	6 (6)		

The number in brackets indicates the total number of meetings the director was eligible to attend during the year. In the case of a director being unable to attend a meeting, the Chair has received a satisfactory reason for their absence.

Professional advice and Board support
A number of external consultants provide professional advice to the Board. There is an agreed procedure by which directors may take independent professional advice at the Bank's expense in furtherance of their duties.

Insurance and indemnities
The Bank maintains appropriate directors' and officers' liability insurance cover, through the ultimate parent organisation, in respect of legal action against its directors and officers. This constitutes a 'qualifying third party indemnity provision' for the purposes of Section 236 of the Companies Act 2006 and applied to all of the Bank's directors serving during the financial year. The insurance cover was reviewed and renewed in 2010. The cover will again be renewed in 2012.

In terms of Section 236 of the Companies Act 2006 a 'qualifying pension scheme indemnity provision' was also in place for one or more of the directors who served during the financial year.

Directors and their interests
No director had a material interest at any time during the year in any contract of significance, other than a service contract, with the Bank or any of its subsidiary undertakings.

No director had a beneficial interest in any shares in the Bank or the Banking Group or in the Co-operative Group Limited, which is the ultimate holding organisation, or in any other entity controlled by the Co-operative Group Limited.

Conflicts of interests
The Board has considered the current external appointments of all directors which may give rise to a situational conflict and has authorised potential conflicts where appropriate.

Effectiveness

Induction and continuing professional development
In line with recommendations of the Code, the Bank has reviewed the induction programme for new directors and all newly elected directors are required to undertake a structured induction programme. This is designed to include key corporate governance and business information, including briefing sessions with the Executive on the strategy and performance of key business areas.

A Board learning and development policy is in place to support all non-executive directors. Following meetings with non-executive directors to review individual and collective training and development, thematic learning and development sessions for the whole Board have taken place.

Specific training has been organised for Board committees including the Remuneration and Appointments Committee, the Audit Committee, the Exposures Committee and the Risk Committee. In addition, one to one support has been provided to a number of directors.

In addition, directors receive information on the operation of the Board's committees, including the powers delegated to the committees, corporate governance practices and procedures and the powers reserved to the Executive together with the latest financial information. This is supplemented by meetings with key senior executives where appropriate, together with in depth training and round table sessions on specific areas.

The directors' website has been used as a resource bank to enable directors to access, revisit and review copies of presentations and materials from the more formal development sessions.

Individual learning and development records were issued to all non-executive directors summarising activity through the year and individual learning plans are in progress with a view to constructing the framework for individual and collective learning and development going forwards.

The Chair addresses the development needs of the Board as a whole, with a view to developing its effectiveness. He ensures that the directors' professional development needs are identified and that they are adequately informed about the Group and their responsibilities as directors.

Performance evaluation
The Code requires the Board to undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

Further to the external evaluation of the Board's effectiveness at the end of 2010, the only significant recommendation (in respect of the size and composition of the Board) was addressed during the year as described above.

A three year programme of assessment of Board and committee effectiveness exercises and peer evaluations was introduced during last year. In 2011, one third of the Board was the subject of a peer evaluation selected on length of service from first appointment to the Board, subject to having served at least one year on the Board as at 30 June.

An internal self assessment of Board effectiveness is also underway.

Each year, the Board committees undergo internal self assessment of their effectiveness. In this year both Audit and Exposures Committees carried out self assessment exercises. The other committees did not carry out assessments as they believed that given the high number of changes to the committees it was not appropriate until the new members had an opportunity to integrate into the committees.

Statutory disclosures information

Relations with members
The Bank has two equity shareholders. The majority of the shares are held by the Banking Group, which is a wholly owned subsidiary of The Co-operative Group. The remainder of the shares are held directly by The Co-operative Group.

The Bank has approximately 2,500 preference shareholders. The preference shares are fixed interest shares and are non-cumulative and irredeemable. The preference shareholders are entitled to attend the AGM, but the shares only hold speaking or voting rights if and when the dividend has been in arrears for six months or more, or if a resolution is to be proposed at general meeting abrogating or varying any of their respective rights or privileges, or for the winding up of the Bank or other return of capital and then only on such resolution.

Principal activities
The Bank and its subsidiary undertakings provide an extensive range of banking and financial services in the UK.

Results and dividends
Profit before taxation and significant items was £197.5m (2010: £108.7m). Profit attributable to the ordinary shareholders amounted to £48.0m (2010: £36.4m). No dividends were paid during 2011. The directors recommend that no final dividend is paid in respect of 2011.

Report of the Board of Directors continued

Risk management

The Board and executive management have the primary responsibility for identifying the key business risks facing the organisation. The risk management framework, which is approved and reviewed by the Bank Board, outlines the approach taken to ensure a robust risk management process is in place throughout the organisation and is regularly reviewed. The framework includes an ongoing process for identifying, evaluating and managing significant risks and has been in place for the year under review and up to the date of the approval of the annual financial statements.

An independent review of the Bank risk management framework was completed in 2011. The objective of the review was to consider whether the current framework is capable of enabling good risk governance and to make recommendations for improvement. The review considered the current framework to be suitable for an organisation of Bank's size and complexity. Areas which could be improved are being acted upon by the Executive.

The Board accepts that there are risks which could impact on the achievement of the Bank's business objectives, but endeavours through positive risk management strategies as outlined in the risk management framework, to manage these in a manner that optimises returns within the confines of the business' risk appetite, whilst protecting members' interests and reserves.

Further information on the Bank's approach to risk management is given on page 46 and details of KPIs are on page 2.

Internal control

Internal controls are the activities undertaken by management, the Board and other parties to enhance risk management and increase the probability that established objectives and goals will be achieved. The Board has overall responsibility for the Bank's system of internal controls which aim to ensure effective and efficient operations, quality of internal and external reporting, safeguarding of the Bank's assets and compliance with laws and regulations. Whilst recognising that the system is designed to manage rather than eliminate risk of failure to achieve business objectives, it can only provide reasonable and not absolute assurance against material misstatement or loss.

The Bank's internal control framework is designed to create an attitude of taking acceptable business risk within clearly defined limits. The control environment includes:

- an organisational governance structure with clear lines of responsibility, delegation of authority and reporting requirements;
- checks and balances to ensure that business processes operate efficiently, reducing the risk posed to the organisation whilst adhering to organisational values;
- comprehensive systems of financial reporting. The annual budget and long term plan of the Bank and of each division are reviewed and approved by the Board;
- a code of business conduct covering relations with customers, shareholders, colleagues, suppliers, community and competitors;
- a whistleblowing policy and procedure which provides for any employee to report, in confidence, suspected serious malpractice;
- internal audit, risk and compliance functions that review the system of internal control; and
- a control self assessment process designed to fully support the annual review of the effectiveness of the system of internal control and enable continual monitoring and improvement of the internal control environment.

External audit

The current auditor is KPMG Audit Plc. In line with good corporate governance a tender process took place during 2011 to consider the appointment of the external auditors to The Co-operative Group. A resolution to appoint and authorise the directors to fix their remuneration was proposed and approved at the Annual General Meeting (AGM) on 12 May 2011 and was also approved by the AGM of The Co-operative Group on 21 May 2011.

The Audit Committee has put in place safeguards to ensure that the independence of the audit is not compromised including a policy on the conduct of non-audit services from the external auditors. The external auditors are permitted to provide some non-audit services that are not, and are not perceived to be, in conflict with their independence. The Audit Committee receives at each meeting a report providing details of assignments (and related financial fees) carried out by the external auditors of the Bank in addition to their statutory audit work. The pre-approval of the committee is required for services above certain thresholds determined by the committee.

In addition, the following assignments are prohibited from being performed by the external auditors:

- bookkeeping or other services related to the accounting records or financial statements;
- financial information systems design and implementation;
- actuarial services;
- internal audit outsourcing services;
- management functions or human resources; and
- any other services that the Audit Committee may determine.

The performance of the external auditors is regularly monitored to ensure it meets the needs of the Bank and the results are reported to the committee.

Internal audit

The internal audit function is an independent function which reports to the Audit Committee. Its primary role is to provide assurance over the adequacy and effectiveness of the internal control framework including risk management practices.

Internal audit seeks to discharge the responsibilities set down in its charter by completing a risk based internal audit plan, reviewing the processes which ensure that the key business risks are effectively managed by key controls.

Internal audit also acts as a source of constructive advice and best practice, assisting senior management with its responsibility to improve the processes by which business risks are identified and managed.

Internal audit reports are submitted to, and significant issues discussed at, the Audit Committee. Full details of the operation of this committee can be found on page 13.

Going concern

The financial statements are prepared on a going concern basis as the directors are satisfied that the Group and parent company have the resources to continue in business for the foreseeable future. In making this assessment, the directors have considered a wide range of information relating to present and future conditions including future projections of profitability, cash flows and capital resources. Further information relevant to the assessment is provided within the basis of preparation section of the financial statements (page 38).

Information and communication
Communication takes place with all key stakeholders through a variety of media including the sustainability report produced by The Co-operative Group. Employees receive and are provided with information on strategy and objectives through their reporting lines and a formal performance measurement process. Newsletters, bulletins and electronic media communicate other information as well as the Company's intranet.

Employees
The Bank and its subsidiary undertakings employed 8,528 persons at 31 December 2011 (2010: 8,583). The weekly average number of people was 8,364 (2010: 8,746) and their aggregate remuneration, before significant items, for the year was £210.8m (2010: £221.0m). The Bank, as part of the Banking Group operates learning and development initiatives across the organisation as part of a continuous improvement programme, supporting its approach to performance management, personal development, talent and succession planning.

The Banking Group, in Bank orientated activities, continues to consult and communicate with colleagues on customer, organisation and business performance issues, using colleague publications, surveys, conferences, videos and both informal and formal consultations with Unite and other unions, which continue to be fully involved where organisational change and other issues affect colleagues.

Employees with disabilities
The Bank, as part of the Banking Group, is a member of the following diversity advisory bodies:

- Employers Forum on Disability;
- Employers Forum on Age;
- Race for Opportunity;
- Opportunity Now; and
- Stonewall.

The Banking Group is a holder of the 'Positive about Disabled People' symbol, a recognition given by Jobcentre Plus to employers who have agreed to meet five commitments regarding the recruitment, employment, retention and career development of disabled people. The Banking Group has policies and processes in place to support disabled colleagues in the workplace.

Further guidance and information for colleagues on disability issues is available through human resources and on the colleagues' intranet. The Banking Group recognises its responsibility for making reasonable adjustments for new colleagues with disabilities and for those individuals who develop disabilities whilst in employment.

Employees' wellbeing
The Bank, as part of the Banking Group, recognises that health and wellbeing at work play a vital part in delivering its core values. Wellbeing services include an occupational health scheme, physiotherapy services and seasonal wellbeing initiatives such as discounted allergy testing and flu jabs.

In addition to this, colleagues and their immediate families have access to an external employee assistance programme, providing free expert advice on a wide range of medical, legal and family issues.

Corporate responsibility
The Bank's corporate responsibility activities are outlined on pages 11 and 12. In addition, The Co-operative Group Sustainability Report, which will be published in the first half of 2012, describes how the Co-operative Group Limited, the Banking Group, the Bank, Co-operative Insurance Society Limited and CIS General Insurance Limited manage their social, ethical and environmental impacts.

Political and charitable donations
During the year, CFS Management Services Limited, a subsidiary of the Banking Group, made donations (which exclude affinity card payments) of £0.3m to charitable organisations on behalf of the Bank (2010: £0.4m). A further £0.5m of donations were made directly by the Bank with £0.4m allocated through the Britannia Foundation. Additional costs associated with the Bank's community involvement are provided within The Co-operative Group Sustainability Report. It is the Bank's policy that no donations are made for political purposes.

Outlets
At 31 December 2011 the Bank had 342 branches (2010: 342 branches).

Market value of land and buildings
Freehold and leasehold land and buildings held by the Bank are held on the balance sheet at historic cost and have not been revalued. These have been internally assessed at a market value of £75.2m which is £14.5m higher than carrying value.

Supplier payment policy and practice
With the exception of the Britannia business area detailed below, the Bank does not pay suppliers directly as all supplies and services are sourced through CFS Management Services Limited, a fellow subsidiary of the Banking Group. A management charge is payable to cover the cost of these services.

Suppliers are paid directly by the former Britannia business where the policy is to agree the terms of payment at the start of trading with the supplier, ensure that suppliers are aware of the terms of payment and pay in accordance with its contractual and other obligations. Creditor days at 31 December 2011 were 27 (2010: 16 days).

Post balance sheet events
The directors consider that there has been no event since the year end that has had a significant effect on the Bank's position or that of any of its connected undertakings.

Significant contracts
The Bank maintains a number of significant contracts with IT providers, cash handling entities and mailing service companies as well as with the Banking Group company, CFS Management Services Limited which provides facilities and services for all Banking Group companies.

Report of the Board of Directors continued

Statement of directors' responsibilities in respect of the report of the Board of Directors and the Annual Report and Financial statements

The directors are responsible for preparing the annual report and financial statements and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare Group and parent company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of their profit or loss for that period. In preparing each of the Group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a remuneration report, a directors' report and a corporate governance report that comply with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Financial statements

So far as the directors are aware, there is no relevant audit information of which the Bank's auditors are unaware, and the directors have taken all steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Bank's auditors are aware of that information.

Auditors

In accordance with Section 489 of the Companies Act 2006, resolutions for the appointment and remuneration of the auditors are proposed at the next AGM and set out on page 124. Further detail in relation to the appointment of the auditors is set out on page 16.

By Order of the Board
Moira Lees, Group Secretary

28 March 2012

Remuneration report

The Co-operative Bank (the Bank), in the interests of good governance uses as a guideline for its remuneration disclosure the requirements applicable to listed companies, as set out in schedule 8 of the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008 (incorporated into the Companies Act 2006). This remuneration report will be subject to an advisory vote by shareholders of the Company at its Annual General Meeting to be held on 12 May 2012.

This report provides details of the remuneration of both the senior executives (including executive directors and executive committee members) and the non-executive directors.

The key considerations this year are:

- continuation of extensive dialogue with the Financial Services Authority (FSA) in connection with our current and future remuneration practices. All remuneration arrangements and practices in place are compliant with the FSA Remuneration Code (the Code); and
- the introduction of a new long term incentive plan (LTIP) with effect from 1 January 2011, based on the wider performance of The Co-operative Group and which replaces the previous LTIP, which was based on performance of The Co-operative Banking Group only.

During 2011 there was a reorganisation of the Board to increase its levels of both independence and diversity. The number of directors on the Board was reduced from 20 to a total of 15. As part of the reorganisation Rod Bulmer, Tim Franklin and Phil Lee stood down as directors. These senior executives remained on the executive committee and attend Board meetings as required.

These considerations are covered in detail in the body of the report.

Introduction

The remuneration report is presented by the Board and contains the following information:

- a description of the role of The Co-operative Banking Group Remuneration and Appointments Committee (the committee), in governing senior executive remuneration in the Bank;
- a summary of the Bank's remuneration policy, including a statement of policy on senior executives and non-executive directors; and
- details of the terms of the service contracts and the remuneration of the senior executives and non-executive directors for the 2011 financial year.

The Remuneration and Appointments Committee meets as a combined committee for The Co-operative Banking Group and the Bank. Its role is described below.

Role of the committee

The committee's terms of reference were last revised and approved by the Bank's Board on 12 May 2010.

The committee's principal terms of reference, with regard to the Bank, are to:

- determine the policy on remuneration and other main terms and conditions of employment of senior executives;
- oversee contractual arrangements for the senior executives and approve the principal terms and conditions of employment of such senior executives;
- review remuneration using comparisons against the agreed market policy for the senior executives;
- make recommendations on senior executive appointments and the terms and conditions relating to these;
- review and agree the remuneration policy and outcomes in respect of all designated code staff under the FSA Remuneration Code;
- approve any relevant incentive schemes, ensure that they are in line with current market practice and the FSA Remuneration Code, and authorise payments under any incentive schemes in line with their rules; and
- receive, review and decide on issues raised in relation to retirement benefit schemes across the Bank and advise the Board on these issues as appropriate.

The Co-operative Group Remuneration and Appointments Committee governs remuneration in respect of the role of the Bank's Chief Executive.

The terms of reference for the committee are available on The Co-operative Banking Group website.

Members of the committee during 2011 were Rodney Baker-Bates (Deputy Chair Co-operative Banking Group) as Chair, together with Len Wardle (Co-operative Group Chair), Peter Marks (Co-operative Group Chief Executive), Paul Flowers (Co-operative Banking Group Chair) and David Davies (Deputy Chair, Co-operative Banking Group). The Board believes that all members of the committee are independent for the purpose of reviewing remuneration matters.

The Bank's Chief Executive and the HR Director are also invited to attend meetings of the committee except when their own remuneration is being discussed. The Chief Risk Officer provides an annual report to the committee and advice on any specific risk adjustments in relation to remuneration issues as required by the FSA. Other individuals were invited to attend for specific agenda items when necessary. The committee worked with The Co-operative Group Remuneration and Appointments Committee to ensure consistency, where appropriate, with arrangements across the wider Co-operative Group.

The committee members are all non-executive directors. They have no personal financial interests in the committee's decisions, and they have no involvement in the day to day management of the Bank.

The committee met five times in the year to 31 December 2011.

To ensure that it receives independent advice on remuneration matters, the committee retained New Bridge Street (an Aon Hewitt company) as its advisers during 2011. New Bridge Street has supplied survey data and advised on market trends and other general remuneration issues. Other than specialist advice in relation to remuneration matters, New Bridge Street does not provide other services to the Bank. Addleshaw Goddard was also retained to provide legal advice to the committee with respect to senior executives' service contracts.

Policy on directors' remuneration

In determining the remuneration policy for senior executives, the committee has considered a number of factors including:

- the importance of attracting, retaining and motivating senior executives of the appropriate calibre to further the success of the Bank;
- the linking of reward to business and individual performance and the application of co-operative values, which include a strong belief in responsible stewardship of all the Bank's resources and prudent management of risk;
- the alignment of the interests of senior executives with those of the wider Group and its members;
- pay practices and conditions of all employees throughout the Bank;
- the motivational impact of incentive arrangements to ensure that they are effective and do not adversely impact matters such as governance, environmental and social issues;
- in conjunction with the Group Remuneration and Appointments Committee ensuring that pay practices are coherent with those in The Co-operative Group as a whole; and
- ensuring appropriate compliance with the FSA Remuneration Code.

Remuneration report continued

The current policy is to pay senior executives base salaries around the market median, when compared with other organisations of comparable size and complexity in relevant business sectors. The committee supports the principle of performance related pay and operates an annual incentive plan (AIP) and a long term incentive plan (LTIP) which, together, mean that over 50% of the remuneration package is performance related. The committee does not consider it appropriate to adhere to the size of variable pay typically available in public limited companies (PLCs) and accordingly the amounts payable under these plans are lower than in comparable PLCs. Together, the AIP and LTIP represent total variable remuneration, with awards under the LTIP comprising the deferred element of variable remuneration as required by the FSA.

The committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the Bank's business environment, and in market remuneration practice. Accordingly, the committee keeps the Bank's remuneration policy under review.

Whilst the business climate in financial services remains challenging, the Bank has remained resilient through the period, having a robust model based on sound co-operative principles (which avoid undue risk taking or reliance on a single business stream). In particular, the absence of highly 'geared' incentive plans (when compared with some practices in the PLC sector) is consistent with prudent risk management.

The committee notes that the remuneration practices already adopted at the Bank, in addition to being good business practice, have been endorsed by the FSA through its Remuneration Code. However, the committee will continue to strive for further improvements in its executive remuneration arrangements as best practice evolves.

The main components of senior executive remuneration are summarised in the table below:

Element	Remuneration objective	Details
Base salary	To provide a competitive base salary to attract and retain talented leaders	Reviewed annually. Targeted around market median
Benefits	To provide executive benefits in line with normal market practice	Car or car allowance, fuel cards, phone and life assurance
Pension	To aid retention and reward long service, whilst controlling the Bank's liabilities	The Co-operative Group provides a Defined Benefit pension plan (on the same career average basis as other employees) or an equivalent cash pension allowance
Annual incentive plan	To ensure pay is linked to the Bank's financial and strategic business objectives and co-operative values	Up to 60% of salary based on annual Bank's financial and non-financial targets
Long term incentive plan	To reward senior executives for delivery of superior long term performance and to retain talent	Awards up to 100% of base salary for the CEO and 75% for other senior executives based on stretching three year Co-operative Group financial and non-financial targets

1. Base salary

It is the committee's policy to ensure that the base salary for each senior executive is appropriate and competitive, for the responsibilities involved and experience required. Base salaries for senior executives are reviewed by the committee, usually annually, having regard to competitive market practice, business and individual performance during the financial year and salary levels throughout the Company. Comparative pay data is used carefully, recognising the potential for an upward ratchet in remuneration caused by over reliance on such data. Any increases are normally effective from the start of the financial year. Base salary is the only element of remuneration that is pensionable. Salaries received by senior executives in respect of 2011 are set out in table 1 and 1a.

2. Annual incentive plan (AIP)

Each senior executive is eligible to participate in the AIP.

The committee reviews and sets incentive targets and levels of eligibility annually.

The design and terms of the 2011 plan are as follows:

- target payment levels for all of the executive team are 35% of base salary with a maximum opportunity of 60%; and
- based on a mixture of financial and non-financial measures derived from the corporate balanced scorecard.

The balanced scorecard approach represents best practice as set out in the FSA Remuneration Code and is aligned to the goals of the business.

The measures and weightings in the balanced scorecard are as set out below:

- financial (35%): operating profit;
- process (35%): cost v budget;
- customer (15%): customer advocacy; and
- people (15%): colleague engagement score.

All balanced scorecard performance measures and results are audited by externally appointed auditors.

The Chief Executive's AIP is based 2/3rds on the above Bank's targets; the balance is based on targets for the wider Co-operative Group: Group profit (70%), Group corporate responsibility (10%), Group colleague engagement (10%) and Group customer satisfaction (10%).

In addition to achieving performance against the balanced scorecard measures (including the Chief Executive's Group AIP element), four further underpins must be achieved before any payment is made. These are as follows:

1. A threshold profit level must be achieved before any element becomes payable.
2. The Bank must stay within its required liquidity range as agreed by The Co-operative Banking Group Board.
3. The Bank must stay above its required minimum capital level as agreed by The Co-operative Banking Group Board.
4. There should be no material breaches of risk in accordance with the risk appetite as agreed by The Co-operative Banking Group Board. The Chief Risk Officer is required to provide an annual report to the committee before bonus payments are signed off.

Additional deferral is also required by the FSA Code: 50% of any AIP earned is paid in March or April following the year end, while the remaining 50% is deferred for an additional six months subject to specified conditions and clawback.

Similar performance conditions will apply for the 2012 AIP.

For the 2011 AIP, bonus on average resulted in payments of 38.1% of base salary, representing slightly above target balanced scorecard performance. For those senior executives new in role, payments are lower to represent previous roles held. In accordance with the FSA Remuneration Code for those senior executives that are not awarded 2012–14 LTIP, deferral of 60% of the AIP bonus is required, fully subject to performance conditions and clawback. Payment, if any, will be 50% in years 3 and 3.5. Of the AIP bonus payments due in April, 50% will be deferred for six months subject to specified conditions and clawback. Details of awards to senior executives are set out in table 1 and 1a.

3. Long term incentive plan (LTIP)

A new LTIP representing deferred remuneration under the FSA Remuneration Code was introduced with effect from 1 January 2011. The plan is designed to focus and align the leadership team with the long term strategy of The Co-operative Group, and aid the retention of talent. The plan measures cumulative performance over a three year period. The 2011 award will be measured over the three year period 2011 to 2013 with potential payment in 2014. It is intended that awards will be made annually thereafter.

The maximum award opportunity under the LTIP is 75% of base salary for senior executives and 100% of base salary for the Chief Executive. These awards represent the maximum amount payable in respect of each three year performance period. The actual amount of award vesting is subject to the achievement of the long term performance measures.

The performance measures are based on the performance of The Co-operative Group (inclusive of the Bank's performance) over a three year period as set out in the balanced scorecard, the measures being designed to ensure delivery of strategic targets. The specific measures for 2011 to 2013 are:

- Cumulative Co-operative Group profit, subject to also achieving a minimum level of average Return on Net Operating Assets (RONOA) (70%);
- Group corporate responsibility (10%);
- Group colleague engagement (10%); and
- Group customer satisfaction (10%).

All balanced scorecard performance measures and results are audited by externally appointed auditors.

Additionally, the financial and risk underpins applicable to the AIP also apply to the LTIP ie the four underpins must be met for any LTIP to become payable. These underpins are to provide appropriate risk adjustment and to be compliant with the FSA Remuneration Code.

Additional deferral is required by the FSA Code: at the point of vesting, 50% of any payment will be deferred for an additional six months subject to specified conditions and clawback (ie for 50% of the LTIP award the total deferral period from grant is 3.5 years).

The 2009–11 LTIP cycle was completed in January 2012. Performance was based on the Bank's shareholder profit, cost management, customer satisfaction and colleague engagement. Details of payment due under the 2009–11 plan cycles are set out in tables 1 and 1a (column performance related pay medium/long term). These equate to 79% of the original grant reflecting maximum awards of 39% to 47%.

To summarise, senior executives' LTIP grants for 2010–12 and 2011–13 remain outstanding. Payments, if any, would be made in 2013 and 2014 respectively, with 50% of due awards retained for an additional six months subject to additional performance conditions. 2011 LTIP terms are still in the process of being agreed by the FSA, once terms of the plan are agreed, grants will be made.

4. Clawback and malus

With effect from the 2010 LTIP grant, and for AIP payments in respect of 2011 performance onwards, including any deferred element, a clawback provision will apply. This enables the committee to seek to recoup part or all of an annual incentive or LTIP payment in the exceptional events that it was based on misstated performance results or if a senior executive is dismissed for gross misconduct.

The Bank also operates malus, ie a provision where the value of deferred remuneration (ie the element deferred for six months under the AIP and LTIP) can be adjusted downwards to take account of specified conditions.

5. Service agreements

It is the Bank's policy that the notice period in senior executives' service contracts should not exceed one year. Senior executives have consistent contracts that are terminable by up to one year's notice by the organisation and six month's notice by the individual. In the event of termination, the standard payment due to a senior executive is based on the value of one year's base salary and contractual benefits. (In (exceptional) circumstances such as a major re-organisation or merger, termination payments to executives leaving the Bank have been enhanced, but applying a formula that is no more generous than that applying to other Bank colleagues leaving the Group in the same circumstances.) The details of the termination payments made to senior executives leaving the Bank during 2011 are disclosed in tables 1 and 1a. The committee may make a discretionary award of bonus earned up to the date of termination of employment. Any such award would be subject to deferral in accordance with the FSA Remuneration Code.

All the Bank senior executives had similar contracts during 2011. The dates of existing contracts or dates of appointment are shown in table 1 and 1a.

Remuneration report continued

Senior executives' joining and leaving arrangements in 2011

- Neville Richardson resigned from the Board on 22 July 2011 and was paid his contractual remuneration until 31 December 2011
- Tim Franklin resigned from the Executive Committee on 30 November 2011 and was paid his contractual remuneration until 31 December 2011
- Karen Moir resigned from the Executive Committee on 30 September 2011
- James Mack was appointed to the Executive Committee as acting CFO on 1 August 2011
- Helen Taylor was appointed to the Executive Committee on 1 October 2011

In normal circumstances, it is the committee's policy to apply service contracts for any newly recruited senior executives in a similar form to the model that has been developed for existing senior executives.

Non-executive directorships

The committee has determined that, subject to the committee's approval, senior executives may accept one non-executive directorship, or similar, with an external organisation believing that this represents an important opportunity for professional development. Any fees received from such a role will normally be paid to the Bank, The Co-operative Banking Group or The Co-operative Group.

Phil Lee holds such a position; non-executive director within EG Solutions PLC.

6. Share option plans

As a co-operative, the Bank does not operate a share or share option plan.

7. Pensions

The financial services businesses participate in The Co-operative Group Pension (Average Career Earnings) Scheme (the PACE Scheme). However, following the merger with Britannia Building Society on 1 August 2009, colleagues who at that date were members of the Britannia Pension Scheme (the Britannia Scheme) continue in membership of the Britannia Scheme. From 1 August 2009, for the interim, only the defined contribution section of the Britannia Scheme is available to new colleagues of the financial services businesses.

The PACE Scheme, which is a registered occupational pension scheme, provides defined benefit (DB) pensions based on 1/60th of average pensionable earnings, re-valued for inflation for each year of pensionable service from 6 April 2006 (the date the PACE Scheme was implemented). Benefits accrued as at 5 April 2006, in respect of membership of the scheme preceding the PACE Scheme, continue to be linked to final pensionable salary at a member's date of leaving or retirement, whichever is earlier. Pensions are also payable to dependants on death and a lump sum is payable if death occurs in service.

The Britannia Scheme, which is also a registered occupational pension scheme, provides benefits under two sections:

- A defined benefit (DB) section (closed to new colleagues), which provides pensions based on an accrual of 1/80th, 1/60th or up to 1/30th for executives, of final pensionable salary for each year of pensionable service.
- A defined contribution (DC) section (open to new colleagues) with an employer contribution rate of 4%, 6% or 8% depending on the level of member contribution.

Under both sections, pensions are also payable to dependants on death and a lump sum is payable if death occurs in service.

Members of the PACE Scheme currently contribute 6% of their pensionable salary whilst members of the Britannia Scheme contribute either 6% or 8% of their pensionable salary if they are in the DB section. The employer pays the balance of cost of providing DB benefits. Members of the Britannia Scheme DC section pay 2%, 3% or 4% of their pensionable salary. All members have the choice of making pension contributions by salary sacrifice.

Prior to the merger on 1 August 2009, Neville Richardson, Tim Franklin and Phil Lee had contractual arrangements under which they accrued pension benefits in an unfunded employer financed retirement scheme (EFRBS). The EFRBS is in place to provide pension benefits that exceed the lifetime allowance. Benefits up to the lifetime allowance will be provided from the Britannia Scheme. These contractual arrangements and those for Karen Moir were revised from 1 August 2009 and the rate of benefit aligned more closely to Group executive pension policy. These arrangements were further adjusted from 1 August 2011 so that the rate of future pension accrual made available under the Britannia Scheme was aligned to that provided by the PACE Scheme, with no further accrual in the EFRBS.

In light of the pension tax changes applying to registered schemes from 6 April 2011, Group executive pension policy was revised. Where an executive may be impacted by the annual allowance or the lifetime allowance they have the facility of opting out of future pension accrual in favour of a pension allowance or opting for restricted pension accrual based on a capped salary of £187,500 and receiving a restricted pension allowance in lieu of pension provision based on salary above £187,500.

Where paid, the rate of pension allowance is based on the employer contribution rate to the PACE Scheme of currently 16.7% of pensionable salary (16% prior to July 2011).

On this basis, Barry Tootell opted for restricted pension accrual with effect from 6 April 2011 and was paid a restricted pension allowance.

James Mack is a member of the Britannia Scheme DC section and has a contractual arrangement under which the employer contribution rate is 12%.

All other executives accrued full pension benefits as members of either the PACE Scheme or the Britannia Scheme during the year.

Supplementary life cover is provided to executives in order to provide total life cover of four times salary when aggregated with benefits from the relevant pension scheme, as appropriate.

Additional details are available in table 2.

Non-executive directors

All the non-executive directors are appointed, and their directors' fees are determined and paid, by The Co-operative Group.

The basic fee for a non-executive director elected to sit on The Co-operative Group Board who is also appointed to serve on the Banking Group Board and its principal subsidiaries (including the Bank) is £16,302 per annum, and these same non-executive directors receive additional fees for serving on the various Banking Group Board committees (which also have responsibility for Bank business). The Chair's fee is £113,025 per annum.

Following a benchmarking exercise by New Bridge Street in 2010 which was approved by The Co-operative Group Board the six independent professional non-executive directors and the professional external non-executive director received a fee of £57,002 per annum. Co-operative Group Board Directors serving on the various committees, as well as Chairs of the various committees also receive additional fees, as do the Deputy Chairs for the Board, to reflect their additional responsibilities. Fees were increased in line with RPI in 2011. The increase in fees in 2011 was 3.7%, effective from 1 June 2011. The independent professional non-executive directors and professional external non-executive director now receive £59,966.

The independent professional non-executive directors and the professional external non-executive director are party to agreements with The Co-operative Group governing the terms on which their services are made available to the Bank. These service agreements expire on 31 July 2014, with the exception of David Davies whose service agreements expire on 31 July 2013.

The Co-operative Group Board may resolve to reappoint any of the independent professional non-executive directors at or before the date their service agreements expire for a further three year term. It is the normal policy of the Board not to allow an independent professional non-executive director to serve for more than nine years in aggregate.

The non-executive directors' service agreements contain no specific provision for liquidated damages on early termination of an agreement.

None of the independent professional non-executive directors are directors of The Co-operative Group or members of any Co-operative Group pension scheme or incentive plan.

Details of the directors' year of appointment and fees are shown in table 3.

Code staff remuneration

Code staff are defined by the FSA as those having a material impact on a firm's risk profile, including a person who performs a significant influence function for a firm, a senior manager and risk takers.

Remuneration policy and outcomes for code staff are determined by the committee. The design of the component parts of remuneration is as set out for the senior executives. For all code staff, performance related pay is risk adjusted through the use of the underpins to the incentive plans, together with the application of deferrals, clawback and malus adjustments in accordance with the FSA Remuneration Code.

Details of the aggregate remuneration information required by the FSA is shown in table 4 and are in respect of all the Bank's Group code staff. The amounts shown in respect of senior executives and non-executive directors do not represent additional remuneration.

By Order of the Board

Rodney Baker-Bates,
Chair, Co-operative Banking Group Remuneration and Appointments Committee

28 March 2012

Remuneration report continued

Table 1 – Emoluments of senior executives (executive directors) for the year ending 31 December 2011

	Date of service contract or appointment	Basic salary £000	Other supplements[1] £000	Performance related pay annual[2] £000	Benefits in kind[3] £000	Total related to 2011 £000	Performance related pay medium/long term[4] £000	2011 Total emoluments £000	2010 Total emoluments[5] £000
Neville Richardson[6] [11]	1 August 2009	398	8	109	3	518	220	738	1,196
Barry Tootell[7] [11]	4 April 2008	448	50	153	5	656	110	766	691
Rod Bulmer[8] [11]	1 June 2008	183	7	63	1	254	45	299	754
Tim Franklin[8] [11]	1 August 2009	186	8	26	1	221	58	279	701
Phil Lee[8] [11]	1 August 2009	186	3	26	4	219	58	277	700
Total		1,401	76	377	14	1,868	491	2,359	4,042
Former directors who served the Bank in 2010[9]								–	425
Compensation for loss of office[10]								1,390	–
								3,749	4,467

The table above represents total emoluments for executive directors in relation to their services for The Co-operative Banking Group.

(1) Other supplements include full or partial pension allowances in lieu of a pension provision, car allowance, phone and healthcare supplements (ie non P11D items).
(2) Performance related pay (annual) refers to bonus amounts earned in respect of 2011. To comply with the FSA Remuneration Code, 50% of the 2011 annual bonus quoted is deferred for six months subject to further performance conditions and clawback. In addition as Neville Richardson is not eligible for 2012–14 LTIP, 60% of the 2011 annual bonus has been deferred (50% for 3 years and 50% for 3.5 years) to comply with FSA deferral rules. The deferred amount is subject to performance conditions and is not quoted in the emoluments table. This amount equates to £163k.
(3) Benefits in kind for Neville Richardson and Phil Lee are in respect of company cars and healthcare cover, Tim Franklin and Barry Tootell are both in respect of healthcare cover (ie P11D items).
(4) Performance related pay (medium/long term) refers to compensatory amounts paid in respect of the lost opportunity as a result of the early vesting of the 2009–11 LTIP plan.
(5) 2010 Total emoluments were in respect of a full year for all executive directors.
(6) Neville Richardson resigned as Chief Executive Officer on 22 July 2011.
(7) Barry Tootell was appointed Acting Chief Executive Officer on 22 July 2011.
(8) Rod Bulmer, Tim Franklin and Phil Lee were executive directors until 16 June 2011. The 2011 emoluments therefore were in respect of a part year only.
(9) John Reizenstein served as executive director until 7 December 2010, emoluments were in respect of a part year.
(10) Compensation for loss of office was in respect of Neville Richardson. Following his resignation on 22 July, Neville received a further payment of £380k for continued employment to 31 December 2011.
(11) In accordance with the FSA Remuneration Code, payment of 60% of 2011 variable pay is deferred over a three year period. Variable pay comprises annual bonus in respect of 2011 plus long term incentive awarded in 2012 in respect of the 2011 year.

Table 1a – Emoluments of senior executives (members of the executive committee) for the year ending 31 December 2011

	Date of service contract or appointment	Basic salary £000	Other supplements[1] £000	Performance related pay annual[2] £000	Benefits in kind[3] £000	Total related to 2011 £000	Performance related pay medium/long term[4] £000	2011 Total emoluments £000	2010 Total emoluments[5] £000
Rod Bulmer[6] [12]	1 June 2008	217	9	74	–	300	53	353	–
Tim Franklin[6] [7] [12]	1 August 2009	186	8	30	–	224	69	293	–
Phil Lee[6] [12]	1 August 2009	221	5	30	5	261	69	330	–
Mike Fairbairn[12]	16 January 2006	237	17	33	3	290	62	352	420
Keith Alderson[12]	1 October 2010	256	17	88	1	362	30	392	94
Karen Moir[8] [12]	1 August 2009	203	12	28	1	244	76	320	483
James Mack[9] [12]	1 August 2011	93	4	25	–	122	–	122	–
Helen Taylor[10] [12]	1 October 2011	50	3	17	–	70	11	81	–
Total		1,463	75	325	10	1,873	370	2,243	997
Compensation for loss of office[11]								1,159	–
								3,402	997

The table above represents total emoluments for executive directors in relation to their services for The Co-operative Banking Group.

(1) Other supplements include full or partial pension allowances in lieu of a pension provision, car allowance, phone and healthcare supplements (ie non P11D items).

(2) Performance related pay (annual) refers to bonus amounts earned in respect of 2011. To comply with the FSA Remuneration Code, 50% of the 2011 annual bonus quoted is deferred for six months subject to further performance conditions and clawback. In addition for executives not eligible for 2012–14 LTIP, 60% of the 2011 annual bonus has been deferred (50% for 3 years and 50% for 3.5 years) to comply with FSA deferral rules. The deferred amount is subject to performance conditions and is not quoted in the emoluments table. These amounts equate to £84k for Phil Lee, £42k for Karen Moir, £84k for Tim Franklin and £49k for Mike Fairbairn respectively.

(3) Benefits in kind are in respect of company car for Phil Lee and medical insurance for Rod Bulmer, Mike Fairbairn, Keith Alderson, Karen Moir and Phil Lee (ie P11D items).

(4) Performance related pay (medium/long term) refers to compensatory amounts paid in respect of the lost opportunity as a result of the early vesting of the 2009–11 LTIP plan.

(5) 2010 Total emoluments were in respect of a full year for all executive committee members.

(6) Rod Bulmer, Tim Franklin and Phil Lee were appointed to the Executive Committee on 17 June 2011. The 2011 emoluments represent earnings from that date.

(7) Tim Franklin resigned as Executive Officer on 30 November 2011.

(8) Karen Moir resigned on 30 September 2011.

(9) James Mack was appointed to the Executive Committee on 1 August 2011. The emoluments shown represent his earnings from that date.

(10) Helen Taylor was appointed to the Executive Committee on 1 October 2011. The emoluments shown represent her earnings from that date.

(11) Compensation for loss of office in 2011 was in respect of Karen Moir £466,000 and Tim Franklin £692.500. In addition, Tim Franklin received payment of £41,000 for continued employment up to 31 December 2011. Karen Moir also received £3,000 in lieu of holiday pay.

(12) In accordance with the FSA Code of Practice, payment of 60% of 2011 variable pay is deferred over a three year period. Variable pay comprises annual bonus in respect of 2011 plan plus long term incentive awarded in 2012 in respect of the 2011 year.

Remuneration report continued

Table 2 – Pension details of senior executives (executive directors or members of the Executive Committee)

	Years of service	Total accrued pension at 31 December 2011 £000	Increase in accrued pension during the year £000	Increase in accrued pension during the year (net of inflation) £000	Transfer value of previous column at 31 December 2011 net of members' contributions £000	Transfer value of total accrued pension at 31 December 2010 £000	Transfer value of total accrued pension at 31 December 2011 £000	Increase in transfer value net of members' contributions £000
Neville Richardson[5]	13	43	(98)	(105)	(2,830)	2,903	1,161	(1,788)
Barry Tootell[6]	3	21	5	4	33	166	274	94
Keith Alderson[7]	8	29	7	6	71	282	451	153
Rod Bulmer[8]	4	20	7	6	42	99	210	87
Mike Fairbairn[9]	36	69	4	1	(15)	1,415	1,664	235
Tim Franklin[10]	11	59	(28)	(33)	(785)	1,536	1,382	(180)
Phil Lee[11]	9	88	9	5	87	1,717	2,326	582
James Mack[12]	1	–	–	–	–	–	–	–
Karen Moir[13]	10	64	5	2	32	1,164	1,406	229
Helen Taylor[14]	4	15	4	3	25	96	172	64

General notes

(1) The table above includes all senior executives who were either executive directors or members of the Executive Committee (or who switched status during the year) for the year ending 31 December 2011 and shows their pension details for the period during the year they were in the employment of the Banking Group.

(2) Pension scheme members have the option of paying additional voluntary contributions to their respective pension scheme. Neither these contributions nor the benefits arising from them are shown in the above table.

(3) Years of service include, where appropriate, pre-merger service with Britannia. The total accrued pension is that which would be paid annually on retirement at normal retirement age, based on service to 31 December 2011, and includes any transferred in benefits as appropriate. Under the terms of their contracts, existing senior executives at 17 January 2007 (only Mike Fairbairn now falls into this category) may take these benefits from age 60 and new executives after 17 January 2007 may take these benefits from age 65. The transfer values in the table above have been calculated on this basis.

(4) All transfer values have been calculated in accordance with the current transfer value method and basis in force for the scheme applicable to the senior executive. This is set by the Trustee(s), after taking actuarial advice, to be consistent with the requirements of legislation and the rules of the scheme.

Individual notes

(5) Neville Richardson resigned as Chief Executive Officer on 22 July 2011 and left the Banking Group on 31 December 2011. He became entitled to a deferred pension from the Britannia Scheme DB section when he left the scheme at the same date. The details shown in the table are calculated at that date. During the year Neville chose to take the value of his EFRBS as a taxable lump sum of £2,120,000 rather than as pension. The negative numbers shown on the table reflect the effect of this.

(6) Barry Tootell (previously an executive director) was appointed Acting Chief Executive Officer on 22 July 2011. He opted for restricted pension accrual from 6 April 2011 and was paid a restricted pension allowance.

(7) Keith Alderson was a member of the Executive Committee during the year.

(8) Rod Bulmer was an executive director until 16 June 2011. He was appointed to the Executive Committee on 17 June 2011.

(9) Mike Fairbairn was a member of the Executive Committee during the year. The figures shown on the table at the start of the year and at the year end are after application of a pension sharing order.

(10) Tim Franklin was an executive director until 16 June 2011. He was appointed to the Executive Committee on 17 June 2011 and resigned on 30 November 2011. He became entitled to a deferred pension from the Britannia Scheme DB section when he left the scheme on 31 December 2011. The details shown in the table are calculated at that date. During the year Tim chose to take the value of his EFRBS as a taxable lump sum of £575,000 rather than as pension. The negative numbers shown on the table reflect the effect of this.

(11) Phil Lee was an executive director until 16 June 2011. He was appointed to the Executive Committee on 17 June 2011.

(12) James Mack was appointed to the Executive Committee on 1 August 2011. He is a member of the Britannia Scheme DC section and his pension details are shown on table 2a.

(13) Karen Moir resigned from the Executive Committee on 30 September 2011. She became entitled to a deferred pension under the Britannia Scheme DB section when she left the scheme at the same date. The details shown in the table are calculated at that date.

(14) Helen Taylor was appointed to the Executive Committee on 1 October 2011.

Table 2a – Defined contributions paid for senior executives

Name	Amount £
James Mack	21,530

Table 3 – Non-executive directors' remuneration

Non-executive directors	Date appointed	2011 fees £000	2010 fees £000
Paul Flowers[1] [20]	2009	**120**	83
Duncan Bowdler[3] [18]	2009	**17**	16
Peter Marks[2]	2009	**–**	–
Ben Reid[3] [4]	2009	**20**	19
Len Wardle[3] [18] [20]	2006	**23**	16
Martyn Wates[2]	2007	**–**	–
Steve Watts[3] [13]	2006	**10**	18
Independent professional non-executive directors (IPNEDS)			
Rodney Baker-Bates[5] [6]	2009	**75**	66
David Davies[5] [6] [17]	2003	**85**	68
Peter Harvey[5] [7] [9]	2009	**68**	57
Chris Jones[5] [11] [19]	2009	**102**	72
Stephen Kingsley[5] [8] [12]	2009	**93**	58
Bob Newton[5] [8] [21]	2007	**88**	56
Piers Williamson[5] [9] [14]	2005	**46**	58
Anne Gunther[5] [15]	2011	**19**	–
Merlyn Lowther[5] [16]	2011	**16**	–
Professional non-executive director (PNED)			
Paul Hewitt[5] [10]	2003	**68**	66

Notes

(1) The Chair of the Board receives £113,025.
(2) Peter Marks and Martyn Wates are employees of The Co-operative Group. Although they are entitled to fees of £16,302 they have both agreed to waive them.
(3) The non-executive directors that also serve on the Group Board receive a fee of £16,302 per annum for serving on the Banking Group Board.
(4) Ben Reid, as a non-executive director who is a member of the Banking Group Audit Committee and who is not an IPNED, receives an additional £3,111 per annum.
(5) Under their service contracts, the IPNEDs and PNED receive a fee from June 2011 of £59,996 per annum.
(6) The Deputy Chairs receive an additional fee of £15,720 per annum.
(7) The Chair of the Banking Group Exposures Committee receives an additional £5,240 per annum. This amount is pro rata if the position is held for part of the year.
(8) The Chair of the Banking Group Transformation Committee receives an additional £7,336 per annum. This amount is pro rata if the position is held for part of the year.
(9) The Chair of the Banking Group Risk Management Committee receives an additional £11,004 per annum. This amount is pro rata if the position is held for part of the year.
(10) The Chair of the Banking Group Audit Committee receives an additional £11,004 per annum. This amount is pro rata if the position is held for part of the year.
(11) The Chair of Illius Properties Limited receives a fee of £15,000 per annum.
(12) Stephen Kingsley stepped down from the Board with effect from 16 June 2011. His remuneration also incorporates his compensation for loss of office of £57,002.
(13) Steve Watts stepped down from the Board with effect from 8 July 2011.
(14) Piers Williamson stepped down from the Board with effect from 8 September 2011.
(15) Anne Gunther was appointed as an IPNED from 8 September 2011.
(16) Merlyn Lowther was appointed as an IPNED from 7 September 2011.
(17) David Davies receives £11,004 as the Chair of PACE.
(18) The non-executive directors that also serve on the Group Board receive a fee of £3,260 per annum for serving on the Banking Group Exposures Committee.
(19) Chris Jones stepped down from the Board with effect from 31 August 2011. His remuneration also incorporates his compensation for loss of office of £57,002.
(20) The non-executive directors that also serve on the Group Board receive a fee of £2,174 per annum for serving on the Banking Group Remuneration and Appointments Committee.
(21) Bob Newton receives a fee of £25,000 per annum for being on the Board of the Reclaim Fund Limited.

Remuneration report continued

Table 4 – Aggregate information in respect of code staff

Number of code staff	Total remuneration[1] £000	Total fixed remuneration[2] £000	Total variable remuneration[3] £000	Annual incentive plan[4] £000	Long term incentive plan[5] £000	Outstanding deferred remuneration[6] £000	Deferred reduced and paid £000	Sign on and severance payments £000	Severance payments made in year[8] £000
Senior management 27[7]	7,398	5,025	2,373	1,205	1,168	421	–	–	2,549
Other code staff 40	9,472	6,870	2,602	1,495	1,107	46	–	–	2,962

The table above represents the emoluments of code staff in relation to their services for The Co-operative Bank.

(1) Total remuneration consists of base salary, allowances, employer pension contributions and incentive payments relating to the 2011 financial year, together with future earnings opportunity comprised in the 2012–14 long term incentive awards.
(2) Total fixed remuneration is base salary plus allowances and employer pension contributions.
(3) Total variable remuneration is the sum of the annual incentive plan payments in respect of the 2011 financial year and the awards made under the 2012–14 long term incentive plan. The awards under the 2012–14 long term plan are performance related and, to the extent achieved will be payable 50% in 2015 and 50% in 2016. All payments as and when due are made in cash.
(4) Payments made under the annual incentive plan are in respect of the 2011 financial year.
(5) Awards made under the 2012–14 long term incentive plan are all unvested and represent deferred remuneration in respect of the 2011 financial year, in accordance with the FSA Remuneration Code.
(6) The outstanding deferred remuneration is deferred cash where no long term incentive award is made or the award is insufficient to satisfy the deferral percentage required by the FSA. These amounts are quoted in annual incentive plan totals and do not represent additional payments.
(7) Senior management consists of executive directors, members of the executive committee and non-executive directors.
(8) Severance payments are in respect of redundancy for both senior managers and other code staff. Fourteen code staff were made redundant in 2011. Severance terms include both redundancy payments and the buyout of notice.

Independent auditor's report to the members of The Co-operative Bank plc

We have audited the financial statements of The Co-operative Bank plc for the year ended 31 December 2011 set out on pages 30 to 68 and pages 71 to 122. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and reporting on corporate governance, on terms that have been agreed. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and reporting on corporate governance, those matters that we have agreed to state to them in our report, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors
As explained more fully in the directors' responsibilities statement set out on page 18, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements
A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements
In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2011 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006
In our opinion:

- the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the information given in the corporate governance statement set out on pages 11 to 18 with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review the directors' statement, set out on page 16, in relation to going concern.

In addition to our audit of the financial statements, the directors have engaged us to review their corporate governance statement as if the Company were required to comply with the Listing Rules and the Disclosure Rules and Transparency Rules of the Financial Services Authority in relation to those matters. Under the terms of our engagement, we are required to review the part of the corporate governance statement on pages 11 to 18 relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review.

Andrew Walker, Senior Statutory Auditor
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
St James Square
Manchester
M2 6DS

28 March 2012

Consolidated income statement

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

	Notes	Before significant items 2011	Significant items 2011	After significant items 2011	Before significant items 2010	Significant items 2010	After significant items 2010
Interest receivable and similar income	4	**1,583.7**	**–**	**1,583.7**	1,713.3	–	1,713.3
Interest expense and similar charges	4	**(948.7)**	**–**	**(948.7)**	(1,104.9)	–	(1,104.9)
Net interest income		**635.0**	**–**	**635.0**	608.4	–	608.4
Fee and commission income	5	**239.6**	**(90.0)**	**149.6**	237.2	(13.1)	224.1
Fee and commission expense	5	**(54.4)**	**–**	**(54.4)**	(60.3)	–	(60.3)
Net fee and commission income		**185.2**	**(90.0)**	**95.2**	176.9	(13.1)	163.8
Net trading income	6	**4.5**	**–**	**4.5**	4.6	–	4.6
Other operating income	7	**46.3**	**–**	**46.3**	8.1	–	8.1
Operating income		**871.0**	**(90.0)**	**781.0**	798.0	(13.1)	784.9
Operating expenses	8	**(528.7)**	**(53.3)**	**(582.0)**	(571.9)	(46.7)	(618.6)
Financial Services Compensation Scheme levies	32	**(14.5)**	**–**	**(14.5)**	(11.5)	–	(11.5)
Operating profit before impairment losses		**327.8**	**(143.3)**	**184.5**	214.6	(59.8)	154.8
Impairment losses on loans and advances	15	**(120.5)**	**–**	**(120.5)**	(97.3)	–	(97.3)
Impairment gains on investments	16	**5.6**	**–**	**5.6**	1.5	–	1.5
Operating profit		**212.9**	**(143.3)**	**69.6**	118.8	(59.8)	59.0
Share of post tax profits from joint ventures	36	**0.2**	**–**	**0.2**	0.7	–	0.7
Profit before taxation and profit based payments		**213.1**	**(143.3)**	**69.8**	119.5	(59.8)	59.7
Profit based payments to members of The Co-operative Group		**(15.6)**	**–**	**(15.6)**	(10.8)	–	(10.8)
Profit before taxation	2	**197.5**	**(143.3)**	**54.2**	108.7	(59.8)	48.9
Income tax	10	**(42.4)**	**38.0**	**(4.4)**	(29.8)	16.7	(13.1)
Profit for the financial year		**155.1**	**(105.3)**	**49.8**	78.9	(43.1)	35.8
Attributable to:							
Equity shareholders	12	**153.3**	**(105.3)**	**48.0**	79.5	(43.1)	36.4
Minority interests		**1.8**	**–**	**1.8**	(0.6)	–	(0.6)
		155.1	**(105.3)**	**49.8**	78.9	(43.1)	35.8
Earnings per share (basic and diluted)	12	**1.87p**	**(1.28)p**	**0.59p**	1.67p	(0.90)p	0.77p

The significant items in 2011 and 2010 relate to a programme of investment and integration and to provisions made for customer compensation relating to past sales of payment protection insurance (PPI) and customer redress (notes 5, 8 and 32).

Consolidated statement of comprehensive income

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

	Group					
	Equity shareholders 2011	**Minority interests 2011**	**Total 2011**	Equity shareholders 2010	Minority interests 2010	Total 2010
Profit for the financial year	**48.0**	**1.8**	**49.8**	36.4	(0.6)	35.8
Other comprehensive income/(expense):						
Changes in cashflow hedges						
Net changes in fair value recognised directly in equity	**88.9**	**0.3**	**89.2**	(2.8)	(0.7)	(3.5)
Income tax	**(19.8)**	**(0.1)**	**(19.9)**	1.3	0.2	1.5
Net gains transferred from equity to income or expense	**(49.3)**	**(0.3)**	**(49.6)**	–	(0.1)	(0.1)
Income tax	**10.9**	**0.1**	**11.0**	–	–	–
Changes in available for sale assets						
Net changes in fair value recognised directly in equity	**101.6**	**–**	**101.6**	(25.3)	–	(25.3)
Income tax	**(26.9)**	**–**	**(26.9)**	6.2	–	6.2
Transfers from equity to income or expense	**(55.8)**	**–**	**(55.8)**	4.8	–	4.8
Income tax	**14.8**	**–**	**14.8**	(1.3)	–	(1.3)
Revaluation of equity shares	**(1.5)**	**–**	**(1.5)**	–	–	–
Income tax	**0.4**	**–**	**0.4**	–	–	–
Defined benefit plan actuarial losses	**–**	**–**	**–**	(0.4)	–	(0.4)
Income tax	**(0.1)**	**–**	**(0.1)**	0.1	–	0.1
Other comprehensive income/(expense) for the financial year, net of income tax	**63.2**	**–**	**63.2**	(17.4)	(0.6)	(18.0)
Total comprehensive income for the financial year	**111.2**	**1.8**	**113.0**	19.0	(1.2)	17.8

The accounting policies and notes on pages 37 to 122 form part of these financial statements.

Consolidated balance sheet

At 31 December 2011

All amounts are stated in £m unless otherwise indicated

	Notes	2011	2010
Assets			
Cash and balances at central banks	13	**6,696.6**	1,735.6
Loans and advances to banks	14	**2,006.5**	2,394.1
Loans and advances to customers	15	**33,766.0**	34,977.3
Fair value adjustments for hedged risk	15	**366.3**	166.8
Investment securities – loans and receivables	16	**804.9**	1,917.3
Investment securities – available for sale	16	**3,423.0**	2,957.1
Investment securities – fair value through income or expense	16	**343.1**	28.7
Derivative financial instruments	17	**975.8**	975.6
Equity shares	18	**5.7**	7.2
Investments in joint ventures	36	**2.7**	2.5
Goodwill	19	**0.6**	0.6
Intangible fixed assets	20	**40.7**	45.1
Investment properties	21	**172.7**	162.3
Property, plant and equipment	22	**80.1**	98.5
Amounts owed by other Co-operative Group undertakings	37	**179.2**	0.6
Other assets	23	**46.6**	8.8
Prepayments and accrued income	24	**18.7**	16.2
Deferred tax assets	33	**26.4**	87.0
Total assets		**48,955.6**	45,581.3
Liabilities			
Deposits by banks	25	**3,302.7**	2,938.6
Customer accounts	26	**34,990.6**	32,320.0
Customer accounts – capital bonds	27	**1,429.8**	1,794.7
Debt securities in issue	28	**4,164.8**	4,212.2
Derivative financial instruments	17	**1,087.9**	702.4
Other borrowed funds	29	**1,258.8**	975.4
Amounts owed to other Co-operative Group undertakings	37	**132.3**	188.5
Other liabilities	30	**173.7**	146.8
Accruals and deferred income	31	**39.9**	131.3
Provisions for liabilities and charges	32	**102.0**	55.8
Current tax liabilities		**–**	42.5
Total liabilities		**46,682.5**	43,508.2
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	38	**410.0**	410.0
Share premium account	38	**8.8**	8.8
Retained earnings		**1,733.8**	1,598.9
Available for sale reserve		**19.5**	(13.1)
Cashflow hedging reserve		**67.6**	36.9
		2,239.7	2,041.5
Minority interests		**33.4**	31.6
Total equity		**2,273.1**	2,073.1
Total liabilities and equity		**48,955.6**	45,581.3

Approved by the Board on 28 March 2012 and signed on its behalf by:

Paul Flowers, Chair
Barry Tootell, Acting Chief Executive
Moira Lees, Secretary

The accounting policies and notes on pages 37 to 122 form part of these financial statements.

Bank balance sheet

At 31 December 2011

All amounts are stated in £m unless otherwise indicated

	Notes	2011	2010
Assets			
Cash and balances at central banks	13	**6,696.6**	1,735.6
Loans and advances to banks	14	**1,300.1**	1,728.6
Loans and advances to customers	15	**22,735.0**	23,844.9
Fair value adjustments for hedged risk	15	**365.8**	164.6
Investment securities – loans and receivables	16	**866.1**	1,986.8
Investment securities – available for sale	16	**3,107.4**	2,621.4
Investment securities – fair value through income or expense	16	**343.1**	28.7
Derivative financial instruments	17	**704.4**	704.7
Equity shares	18	**5.7**	7.2
Investments in Group undertakings	36	**1,573.4**	1,458.9
Goodwill	19	**0.6**	0.6
Intangible fixed assets	20	**39.3**	43.8
Property, plant and equipment	22	**61.5**	79.1
Amounts owed by other Co-operative Group undertakings		**12,961.2**	14,233.7
Other assets	23	**77.5**	7.8
Prepayments and accrued income	24	**17.7**	14.5
Deferred tax assets	33	**110.3**	154.0
Total assets		**50,965.7**	48,814.9
Liabilities			
Deposits by banks	25	**3,239.8**	2,870.8
Customer accounts	26	**32,670.1**	29,912.0
Customer accounts – capital bonds	27	**1,397.3**	1,744.0
Debt securities in issue	28	**1,431.0**	1,856.8
Derivative financial instruments	17	**1,051.5**	697.4
Other borrowed funds	29	**1,258.8**	975.4
Amounts owed to other Co-operative Group undertakings		**7,461.2**	8,340.9
Other liabilities	30	**169.1**	140.5
Accruals and deferred income	31	**33.1**	117.0
Provisions for liabilities and charges	32	**93.4**	39.3
Current tax liabilities		**–**	17.3
Total liabilities		**48,805.3**	46,711.4
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	38	**410.0**	410.0
Share premium account	38	**8.8**	8.8
Retained earnings		**1,655.0**	1,661.4
Available for sale reserve		**19.5**	(13.1)
Cashflow hedging reserve		**67.1**	36.4
Total equity		**2,160.4**	2,103.5
Total liabilities and equity		**50,965.7**	48,814.9

Approved by the Board on 28 March 2012 and signed on its behalf by:

Paul Flowers, Chair
Barry Tootell, Acting Chief Executive
Moira Lees, Secretary

The accounting policies and notes on pages 37 to 122 form part of these financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

	2011	2010
Cash flows from operating activities		
Profit before taxation	**54.2**	48.9
Adjustments for:		
(Increase)/decrease in prepayments and accrued income	**(38.3)**	16.0
Decrease in accruals and deferred income	**(90.6)**	(81.9)
Interest payable in respect of other borrowed funds	**86.7**	45.5
Effect of exchange rate movements	**16.0**	(2.8)
Impairment losses on loans and advances	**130.5**	97.3
Movements on investment impairments	**(39.9)**	(1.5)
Depreciation and amortisation	**21.4**	26.3
Interest amortisation	**(15.7)**	(6.3)
Amortisation of investments	**(340.8)**	(40.6)
Loss on disposal of fixed assets	**0.3**	0.8
Unwind of fair value adjustments arising on transfer of engagements	**(86.3)**	14.2
Preference dividend	**5.6**	5.6
	(296.9)	121.5
Increase/(decrease) in deposits by banks	**364.1**	(3,143.8)
Increase in customer accounts and capital bonds	**2,306.7**	1,639.1
(Decrease)/increase in debt securities in issue	**(141.0)**	471.6
(Increase)/decrease in loans and advances to banks	**(73.2)**	401.5
Decrease/(increase) in loans and advances to customers	**1,034.2**	(850.6)
(Increase)/decrease in amounts owed by other Co-operative Group undertakings	**(178.6)**	90.4
Decrease in amounts owed to other Co-operative Group undertakings	**(56.2)**	(140.7)
Net movement of other assets and other liabilities	**532.3**	112.4
Income tax paid	**(21.2)**	(34.9)
Net cash flows from operating activities	**3,470.2**	(1,333.5)
Cash flows from investing activities		
Purchase of tangible and intangible fixed assets	**(14.8)**	(30.9)
Proceeds from sale of investment properties	**0.8**	0.5
Purchase of investment securities	**(3,667.6)**	(1,506.2)
Proceeds from sale and maturity of investment securities	**4,513.5**	3,757.2
Net cash flows from investing activities	**831.9**	2,220.6
Cash flows from financing activities		
Interest paid on other borrowed funds	**(69.6)**	(44.8)
Proceeds of issued shares	**–**	180.0
Repayment of other borrowed funds	**(102.3)**	–
Issuance of other borrowed funds	**273.6**	–
Preference share dividends paid	**(5.6)**	(5.6)
Capital contribution from parent	**87.0**	–
Dividends paid to minority shareholders in subsidiary undertaking	**–**	(0.8)
Net cash flows from financing activities	**183.1**	128.8
Increase in cash and cash equivalents	**4,485.2**	1,015.9
Cash and cash equivalents at the beginning of the financial year	**3,403.2**	2,387.3
Cash and cash equivalents at the end of the financial year	**7,888.4**	3,403.2
Cash and balances with central banks (note 13)	**6,658.6**	1,699.5
Loans and advances to banks (note 14)	**1,019.8**	1,478.7
Short term investments (note 16)	**210.0**	225.0
	7,888.4	3,403.2

The cash flows cannot be directly reconciled to the Group balance sheet movements as these movements include the non-cash unwinds of the fair value adjustments arising on the transfer of engagements of Britannia Building Society.

The accounting policies and notes on pages 37 to 122 form part of these financial statements.

Bank statement of cash flows

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

	2011	2010
Cash flows from operating activities		
Profit before taxation	**(128.4)**	101.9
Adjustments for:		
(Increase)/decrease in prepayments and accrued income	**(39.0)**	14.1
Decrease in accruals and deferred income	**(82.9)**	(67.2)
Interest payable in respect of other borrowed funds	**86.7**	45.5
Effect of exchange rate movements	**16.0**	(2.8)
Impairment losses on loans and advances	**103.4**	94.5
Movements on investment impairments	**(39.9)**	(1.5)
Depreciation and amortisation	**23.9**	26.5
Interest amortisation	**(15.7)**	(6.3)
Amortisation of investments	**(296.7)**	(82.6)
Loss on disposal of fixed assets	**0.2**	0.8
Unwind of fair value adjustments arising on transfer of engagements	**(154.0)**	(234.3)
Preference dividends	**5.6**	5.6
	(520.8)	(105.8)
Increase/(decrease) in deposits by banks	**369.0**	(2,742.2)
Increase in customer accounts and capital bonds	**2,412.4**	1,398.6
(Decrease)/increase in debt securities in issue	**(433.3)**	98.4
(Increase)/decrease in loans and advances to banks	**(31.6)**	517.1
Decrease/(increase) in loans and advances to customers	**935.9**	(812.3)
Decrease/(increase) in amounts owed by other Co-operative Group undertakings	**1,272.5**	(2,372.1)
(Decrease)/increase in amounts owed to other Co-operative Group undertakings	**(879.7)**	2,575.9
Net movement of other assets and other liabilities	**359.6**	151.0
Income tax paid	**(8.2)**	(10.6)
Net cash flows from operating activities	**3,475.8**	(1,302.0)
Cash flows from investing activities		
Purchase of tangible and intangible fixed assets	**(2.4)**	(4.3)
Purchase of investment securities	**(3,237.6)**	(126.2)
Proceeds from sale and maturity of investment securities	**3,857.0**	2,330.3
Net cash flows from investing activities	**617.0**	2,199.8
Cash flows from financing activities		
Interest paid on other borrowed funds	**(69.6)**	(44.8)
Repayment of other borrowed funds	**(102.3)**	–
Issuance of other borrowed funds	**273.6**	–
Proceeds of issued shares	**–**	180.0
Preference share dividends paid	**(5.6)**	(5.6)
Capital contribution from parent	**87.0**	–
Net cash flows from financing activities	**183.1**	129.6
Increase in cash and cash equivalents	**4,275.9**	1,027.4
Cash and cash equivalents at the beginning of the financial year	**3,391.0**	2,363.6
Cash and cash equivalents at the end of the financial year	**7,666.9**	3,391.0
Cash and balances with central banks (note 13)	**6,658.6**	1,699.5
Loans and advances to banks (note 14)	**1,008.3**	1,466.5
Short term investments (note 16)	**–**	225.0
	7,666.9	3,391.0

The cash flows cannot be directly reconciled to the Bank balance sheet movements as these movements include the non-cash unwinds of the fair value adjustments arising on the transfer of engagements of Britannia Building Society.

The accounting policies and notes on pages 37 to 122 form part of these financial statements.

Consolidated and Bank statements of changes in equity

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Company							
	Share capital	Share premium	Available for sale reserve	Cashflow hedging reserve	Retained earnings	Total	Minority interest	Total equity
Group								
2011								
Balance at the beginning of the year	**410.0**	**8.8**	**(13.1)**	**36.9**	**1,598.9**	**2,041.5**	**31.6**	**2,073.1**
Total comprehensive income for the financial year	**–**	**–**	**32.6**	**30.7**	**47.9**	**111.2**	**1.8**	**113.0**
Transactions with owners recorded directly in equity:								
Capital contribution	**–**	**–**	**–**	**–**	**87.0**	**87.0**	**–**	**87.0**
Balance at the end of the year	**410.0**	**8.8**	**19.5**	**67.6**	**1,733.8**	**2,239.7**	**33.4**	**2,273.1**
Group								
2010								
Balance at the beginning of the year	230.0	8.8	2.5	38.4	1,562.8	1,842.5	33.6	1,876.1
Total comprehensive income for the financial year	–	–	(15.6)	(1.5)	36.1	19.0	(1.2)	17.8
Transactions with owners recorded directly in equity:								
Increase in share capital	180.0	–	–	–	–	180.0	–	180.0
Dividend	–	–	–	–	–	–	(0.8)	(0.8)
Balance at the end of the year	410.0	8.8	(13.1)	36.9	1,598.9	2,041.5	31.6	2,073.1

	Attributable to equity holders of the Company					
	Share capital	Share premium	Available for sale reserve	Cashflow hedging reserve	Retained earnings	Total equity
Bank						
2011						
Balance at the beginning of the year	**410.0**	**8.8**	**(13.1)**	**36.4**	**1,661.4**	**2,103.5**
Total comprehensive income for the financial year	**–**	**–**	**32.6**	**30.7**	**(93.4)**	**(30.1)**
Transactions with owners recorded directly in equity:						
Capital contribution	**–**	**–**	**–**	**–**	**87.0**	**87.0**
Balance at the end of the year	**410.0**	**8.8**	**19.5**	**67.1**	**1,655.0**	**2,160.4**
Bank						
2010						
Balance at the beginning of the year	230.0	8.8	2.5	37.7	1,588.5	1,867.5
Total comprehensive income for the financial year	–	–	(15.6)	(1.3)	72.9	56.0
Transactions with owners recorded directly in equity:						
Increase in share capital	180.0	–	–	–	–	180.0
Balance at the end of the year	410.0	8.8	(13.1)	36.4	1,661.4	2,103.5

Basis of preparation and significant accounting policies

For the year ended 31 December 2011

The Co-operative Bank plc is registered in England and Wales under the Companies Act 2006.

Basis of preparation

Both the parent company financial statements and the Group financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and IFRS Interpretations Committee (IFRIC) guidance as adopted by the European Union (EU). On including the parent company financial statements here together with the Group financial statements, the Company is taking advantage of the exemption in Section 408 of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these approved financial statements. Information in respect of the Company alone is labelled throughout as 'Bank'.

The financial information has been prepared under the historic cost convention as modified by the revaluation of available for sale financial assets, derivative contracts, investment properties and certain other financial assets and financial liabilities held at fair value. The Group applies the recognition, measurement and disclosure requirements of IFRS in issue that are endorsed by the EU and are effective for accounting periods beginning on or after 1 January 2011.

Standards and interpretations issued and effective

In preparing these consolidated financial statements, the Group has adopted the following pronouncements during the year that are new or revised but have no material impact on the financial statements:

- Revised IAS 24 (Related Party Disclosures (2009))
  IAS 24 requires entities to disclose in their financial statements information about transactions with related parties. In broad terms, two parties are related to each other if one party controls, or significantly influences, the other party.

  The standard simplifies the disclosure requirements for government related entities and clarifies the definition of a related party.

- IFRIC 19 (Extinguishing Financial Liabilities with Equity Instruments (2009))
  This interpretation addresses the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability. It does not address the accounting by the creditor.

Standards and interpretations issued but not yet effective

- Amended IFRS 7 (Disclosures: Transfers of Financial Assets (2010))
  This amendment's objective is to promote the transparency of off balance sheet activities, particularly in relation to the securitisation of financial assets. Specifically, the transference of these assets and their associated risks shall be reported in a way that ensures that the user of the accounts is able to understand the financial position of such risks being transferred.

  It becomes effective for the year beginning 1 January 2012 which is the first annual accounting period beginning on or after 1 July 2011. The impact of the amendment to IFRS 7 is unlikely to be material to the Group because all of the Group's existing securitisations are on balance sheet.

- IFRS 9 (Financial Instruments: Classification and Measurement (2010))
  This new standard's objective is to gradually phase out IAS 39 (Financial Instruments: Recognition and Measurement (2009)). Phase one of this process specifically requires financial assets to be classified as at amortised cost or at fair value. Consequently, the available for sale category currently used by the Group will become void. IFRS 9 incorporates IAS 39's authority on financial liabilities, recognising them at either amortised cost or fair value, but refines treatment of own credit risk fair value from being taken in the income statement to being taken through other comprehensive income. Further development phases for IFRS 9 are scheduled to cover key areas such as impairment, hedge accounting and the offsetting of assets and liabilities.

  It becomes effective as of 1 January 2015. Early adoption is permitted, once endorsed by the EU. The impact of IFRS 9 is likely to be material to the Group, due to the magnitude of financial instruments held on the Group's balance sheet. Given the standard's changing scope, a detailed materiality assessment of its impact is not currently possible.

- IFRS 10 (Consolidated Financial Statements (2011))
  This new standard establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. It supersedes both IAS 27 (Consolidated and Separate Financial Statements (2008)) except where IAS 27 still applies as noted below and Amended SIC 12 (Consolidation: Special Purpose Entities (2004)). It aims to provide transparency in identifying off balance sheet, parent subsidiary relationships, using a consistent basis for determining the existence and thus consolidation of those underlying entities being controlled by the reporting entity.

  It becomes effective as of 1 January 2013. Early adoption is permitted, once endorsed by the EU. The impact to the Group of IFRS 10 is currently being considered in accordance with its effective date.

- IFRS 11 (Joint Arrangements (2011))
  This new standard establishes principles for financial reporting by parties to a joint arrangement. It supersedes both IAS 31 (Interests in Joint Ventures (2010)) and Amended SIC 13 (Jointly Controlled Entities: Non-Monetary Contributions by Venturers (2007)). Recognition criteria now distinguish between joint operations and joint ventures on their relative 'rights and obligations' scope. A joint operation interest is accounted for between assets, liabilities, revenue and expense, whilst a joint venture is restricted to equity accounting.

  It becomes effective as of 1 January 2013. Early adoption is permitted, once endorsed by the EU. The impact to the Group of IFRS 11 is currently being considered in accordance with its effective date.

- IFRS 12 (Disclosure of Interests in Other Entities (2011))
  This new standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It aims to provide disclosure transparency on the reporting entity's risks associated with its interests in other entities, in conjunction with IFRS 10's application which determines the existence of such entities.

  It becomes effective as of 1 January 2013. Early adoption is permitted, once endorsed by the EU. The impact to the Group of IFRS 12 is currently being considered in accordance with its effective date.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2011

Basis of preparation continued

- IFRS 13 (Fair Value Measurement (2011))
  This new standard defines fair value and also acts as its single authority, dealing primarily with both its measurement and disclosure. It does not require fair value measurements in addition to those already required, or permitted by other IFRSs, and is not intended to establish valuation standards or affect valuation practices outside of financial reporting.

  It becomes effective as of 1 January 2013. Early adoption is permitted, once endorsed by the EU. The impact to the Group of IFRS 13 is currently being considered in accordance with its effective date.

- Amended IAS 1 (Presentation of Financial Statements on the Statement of Comprehensive Income (2010))
  This amendment proposes to split the presentation of other comprehensive income into two sections. The different sections will distinguish between items which may or may not be recycled into any future income or expense.

  It becomes effective as of 1 July 2012. Early adoption is permitted, once endorsed by the EU. The impact of the amendment to IAS 1 is likely to be immaterial to the Group.

- Amended IAS 12 (Income Taxes: Deferred Tax – Recovery of Underlying Assets (2010))
  This amendment's objective is to refine IAS 12's measurement of deferred tax which relates to the recovery of an entity's assets. Previously, the standard stated that an asset's recovery would occur only when it was either used or sold. However, and as a consequence of this amendment, investment properties measured at fair value are excluded from the standard's scope on recovery.

  It becomes effective as of 1 January 2012. Early adoption is permitted, once endorsed by the EU. The impact of the amendment to IAS 12 is likely to be immaterial to the Group.

- Revised IAS 19 (Employee Benefits (2011))
  This revision covers the standard's recognition, measurement and presentation criteria with regard to a pension scheme's expense contained within IAS 19's 'defined benefit' scope. Actuarial gains or losses will now be fully recognised within income or expense, thus removing the previous partial recognition of 'corridor and spreading'.

  Furthermore, the revision eliminates the 'expected return on assets' from the measurement of a pension's expense and directs entities to instead charge a cost of finance against its net unfunded liability position.

  When determining a discount rate, that calculates a pension obligation's present value, reference should be made to market yields. These yields should be matched to high quality corporate bonds, in terms of both the obligation's currency and maturity, ahead of any previously assumed government bond yield reference point.

  It becomes effective as of 1 January 2013. Early adoption is permitted, once endorsed by the EU. The impact of the revision to IAS 19 is likely to be material to the Group, due to the likely impact on the pension costs recharged to the Group.

- Amended IAS 27 (Consolidated and Separate Financial Statements (2011))
  This amendment occurs as a direct consequence of IFRS 10's issuance, which now acts as the new single authority on consolidation requirements. IAS 27's scope has therefore reduced and focuses more specifically on separate financial statements' accounting bases. An entity shall therefore prepare its separate financial statements using one of two bases; either at cost or in accordance with IFRS 9.

  It becomes effective as of 1 January 2013. Early adoption is permitted, once endorsed by the EU. The impact of the amendment to IAS 27 is likely to be immaterial to the Group.

- Amended IAS 28 (Investments in Associates and Joint Ventures (2011))
  This amendment occurs as a direct consequence of IFRS 11's issuance, which now acts as the new single authority on joint arrangements. IAS 28 changes in order to consistently apply equity accounting methods for both joint ventures and associates. An entity shall therefore use IAS 28's equity accounting method, when accounting for any of IFRS 11's joint arrangements.

  It becomes effective as of 1 January 2013. Early adoption is permitted, once endorsed by the EU. The impact of the amendment to IAS 28 is likely to be immaterial to the Group.

  Other standards and interpretations have been issued but these are not considered to be relevant to the Group's operations.

Going concern

The Group's business activities, together with its financial position, and the factors likely to affect its future development and performance, are set out in the business and financial review on pages 5 to 7. In addition, the risk management section on pages 46 to 70 includes the Group's objectives, policies and processes for managing its risk and details of its exposure to risk. The capital management section on page 71 provides information on the Group's capital policies and capital resources.

In common with many financial institutions, the Group meets its day to day liquidity requirements through managing both its retail and wholesale funding sources, and is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business. The Group's forecasts and objectives, taking into account a number of potential changes in trading performance and funding retention, show that the Group should be able to operate at adequate levels of both liquidity and capital, for the foreseeable future. The Group has also considered a number of stress tests on capital and liquidity and these provide assurance that the Group is sufficiently capitalised and adequately positioned in excess of liquidity stress tests.

Consequently, after making enquiries, the directors are satisfied that the Group has sufficient resources to continue in business for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements. When making this assessment, the directors act within the principles of the Financial Reporting Council's 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009' report.

Basis of preparation continued

Use of estimates and judgments

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

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of estimation, uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements are described within the risk management section on pages 46 to 70 and the critical judgments section on pages 73 to 74.

Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

(1) Business combinations

On 1 August 2009 The Co-operative Bank plc merged with Britannia Building Society, with Britannia transferring their engagements to the Group.

This business combination has been accounted for applying the requirements of IFRS 3 (Business Combinations (2004)).

The consideration transferred was valued by reference to the members' interests acquired. Financial assets and liabilities which, following the Group's accounting policies, would be carried at amortised cost, were brought onto the balance sheet at their fair value at acquisition and were subsequently carried at amortised cost using the effective interest rate method. The income statement includes the results of the engagements transferred from Britannia since the date of acquisition.

(2) Basis of consolidation

(a) Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists whenever the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The financial statements have been prepared using uniform accounting policies and are based on the same accounting period as the Group.

Intra-group balances and transactions, and any unrealised gains and losses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

(b) Special purpose entities

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well defined objective; for the Group this includes:

- various securitisation transactions in which mortgages were sold to SPEs. The equity of these SPEs is not owned by the Group; and
- Covered Bond Limited Liability Partnerships created in order to act as a guarantor for the issue of covered bonds (refer to note 36 for further information).

An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Group and the SPE's risks and rewards, the Group concludes that it controls the SPE.

The following circumstances may indicate a relationship in which, in substance, the Group controls and consequently consolidates an SPE:

- the activities of the SPE are being conducted on behalf of the Group according to its specific business needs so that the Group obtains benefits from the SPE's operation;
- the Group has the decision making powers to obtain the majority of the benefits of the activities of the SPE;
- the Group has the rights to obtain the majority of the benefits of the SPE and therefore may be exposed to the risks incidental to the activities of the SPE; or
- the Group retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The assessment of whether the Group has control over an SPE is carried out at inception. No further assessment of control is carried out unless changes in the structure or terms of the SPE or additional transactions between the Group and the SPE occur.

(c) Interests in joint ventures

The Group's interests in joint ventures are accounted for using the equity method. The consolidated financial statements include the Group's share of the income and expenses and equity movements of equity accounted investees, after adjustments to align the accounting policies with those of the Group.

(3) Revenue recognition

(a) Interest income and expense

Interest income and expense is recognised on an effective interest rate (EIR) basis, inclusive of directly attributable incremental transaction costs and fees including arrangement and broker fees, valuation and solicitor costs, discounts and premiums where appropriate and early redemption fees.

The EIR basis spreads the interest income and expense over the expected life of each instrument. The EIR is the rate that, at the inception of the instrument, exactly discounts expected future cash payments and receipts through the expected life of the instrument back to the initial carrying amount. When calculating the EIR, the Group estimates cash flows considering all contractual terms of the instrument (for example, prepayment options) but does not consider assets' future credit losses except for assets acquired at a deep discount.

For assets acquired at a value significantly below the carrying value in the acquiree's financial statements because they have incurred loss, expectations of future loss are higher than at origination, and interest spreads have widened because of deteriorating market conditions, the calculation of EIR is the same as shown above with the exception that the estimates of future cash flows include credit losses.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2011

Significant accounting policies continued

(b) Fees and commissions
Fee and commission income is predominantly made up of arrangement and other fees relating to loans and advances to customers that are included in the effective interest calculation. Commitment fees received are deferred and included in the EIR calculation upon completion or taken in full at the date the commitment period expires and completion does not occur.

Fees and commissions payable to introducers in respect of obtaining lending business, where these are direct and incremental costs related to the issue of a financial instrument, are included in interest income as part of the effective interest rate.

All other fee and commission income, such as loan closure fees or arrears fees, not included in the effective interest calculation, is recognised on an accruals basis as the service is provided.

(4) Significant items
Items which are material by both size and nature (ie outside of the normal operating activities of the Group) are treated as significant items and disclosed separately on the face of the income statement.

The separate reporting of significant items helps to provide an indication of the Group's underlying business performance. Events which may give rise to the classification of items as significant include individually significant programmes of restructuring, investment, integration and provisions for material non-recurring items.

(5) Financial instruments (excluding derivatives)
(a) Recognition
The Group initially recognises loans and advances, deposits, debt securities issued and other borrowed funds on the date at which they are originated.

Regular way purchases and sales of financial assets are recognised on the trade date at which the Group commits to purchase or sell the asset. All other financial assets and liabilities are initially recognised on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

(b) Derecognition
Financial assets are derecognised when they are qualifying transfers and:

- the rights to receive cash flows from the assets have ceased; or
- the Group has transferred substantially all the risks and rewards of ownership of the assets.

When available for sale financial assets are derecognised the cumulative gain or loss, including that previously recognised in reserves, is recognised in the income statement.

A financial liability is derecognised when the obligation is discharged, cancelled or expires. Any difference between the carrying amount of a financial liability derecognised and the consideration paid is recognised through the income statement.

(c) Financial assets
i) Overview
The Group classifies its financial assets (excluding derivatives) as either:

- loans and receivables;
- available for sale; or
- financial assets at fair value through income statement.

ii) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and the Group does not intend to sell immediately or in the near term. These are initially measured at fair value plus transaction costs that are directly attributable to the financial asset. Subsequently, these are measured at amortised cost using the effective interest method. The amortised cost is the amount advanced less principal repayments, plus or minus the cumulative amortisation using the EIR method of any difference between the amount advanced and the maturity amount less impairment provisions for incurred losses.

Loans and receivables mainly comprise loans and advances to banks and customers (except where the Group has elected to carry the loans and advances to customers at fair value through income or expense as described in accounting policy (5c. iv. below)) and assets reclassified from available for sale (see below).

iii) Available for sale
Available for sale financial assets are debt securities that are not held for trading and are intended to be held for an indefinite period of time. These are measured at fair value based on current bid prices where quoted in an active market. Where the securities are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Movements in fair value are recorded in equity as they occur. On disposal, gains and losses recognised previously in equity are transferred to the income statement. In exceptional circumstances, for instance where the market in the securities has become inactive, the Group has reclassified such assets as loans and receivables.

Any transfer back from loans and receivables, upon reclassification, would be measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the securities are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques.

Significant accounting policies continued

iv) Financial assets at fair value through income or expense

These are either:

- acquired or incurred principally for the purpose of selling or repurchasing in the near term;
- part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short term profit taking; or
- upon initial recognition designated at fair value through income or expense to eliminate or significantly reduce a measurement and recognition inconsistency or where management specifically manages an asset or liability on that basis ie capital bonds.

These are measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the securities are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Gains and losses arising from changes in the fair value are brought into the income statement within trading income as they arise.

(d) Financial liabilities

i) Overview

Financial liabilities are contractual obligations to deliver cash or another financial asset. Financial liabilities are recognised initially at fair value, net of directly attributable transaction costs.

Financial liabilities, other than derivatives and capital bonds, are subsequently measured at amortised cost.

Certain non-derivative financial liabilities included within customer accounts (capital bonds) have been designated at fair value upon initial recognition in the balance sheet. Changes in fair value are recognised through the income statement. The capital bonds are economically matched using equity linked derivatives, which do not meet the requirements for hedge accounting. Recording changes in fair value of both the derivatives and the related liabilities through the income statement most closely reflects the economic reality of the transactions. In doing so this accounting treatment eliminates a measurement inconsistency that would otherwise arise from valuing the capital bonds at amortised cost and the derivatives at fair value.

ii) Borrowed funds

Borrowings are recognised initially at fair value, which equates to issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

The Group classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. The Group's preference shares are classified as financial liabilities as they carry the right to a fixed non-cumulative preferential dividend (further information is provided in note 29) and are subsequently presented in other borrowed funds. The dividends on these preference shares are recognised in the income statement as interest expense on an amortised cost basis using the EIR method.

iii) Perpetual subordinated bonds

Perpetual subordinated bonds are carried at their nominal value plus any premium and a fair value adjustment for hedged risk where items are designated as part of a fair value hedge relationship.

Interest payable on perpetual subordinated bonds is recognised in the income statement using the EIR method.

(6) Impairment provisions

(a) Assessment

i) Objective evidence

At the balance sheet date, the Group assesses its financial assets not at fair value through income or expense for objective evidence that an impairment loss has been incurred.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a loan or advance on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, or the disappearance of an active market for a security.

The Group considers evidence for impairment for loans and advances at both a specific asset and collective level.

ii) Forbearance

The Group operates a policy of forbearance which mitigates against borrower default. All such cases are included within its provisioning methodology. For further information on the Group's approach to forbearance, its management and execution, see the risk management section on pages 46 to 70.

(b) Scope

i) Individual accounts

All individually significant loans and advances are assessed specifically for impairment using a range of watchlists progressively graded for higher levels of risk. Accounts at risk of impairment are monitored and impaired from the point at which they display clear indication of underperformance. Loans and advances not individually significant are collectively assessed for impairment by grouping together loans and advances of similar risk characteristics.

ii) Collective accounts

a) Retail

In assessing collective impairment, the Group uses statistical modelling of historical trends of probability of default, timing of recoveries and the amount of loss incurred. The model's results are adjusted for management's judgment as to whether current economic and credit conditions are such that actual losses are likely to differ from those suggested by historical modelling. Once impaired, accounts are subjected to higher levels of impairment according to both their relevant stage of delinquency, ie the number of days in arrears, and their consequent likelihood of ultimately being charged off. Default rates, loss rates and future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2011

Significant accounting policies continued

(6) Impairment provisions continued

b) Corporate

Collective risk cover provides further balance sheet protection for total impairment losses. The amount of collective risk cover is adjusted monthly by the Group. The Group reviews all higher risk loans and considers the potential loss which might arise were the borrowers to fail (notwithstanding that continued trading remains the expectation). Events which may trigger higher risk status include a deteriorating balance sheet, material losses, trading difficulties (eg loss of material contracts or suppliers), breach of financial covenants, poor account conduct, arrears and material reduction in value of security. A collective impairment provision is raised against these loans based on the total estimated loss that may arise and the propensity for the borrower to fail.

(c) Measurement

The amount of the loss is the difference between:

- the asset's carrying amount; and
- the present value of estimated future cash flows (discounted at the asset's original or variable EIR for amortised cost assets and at the current market rate for available for sale assets).

Where the debt is secured, the assessment reflects the expected cash flows from the realisation of the security, net of cost to realise, whether or not foreclosure or realisation of the collateral is probable.

(d) Impairment of financial assets carried at amortised cost

The amount of the impairment loss on assets carried at amortised cost is recognised immediately through the income statement and a corresponding reduction in the value of the financial asset is recognised through the use of an allowance account.

A write off is made when all or part of a claim is deemed uncollectable or forgiven after all the possible collection procedures have been completed and the amount of loss has been determined. Write offs are charged against previously established provisions for impairment or directly to the income statement. Any additional recoveries from borrowers, counterparties or other third parties made in future periods are offset against the write off charge in the income statement once they are received.

Provisions are released at the point when it is deemed that following a subsequent event the risk of loss has reduced to the extent that a provision is no longer required.

(e) Impairment of financial assets classified as available for sale

Available for sale assets are assessed at each balance sheet date to see whether there is objective evidence of impairment. In such cases, any impairment losses are recognised by transferring the cumulative loss that has been recognised directly in equity to income or expense.

When a subsequent event causes the amount of impaired loss on available for sale investment securities to decrease, and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income statement. However any further recovery in fair value of an impaired available for sale equity security is recognised directly in equity.

(7) Offsetting

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to do so and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(8) Sale and repurchase agreements

Securities sold subject to repurchase agreements (repos) are reclassified on the balance sheet as pledged assets when the transferee has the right by contract or custom to sell or repledge the assets. The liability to the transferee is also included on the balance sheet, in deposits by banks. The difference between sale and repurchase price is accrued over the life of the agreements using the EIR method.

Securities purchased under agreements to re-sell (reverse repos) are classified as loans and advances to banks on the balance sheet, as appropriate.

Securities lent to counterparties are retained on the balance sheet.

Securities borrowed are not recognised on the balance sheet, unless they are sold to third parties, in which case the purchase and sale are recorded. The obligation to return them is recorded at fair value as a trading liability.

(9) Derivative financial instruments and hedge accounting

(a) Derivatives used for asset and liability management purposes

Derivatives are used to hedge interest and exchange rate exposures related to non-trading positions. Instruments used for hedging purposes include swaps, forward rate agreements, futures, options and combinations of these instruments. The Group also uses equity derivatives to hedge the equity risks within its capital bonds.

Derivative financial instruments are stated at fair value based on quoted market prices in active markets, and where these are not available, using valuation techniques such as discounted cashflow models. Further information is provided on page 116. All derivatives are carried as assets when the fair value is positive and liabilities when the fair value is negative. The gain or loss on re-measurement to fair value is recognised immediately in the income statement except where derivatives qualify for cashflow hedge accounting.

On initial designation of derivatives and qualifying hedged items as a hedge, the Group formally documents the relationship between the hedging instrument(s) and hedged item(s) including the risk management objective and strategy in undertaking the hedge transaction together with the method used to assess effectiveness of the hedging relationship.

The Group makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, as to whether the hedging instruments are expected to be 'highly effective' on offsetting the changes in fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80%–125%.

Significant accounting policies continued

i) Cashflow hedges

Where derivatives are designated as hedges of the exposure to variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the portion of the fair value gain or loss on the derivative that is determined to be an effective hedge is recognised directly in equity. The ineffective part of any gain or loss is recognised in the income statement immediately.

The accumulated gains and losses recognised in equity are reclassified to the income statement in the periods in which the hedged item will affect income or expense. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss recognised at that time remains in equity until the forecast transaction is eventually recognised in the income statement.

When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in equity is immediately reclassified to the income statement.

ii) Fair value hedges

Where a derivative is designated as the hedging instrument to hedge the change in fair value of a recognised asset or liability or a firm commitment that could affect income or expense, changes in the value of the derivative are recognised immediately in the income statement together with changes in the fair value of the hedged item that are attributable to the hedged risk.

Fair values are based on quoted market prices in active markets, or where these are not available, using valuation techniques such as discounted cashflow models.

If the derivative expires or is sold, terminated, or exercised, or no longer meets the criteria for fair value hedge accounting, or the designation is revoked, then hedge accounting is prospectively discontinued. Any adjustment up to that point, to a hedged item for which the EIR method is used, is amortised to income or expense as part of the recalculated EIR of the item over its remaining life.

iii) Fair value hedge accounting for a portfolio hedge of interest rate risk

As part of its risk management process the Group identifies portfolios whose interest rate risk it wishes to hedge. The portfolios may comprise only assets, only liabilities or both assets and liabilities. The Group analyses each portfolio into repricing time periods based on expected repricing dates, by scheduling cash flows into the periods in which they are expected to occur. Using this analysis, the Group decides the amount it wishes to hedge and designates as the hedged item an amount of assets or liabilities from each portfolio equal to this.

The Group measures monthly the change in fair value of the portfolio relating to the risk that is being hedged. Provided that the hedge has been highly effective the Group recognises the change in fair value of each hedged item in the income statement with the cumulative movement in its value being shown on the balance sheet as a separate item, fair value adjustment for hedged risk, either within assets or liabilities as appropriate. If the hedge no longer meets the criteria for hedge accounting, this amount is amortised to the income statement over the remaining average useful life of the hedge relationship.

The Group measures the fair value of each hedging instrument monthly. The value is included in derivative financial instruments in either assets or liabilities as appropriate, with the change in value recorded in the income statement.

Any hedge ineffectiveness is recognised in the income statement as the difference between the change in fair value of the hedged item and the change in fair value of the hedging instrument.

(b) Embedded derivatives

A derivative may be embedded in another instrument, known as the host contract. Where the economic characteristics and risks of an embedded derivative are not closely related to those of the host contract (and the host contract is not carried at fair value through income or expense), the embedded derivative is separated from the host and held on balance sheet at fair value.

Movements in fair value are posted to the income statement, whilst the host contract is accounted for according to the relevant accounting policy for that particular asset or liability.

(c) Derivatives used for trading purposes

Derivatives entered into for trading purposes include swaps, forward rate agreements, futures, options and combinations of these instruments. Derivatives used for trading purposes are measured at fair value and any gains or losses are included in the income statement. The use of derivatives and their sale to customers as risk management products is an integral part of the Group's trading activities.

(10) Financial guarantee contracts

Other financial guarantees, in respect of intra-group funding and the pension deficit in respect of the former Britannia Pension Scheme, between the Group and its subsidiaries are treated as insurance contracts in accordance with IFRS 4 (Insurance Contracts (2004)). In accordance with the standard, the recognised insurance liability is assessed based on the current estimate of forecast future cash flows. If this highlights that the liability is inadequate, the liability is increased and the corresponding charge taken through the income statement.

(11) Property, plant and equipment

Items of property, plant and equipment are stated at cost less any accumulated depreciation and impairment losses. Depreciation is provided on a straight line basis at the following rates, which are estimated to write down the assets to realisable values at the end of their useful lives.

Freehold and long leasehold buildings	2% to 2.5% per annum
Short leasehold buildings	life of lease
Equipment	10% to 33.3% per annum
Vehicles	25% per annum

All items of property, plant and equipment are reviewed for indications of impairment on a regular basis and at each balance sheet date. Any impairment identified would be charged to the income statement.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2011

Significant accounting policies continued

(12) Intangible assets

(a) Computer software

Computer software is stated at cost less cumulative amortisation and impairment. All costs directly attributable in the development of computer software for internal use are capitalised and classified as intangible assets where they are not an integral part of the related hardware and amortised over their useful life up to a maximum of seven years.

(b) Other intangible assets

Other intangible assets are stated at cost less cumulative amortisation and impairment. Amortisation is charged over the useful life of the asset. For core systems, such as core deposit intangibles, a review of the asset's useful life is carried out and a maximum useful life of up to ten years is applied.

(13) Goodwill

All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries, associates and joint ventures and represents the difference between the cost of the acquisition and the fair value of the identifiable assets, liabilities and contingent liabilities acquired.

If a business combination is achieved without transfer of consideration, the amount of goodwill is calculated by reference to the fair value of the Group's interest in the acquiree using a valuation technique. The technique involves assessing the future net profit of the acquiree and then discounting using a rate that reflects current market assessment of the time value of money and risks specific to the acquiree.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is not amortised but is tested for impairment on an annual basis. Where impairment is required, the amount is recognised in the income statement and cannot be subsequently reversed.

(14) Leases

(a) Overview

The Group enters into leases for land and buildings and operating leases for vehicles.

Leases for land and buildings are split between leases for the land and leases for the buildings for accounting purposes only. The leases are separately assessed as to whether they are finance or operating leases.

The Group policy is to provide for the minimum future lease payments on buildings that it does not currently use, net of expected rental income from sub-leases.

(b) Assets leased to customers

All leases of assets to customers are finance leases. Income from assets leased to customers is credited to the income statement based on a pattern reflecting a constant periodic rate of return on the net investment in the lease.

(c) Assets leased from third parties

i) Finance leases

Finance lease assets are initially recorded at the lower of fair value and the present value of the minimum lease payments, and subsequently in accordance with the relevant policy for the underlying asset. An equal liability is recorded in other liabilities. Interest is allocated to the lease payments so as to record a constant periodic rate of charge on the outstanding liability.

ii) Operating leases

Operating lease payments are charged to the income statement on a straight line basis over the term of the lease and the asset is not recognised on the balance sheet.

(15) Cash and cash equivalents

Cash and cash equivalents comprises cash balances and balances with a maturity of three months or less from the acquisition date, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

(16) Income tax

(a) Overview

Tax on the income statement for the year comprises current and deferred tax, which is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in the statement of comprehensive income.

(b) Current tax

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

(c) Deferred tax

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided for is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Significant accounting policies continued

(17) Pension costs

(a) Defined contribution basis

With effect from 6 April 2006, the Group, along with other businesses within The Co-operative Group, has participated in the Co-operative Group Pension (Average Career Earnings) Scheme (the PACE scheme) the assets of which are held in a separate fund administered by trustees. The Group's de facto participation level is on a defined contribution basis, as it pays fixed sums into the fund on a regular basis. This level of participation is required because the PACE defined benefit scheme exposes the participating businesses to actuarial risks associated with the current and former employees of other group companies, with the result that there is no consistent and reliable basis for allocating PACE's liabilities, assets and costs to individual companies participating in the scheme. Therefore pension costs in respect of the scheme are accounted for on a defined contribution basis and recognised as an expense in the income statement as incurred.

(b) Former Britannia Building Society pension scheme

Following the transfer of engagements of Britannia Building Society, the Britannia defined benefit pension scheme transferred to the Co-operative Financial Services Management Services Limited (CFSMS), a fellow subsidiary undertaking of The Co-operative Banking Group. In accordance with policy 17.a, the pension costs in respect of this scheme are accounted for on a defined contribution basis and recognised as an expense in the income statement as incurred.

(18) Foreign currency

The functional and presentational currency for the Group is sterling. Transactions in foreign currencies are translated at the foreign exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to sterling at the foreign exchange rate ruling at that date. Foreign currency differences arising on retranslation are recognised in the income statement, except for foreign currency differences arising on retranslation of available for sale equity instruments or a qualifying cashflow hedge, which are recognised directly in the statement of comprehensive income. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair values are translated to sterling at the exchange rates prevailing at the dates the values were determined.

(19) Investments in Group undertakings

Investments in subsidiaries are initially measured at fair value which equates to cost and subsequently valued at cost less impairment.

(20) Provisions for liabilities and charges

A provision is recognised in the balance sheet if the Group has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(21) Profit based payments to members of The Co-operative Group

Members of The Co-operative Group receive a dividend based on their transactions with The Co-operative Group and its subsidiaries including the Bank. Once these profit based payments are approved by the Co-operative Group Limited, the Bank is recharged an amount which reflects its eligible products' contribution to the overall Co-operative Group member dividend.

Risk management

For the year ended 31 December 2011

All the amounts are stated in £m unless otherwise indicated

The Co-operative Banking Group (the Banking Group) companies, including Co-operative Insurance Society Limited, CIS General Insurance Limited and The Co-operative Bank plc, have a common Board composition.

The Banking Group has developed and implemented a common governance and organisation structure, which supports all the Boards within the Banking Group.

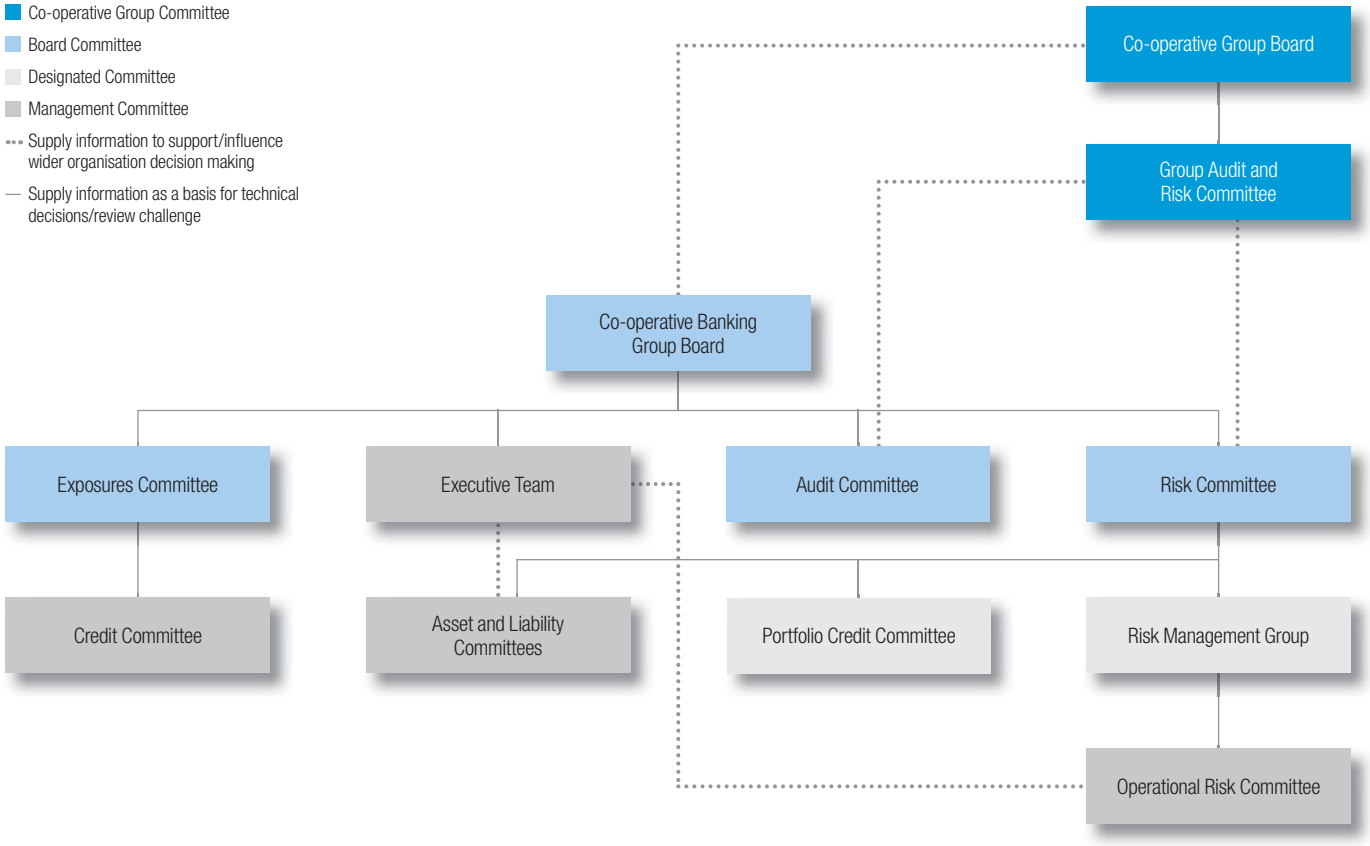
The Banking Group Board is responsible for approving the Banking Group strategy, its principal markets and the level of acceptable risks articulated through its statement of risk appetite. It is also responsible for overall corporate governance which includes ensuring that there is an adequate system of risk management and that the level of capital and liquidity held is consistent with the risk profile of the business.

The Board has established Board committees and senior management committees to:

- oversee the risk management process;
- identify the key risks facing the business; and
- assess the effectiveness of planned management actions.

Specific Board authority has been delegated to Board committees and the Chief Executive who may, in turn, delegate elements of his discretions to appropriate executive directors and their senior line managers.

Risk management structure



Risk management structure continued

Risk management committees

The Banking Group's Board delegates authority to the Banking Group's Risk Committee for monitoring compliance with the Board approved risk appetite statements. This includes:

- setting limits for individual types of risk; and
- approving (at least annually) and monitoring compliance with risk policies and delegated levels of authority.

Risk Committee (RC): this committee is responsible for the oversight of the adequacy of capital for all risks (technical, operational and business model and external) across the Banking Group. This includes:

- operation of mandates and limits and any breaches thereof;
- risk management policy approval;
- risk management information reporting and integrity of relevant data;
- identification and measurement of risk;
- risk and portfolio exposure management strategy;
- adequacy of the risk mitigation process;
- review and discussion of risk issues identified as a result of internal audit work; and
- review and challenge of the impact assessment of the strategic plan on the risk and capital profile.

Audit Committee (AC): this committee provides oversight on financial reporting, internal control, regulatory compliance, external and internal audit.

Exposures Committee: this committee ensures that non-executive directors are actively involved in major credit decisions (including sanctioning large counterparty transactions), monitors large exposures and problem loans as well as reviewing the adequacy of individual credit provisions.

Executive Team: the Executive Team manages the business in line with the Board risk appetite statement. It also maintains oversight of risk management processes and management information.

Risk and capital management sub-committees

Portfolio Credit Committee (PCC): this committee reports to RC and is chaired by the Banking Risk Officer. It is responsible for defining the Banking Group's credit risk appetite; providing oversight and timely action in relation to credit risk management; monitoring, challenging and approving changes to Basel rating systems; and reviewing lending and arrears policies.

Asset and Liability Committees (ALCO): these committees are management committees of the Board which are chaired by the Chief Financial Officer. They are primarily responsible for overseeing the management of market, liquidity and funding risks. They also advise on capital utilisation and the composition and sourcing of adequate capital.

Risk Management Group (RMG): this committee reports to RC and is chaired by the Chief Risk Officer. Its purpose is to provide a mechanism to ensure that the Banking Group's risk management is reviewed, challenged, approved (with escalation to RC where required) and embedded within the Banking Group. The committee also monitors all significant and emerging risks, and oversees the development and implementation of stress testing and risk appetite across the Banking Group.

Credit Committee: this committee is chaired by the Banking Risk Officer. The chair has delegated authority for approving credit facilities within approved strategies and delegated authorities.

Operational Risk Committee (ORC): this committee reports into RMG and is chaired by the Director of Specialist Risk Services. It monitors significant operational risks and controls as well as the management actions taken to mitigate them to an acceptable level or transfer them. This includes business continuity arrangements and insurance cover to protect the Banking Group's business. Capital requirements in relation to operational risk are monitored by the RC.

There is also a framework of sector specific management committees carrying out the following roles:

- supporting risk and capital management;
- implementing changes in business strategy;
- optimising performance;
- monitoring adherence to and setting of policy; and
- developing management information and training.

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

Group significant risks
The Group's significant risks arise in five broad categories:

Risk type	Definition	Page
1. Credit risk	Credit risk is the current or prospective risk to earnings and capital arising from a borrower's failure to meet the terms of any contract with the Group or their failure to perform as agreed.	48
2. Liquidity risk	Liquidity risk is the risk that the Group's resources will prove inadequate to meet its commitments. It arises from the mismatch of timings of cash flows generated from the Banking Group's assets and liabilities (including derivatives).	64
3. Market risk	Market risk is the risk relating to changes in market prices of financial instruments, execution of customer and interbank business and proprietary trading. The majority of the Group's market risk arises from changes in interest rates.	67
4. Operational risk	Operational risk is 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.	69
5. Additional risks	Additional risks cover any non-operational risks as well as exposure to material loss due to the Banking Group being unable to meet its capital/liquidity/profit targets in line with approved risk appetite.	69

1. Credit risk
1.1 Overview
Credit risk is an integral part of our business activities and is inherent in both traditional banking products (loans, commitments to lend, and contingent liabilities such as letters of credit) and in 'traded products' (derivative contracts (such as forwards, swaps and options), repurchase agreements, securities borrowing and lending transactions).

All authority to take credit risk derives from the Banking Group's Board. This authority is delegated to the Chief Executive and then on to other 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.

1.2 Credit risk policies
The credit risk policies are approved annually by the RC. The policies determine the criteria for the management of:

- credit risk associated with retail, corporate and wholesale segments (including securitisation, market exposures and credit management standards);
- country, sector and counterparty limits;
- risk appetites; and
- delegated authorities.

1.2.1 Retail credit risk
The Group'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 Group'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 historic data. Regular updates are provided to the PCC and RC on the performance of the portfolios.

1.2.2 Corporate credit risk
The Group's corporate sector policy is to maintain a broad spread of exposures across sectors which reflect the Group's areas of expertise. Credit exposures to corporate and business banking customers are assessed individually. The quality of the overall portfolio is monitored using a credit grading system calibrated to expected loss. The PCC and RC receive regular reports on the performance of the portfolio. The Exposures Committee receives regular reports on lending facilities, bad debt provisions and the management of problem loans.

1.2.3 Wholesale credit risk
The Group's credit risk framework for wholesale markets has, at its centre, a credit risk policy which governs the types of exposure the business can take and sets concentration parameters. To complement this, individual authority is delegated, dependent on Internal Rating Grade and associated Probability of Default (PD), to approve limits to individual counterparties within the parameters established by the credit risk policy. The RC receives regular reports on the performance of the portfolio. The Exposures Committee receives regular reports on changes in exposure limits, watchlist and problem counterparty information.

1.3 Credit exposure
1.3.1 Definitions
Impaired and past due but not impaired in the tables below are further defined in the following sections on retail and corporate credit risk and investment securities.

Within neither past due nor impaired, low risk has been defined as exposures where the PD is 1% or below over a one year time horizon for exposures on an internal ratings based (IRB) approach under Basel II, and strong/good/satisfactory categories for corporate exposures under the slotting approach. Medium to high risk has been defined as a PD of greater than 1% over a one year time horizon for exposure on IRB approach under Basel II and weak category for corporate exposures under the slotting approach.

Fair value adjustments represent lifetime expected credit losses on assets acquired on the merger of the Bank and Britannia Building Society on 1 August 2009 and are reviewed on a regular basis to ensure appropriate allocation and utilisation.

1. Credit risk continued

1.3.2 Analyses of credit exposure

The following analysis of credit exposure shows:

- carrying amounts by class of asset in the balance sheet;
- the gross credit exposure by class of asset (excluding allowance for losses and including credit commitments);
- the net credit exposure by class of asset (including both allowance for losses and credit commitments);
- an analysis of the net credit exposures by level of impairment or risk; and
- fair value adjustments.

Cash and balances at central banks are credit exposures with the Bank of England and have been excluded from the analysis.

Group	Loans and advances to banks	Loans and advances to customers	Investment securities loans and receivables	Investment securities available for sale	Investment securities fair value through income or expense	Derivative financial instruments	Total
2011							
Analysis of balance per note	14	15	16	16	16	17	
Gross balance	**2,006.5**	**34,058.0**	**807.6**	**3,465.5**	**343.1**	**975.8**	**41,656.5**
Less: allowance for losses	**–**	**(292.0)**	**(2.7)**	**(42.5)**	**–**	**–**	**(337.2)**
	2,006.5	**33,766.0**	**804.9**	**3,423.0**	**343.1**	**975.8**	**41,319.3**
Analysis of credit risk exposure							
Gross balance	**2,006.5**	**34,058.0**	**807.6**	**3,465.5**	**343.1**	**975.8**	**41,656.5**
Credit commitments	**40.6**	**4,858.7**	**–**	**–**	**–**	**–**	**4,899.3**
Gross credit risk exposure	**2,047.1**	**38,916.7**	**807.6**	**3,465.5**	**343.1**	**975.8**	**46,555.8**
Less: allowance for losses	**–**	**(292.0)**	**(2.7)**	**(42.5)**	**–**	**–**	**(337.2)**
Net credit risk exposure	**2,047.1**	**38,624.7**	**804.9**	**3,423.0**	**343.1**	**975.8**	**46,218.6**
Analysis of net credit risk exposure by level of impairment or risk							
Individually impaired							
90 days past due or evidence of impairment	**–**	**1,657.7**	**3.9**	**42.5**	**–**	**0.4**	**1,704.5**
Impairment recognised	**–**	**(114.1)**	**(2.7)**	**(42.5)**	**–**	**–**	**(159.3)**
	–	**1,543.6**	**1.2**	**–**	**–**	**0.4**	**1,545.2**
Collectively impaired							
Less than 90 days past due	**–**	**1,236.8**	**–**	**–**	**–**	**–**	**1,236.8**
90–179 days past due	**–**	**15.5**	**–**	**–**	**–**	**–**	**15.5**
180 days plus past due	**21.0**	**152.6**	**–**	**–**	**–**	**–**	**173.6**
Impairment recognised	**–**	**(177.9)**	**–**	**–**	**–**	**–**	**(177.9)**
	21.0	**1,227.0**	**–**	**–**	**–**	**–**	**1,248.0**
Past due but not impaired							
0–29 days past due	**–**	**272.4**	**–**	**–**	**–**	**–**	**272.4**
30–59 days past due	**–**	**87.3**	**–**	**–**	**–**	**–**	**87.3**
60–89 days past due	**–**	**50.7**	**–**	**–**	**–**	**–**	**50.7**
	–	**410.4**	**–**	**–**	**–**	**–**	**410.4**
Neither past due nor impaired							
Low risk	**2,000.8**	**31,579.5**	**768.4**	**3,334.4**	**343.1**	**970.6**	**38,996.8**
Medium to high risk	**41.7**	**4,260.6**	**55.1**	**88.6**	**–**	**4.8**	**4,450.8**
	2,042.5	**35,840.1**	**823.5**	**3,423.0**	**343.1**	**975.4**	**43,447.6**
Fair value adjustments	**(16.4)**	**(396.4)**	**(19.8)**	**–**	**–**	**–**	**(432.6)**
	2,047.1	**38,624.7**	**804.9**	**3,423.0**	**343.1**	**975.8**	**46,218.6**

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Group	Loans and advances to banks	Loans and advances to customers	Investment securities loans and receivables	Investment securities available for sale	Investment securities fair value through income or expense	Derivative financial instruments	Total
2010							
Analysis of balance per note	14	15	16	16	16	17	
Gross balance	2,394.1	35,199.9	1,930.3	3,029.4	28.7	975.6	43,558.0
Less: allowance for losses	–	(222.6)	(13.0)	(72.3)	–	–	(307.9)
	2,394.1	34,977.3	1,917.3	2,957.1	28.7	975.6	43,250.1
Analysis of credit risk exposure							
Gross balance	2,394.1	35,199.9	1,930.3	3,029.4	28.7	975.6	43,558.0
Credit commitments	176.0	4,717.7	–	–	–	–	4,893.7
Gross credit risk exposure	2,570.1	39,917.6	1,930.3	3,029.4	28.7	975.6	48,451.7
Less: allowance for losses	–	(222.6)	(13.0)	(72.3)	–	–	(307.9)
Net credit risk exposure	2,570.1	39,695.0	1,917.3	2,957.1	28.7	975.6	48,143.8
Analysis of net credit risk exposure by level of impairment or risk							
Individually impaired							
90 days past due or evidence of impairment	–	1,790.1	25.0	72.3	–	–	1,887.4
Impairment recognised	–	(64.4)	(8.5)	(72.3)	–	–	(145.2)
	–	1,725.7	16.5	–	–	–	1,742.2
Collectively impaired							
Less than 90 days past due	–	796.4	119.2	–	–	–	915.6
90–179 days past due	–	18.4	–	–	–	–	18.4
180 days plus past due	21.0	143.4	–	–	–	–	164.4
Impairment recognised	–	(158.2)	(4.5)	–	–	–	(162.7)
	21.0	800.0	114.7	–	–	–	935.7
Past due but not impaired							
0–29 days past due	–	240.1	–	–	–	–	240.1
30–59 days past due	–	118.7	–	–	–	–	118.7
60–89 days past due	–	178.7	–	–	–	–	178.7
	–	537.5	–	–	–	–	537.5
Neither past due nor impaired							
Low risk	2,565.5	31,997.2	1,831.1	2,946.2	28.7	975.6	40,344.3
Medium to high risk	–	5,112.8	–	10.9	–	–	5,123.7
	2,565.5	37,110.0	1,831.1	2,957.1	28.7	975.6	45,468.0
Fair value adjustments	(16.4)	(478.2)	(45.0)	–	–	–	(539.6)
	2,570.1	39,695.0	1,917.3	2,957.1	28.7	975.6	48,143.8

The impairment analysis of loans and advances to customers has been restated to show a consistent comparison to 2011 following the inclusion of assets subject to forbearance in impairment definitions.

1. Credit risk continued

Bank	Loans and advances to banks	Loans and advances to customers	Investment securities loans and receivables	Investment securities available for sale	Investment securities fair value through income or expense	Derivative financial instruments	Total
2011							
Analysis of balance per note	14	15	16	16	16	17	
Gross balance	**1,300.1**	**22,993.1**	**868.8**	**3,149.9**	**343.1**	**704.4**	**29,359.4**
Less: allowance for losses	**–**	**(258.1)**	**(2.7)**	**(42.5)**	**–**	**–**	**(303.3)**
	1,300.1	**22,735.0**	**866.1**	**3,107.4**	**343.1**	**704.4**	**29,056.1**
Analysis of credit risk exposure							
Gross balance	**1,300.1**	**22,993.1**	**868.8**	**3,149.9**	**343.1**	**704.4**	**29,359.4**
Credit commitments	**40.6**	**4,661.8**	**–**	**–**	**–**	**–**	**4,702.4**
Gross credit risk exposure	**1,340.7**	**27,654.9**	**868.8**	**3,149.9**	**343.1**	**704.4**	**34,061.8**
Less: allowance for losses	**–**	**(258.1)**	**(2.7)**	**(42.5)**	**–**	**–**	**(303.3)**
Net credit risk exposure	**1,340.7**	**27,396.8**	**866.1**	**3,107.4**	**343.1**	**704.4**	**33,758.5**
Analysis of net credit risk exposure by level of impairment or risk							
Individually impaired							
90 days past due or evidence of impairment	**–**	**418.2**	**3.9**	**42.5**	**–**	**0.4**	**465.0**
Impairment recognised	**–**	**(88.7)**	**(2.7)**	**(42.5)**	**–**	**–**	**(133.9)**
	–	**329.5**	**1.2**	**–**	**–**	**0.4**	**331.1**
Collectively impaired							
Less than 90 days past due	**–**	**295.1**	**–**	**–**	**–**	**–**	**295.1**
90–179 days past due	**–**	**15.5**	**–**	**–**	**–**	**–**	**15.5**
180 days plus past due	**21.0**	**152.6**	**–**	**–**	**–**	**–**	**173.6**
Impairment recognised	**–**	**(169.4)**	**–**	**–**	**–**	**–**	**(169.4)**
	21.0	**293.8**	**–**	**–**	**–**	**–**	**314.8**
Past due but not impaired							
0–29 days past due	**–**	**46.8**	**–**	**–**	**–**	**–**	**46.8**
30–59 days past due	**–**	**27.1**	**–**	**–**	**–**	**–**	**27.1**
60–89 days past due	**–**	**12.7**	**–**	**–**	**–**	**–**	**12.7**
	–	**86.6**	**–**	**–**	**–**	**–**	**86.6**
Neither past due nor impaired							
Low risk	**1,294.4**	**24,672.8**	**829.6**	**3,018.8**	**343.1**	**699.2**	**30,857.9**
Medium to high risk	**41.7**	**2,056.9**	**55.1**	**88.6**	**–**	**4.8**	**2,247.1**
	1,336.1	**26,729.7**	**884.7**	**3,107.4**	**343.1**	**704.0**	**33,105.0**
Fair value adjustments	**(16.4)**	**(42.8)**	**(19.8)**	**–**	**–**	**–**	**(79.0)**
	1,340.7	**27,396.8**	**866.1**	**3,107.4**	**343.1**	**704.4**	**33,758.5**

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Bank	Loans and advances to banks	Loans and advances to customers	Investment securities loans and receivables	Investment securities available for sale	Investment securities fair value through income or expense	Derivative financial instruments	Total
2010							
Analysis of balance per note	14	15	16	16	16	17	
Gross balance	1,728.6	24,055.4	1,999.8	2,693.7	28.7	704.7	31,210.9
Less: allowance for losses	–	(210.5)	(13.0)	(72.3)	–	–	(295.8)
	1,728.6	23,844.9	1,986.8	2,621.4	28.7	704.7	30,915.1
Analysis of credit risk exposure							
Gross balance	1,728.6	24,055.4	1,999.8	2,693.7	28.7	704.7	31,210.9
Credit commitments	176.0	4,576.3	–	–	–	–	4,752.3
Gross credit risk exposure	1,904.6	28,631.7	1,999.8	2,693.7	28.7	704.7	35,963.2
Less: allowance for losses	–	(210.5)	(13.0)	(72.3)	–	–	(295.8)
Net credit risk exposure	1,904.6	28,421.2	1,986.8	2,621.4	28.7	704.7	35,667.4
Analysis of net credit risk exposure by level of impairment or risk							
Individually impaired							
90 days past due or evidence of impairment	–	277.0	25.0	72.3	–	–	374.3
Impairment recognised	–	(52.3)	(8.5)	(72.3)	–	–	(133.1)
	–	224.7	16.5	–	–	–	241.2
Collectively impaired							
Less than 90 days past due	–	149.6	119.2	–	–	–	268.8
90–179 days past due	–	18.4	–	–	–	–	18.4
180 days plus past due	21.0	143.4	–	–	–	–	164.4
Impairment recognised	–	(158.2)	(4.5)	–	–	–	(162.7)
	21.0	153.2	114.7	–	–	–	288.9
Past due but not impaired							
0–29 days past due	–	50.7	–	–	–	–	50.7
30–59 days past due	–	39.4	–	–	–	–	39.4
60–89 days past due	–	29.0	–	–	–	–	29.0
	–	119.1	–	–	–	–	119.1
Neither past due nor impaired							
Low risk	1,900.0	25,546.7	1,900.6	2,610.5	28.7	704.7	32,691.2
Medium to high risk	–	2,430.2	–	10.9	–	–	2,441.1
	1,900.0	27,976.9	1,900.6	2,621.4	28.7	704.7	35,132.3
Fair value adjustments	(16.4)	(52.7)	(45.0)	–	–	–	(114.1)
	1,904.6	28,421.2	1,986.8	2,621.4	28.7	704.7	35,667.4

The impairment analysis of loans and advances to customers has been restated to show a consistent comparison to 2011 following the inclusion of assets subject to forbearance in impairment definitions.

1.4 Analysis of impaired assets and associated collateral
The following sections provide further analysis and disclosure of the Group's credit risk associated with:

- loans and advances to customers;
- investment securities; and
- loans and advances to banks.

1. Credit risk continued

1.4.1 Loans and advances to customers

1.4.1.1 How we oversee and control credit risk

The Credit Risk Control Unit (CRCU) provides an independent view of credit risk in order to support the business' decision making. CRCU does not directly benefit from decisions to extend credit. The CRCU provides risk oversight by virtue of its independence from the business management functions. The CRCU function is in house and is not outsourced.

CRCU is responsible for procedures across both retail and corporate, and performs the following tasks and responsibilities related to its role:

- design and implementation of risk assessment and rating systems;
- testing, validating, documenting and monitoring of risk assessment and rating systems;
- production and analysis of summary reports of risk assessment and rating systems;
- maintenance of lending policy and procedures, and upkeep of various returns and reporting requirements;
- monitoring system decision overrides and exceptions;
- benchmarking against third party data and vendor model sources;
- reviewing the risk criteria to ensure they remain predictive of risk;
- oversight of independent validation;
- development and monitoring of risk appetites; and
- liaison with FSA regarding proposed changes to rating systems and forecast regulatory capital levels.

On pages 54 to 61 the management of credit risk by portfolio is described covering:

- acquisition and account management;
- collateral;
- impairment assessment; and
- forbearance.

1.4.1.2 Assessment for impairment

The loan portfolios are periodically reviewed, usually once a month, to assess impairment. A loan will be deemed to be impaired where there is objective evidence that a loss event has occurred after recognition of an asset and by 31 December 2011. Further detail is provided in the following credit risk sections.

Once a loan is defined as impaired the provision will be calculated as the difference between the current carrying value of the asset (including fair value adjustments) and the expected future recovery, discounted at the loan's effective interest rate, taking into account the expected charge off rate and any supporting collateral. (Full details are contained in the significant accounting policies on page 41 and in the following credit risk sections.)

The following table analyses the gross balance by impairment classification for the Retail (secured and unsecured) and CABB (corporate, Platform and Optimum) business segments. It includes credit commitments, impairment provisions and fair value adjustments.

	Retail		CABB			
Group	**Secured**	**Unsecured**	**Corporate**	**Platform**	**Optimum**	**Total**
2011						
Individually impaired						
90 days past due or evidence of impairment	**68.7**	**–**	**710.0**	**5.0**	**874.0**	**1,657.7**
Impairment recognised	**(2.6)**	**–**	**(105.1)**	**(0.1)**	**(6.3)**	**(114.1)**
	66.1	**–**	**604.9**	**4.9**	**867.7**	**1,543.6**
Collectively impaired						
Less than 90 days past due	**195.7**	**52.6**	**290.4**	**7.9**	**690.2**	**1,236.8**
90–179 days past due	**–**	**15.5**	**–**	**–**	**–**	**15.5**
180 days plus past due	**–**	**151.5**	**1.1**	**–**	**–**	**152.6**
Impairment recognised	**(0.4)**	**(163.3)**	**(12.2)**	**–**	**(2.0)**	**(177.9)**
	195.3	**56.3**	**279.3**	**7.9**	**688.2**	**1,227.0**
Past due but not impaired						
0–29 days past due	**39.9**	**6.5**	**0.4**	**4.6**	**221.0**	**272.4**
30–59 days past due	**27.1**	**–**	**–**	**4.0**	**56.2**	**87.3**
60–89 days past due	**9.8**	**–**	**11.4**	**1.5**	**28.0**	**50.7**
	76.8	**6.5**	**11.8**	**10.1**	**305.2**	**410.4**
Neither past due nor impaired						
Low risk	**13,972.1**	**2,585.2**	**9,285.7**	**1,467.7**	**4,268.8**	**31,579.5**
Medium to high risk	**230.0**	**1,129.6**	**1,067.0**	**87.1**	**1,746.9**	**4,260.6**
	14,202.1	**3,714.8**	**10,352.7**	**1,554.8**	**6,015.7**	**35,840.1**
Fair value adjustments	**(6.7)**	**–**	**(251.5)**	**–**	**(138.2)**	**(396.4)**
	14,533.6	**3,777.6**	**10,997.2**	**1,577.7**	**7,738.6**	**38,624.7**

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Group	Retail Secured	Retail Unsecured	Corporate	CABB Platform	Optimum	Total
2010						
Individually impaired						
90 days past due or evidence of impairment	56.3	–	609.4	6.3	1,118.1	1,790.1
Impairment recognised	(3.0)	–	(55.8)	–	(5.6)	(64.4)
	53.3	–	553.6	6.3	1,112.5	1,725.7
Collectively impaired						
Less than 90 days past due	100.4	49.2	–	4.7	642.1	796.4
90–179 days past due	–	18.4	–	–	–	18.4
180 days plus past due	–	142.9	0.5	–	–	143.4
Impairment recognised	–	(158.2)	–	–	–	(158.2)
	100.4	52.3	0.5	4.7	642.1	800.0
Past due but not impaired						
0–29 days past due	44.9	5.7	0.1	3.6	185.8	240.1
30–59 days past due	39.0	–	0.4	3.8	75.5	118.7
60–89 days past due	15.3	–	126.4	2.7	34.3	178.7
	99.2	5.7	126.9	10.1	295.6	537.5
Neither past due nor impaired						
Low risk	15,303.6	2,782.5	8,772.6	808.4	4,330.1	31,997.2
Medium to high risk	368.8	1,203.2	1,418.1	74.1	2,048.6	5,112.8
	15,672.4	3,985.7	10,190.7	882.5	6,378.7	37,110.0
Fair value adjustments	(7.8)	–	(265.4)	–	(205.0)	(478.2)
	15,917.5	4,043.7	10,606.3	903.6	8,223.9	39,695.0

1.4.1.3 Secured residential credit risk

Acquisition and account management

Secured loans are mortgages originated directly to customers via branches, telephone and the internet in the retail business and via intermediaries in the Platform business. In 2011 55% (2010: 79%) of mortgages were originated through the retail business and 45% (2010: 21%) through Platform. Completions of retail and Platform prime mortgages have fallen whilst completions of buy to let mortgages originated through Platform have substantially increased.

Retail mortgages are prime residential mortgages and include loans originated via both Britannia and Co-operative Bank branded sales channels.

Platform originates a combination of prime and 'almost prime' residential mortgages together with buy to let loans.

Loans originated by Platform prior to 2009 and those acquired by Britannia Treasury Services are managed as part of a closed portfolio, Optimum. These loans include a range of asset types, including prime residential (both income verified and self-certified), buy to let, and non-conforming mortgages.

Loan repayment methods may be capital and interest, where the loan is repaid over the term of the loan, or interest only, where the capital element of the loan is normally repaid at the end of the term.

The table below shows residential mortgage completions analysed by loan to value (LTV) and repayment method:

	2011 Amount advanced	2011 Average LTV %	2011 % Interest only	2010 Amount advanced	2010 Average LTV %	2010 % Interest only
Retail prime	**790.5**	**57.9**	**11.8**	2,444.3	60.0	20.9
Platform prime	**182.1**	**66.1**	**22.1**	526.4	66.4	25.7
Total prime	**972.6**	**59.3**	**13.0**	2,970.7	61.0	21.5
Buy to let	**446.3**	**62.6**	**83.0**	68.7	59.5	87.5
Almost prime	**10.3**	**52.9**	**13.4**	39.2	54.5	23.9
Self certified	**–**	**–**	**–**	0.5	54.3	100.0
Total completions	**1,429.2**	**60.4**	**30.4**	3,079.1	60.9	22.9

The risk in the portfolio is re-evaluated monthly using internally developed behavioural scorecards, to assess the probability of a borrower defaulting in the following 12 months and to reflect any changes in the value of collateral. The revaluation will determine the amount of capital required to be held for individual loans.

1. Credit risk continued

The table below shows the residential mortgages gross customer balances analysed by LTV banding:

2011	Retail secured	Platform	Optimum	Total
Less than 50%	**5,524.2**	**182.5**	**484.0**	**6,190.7**
50% to 60%	**1,929.0**	**228.8**	**372.7**	**2,530.5**
60% to 70%	**2,001.3**	**416.7**	**673.0**	**3,091.0**
70% to 80%	**2,088.9**	**474.5**	**1,067.7**	**3,631.1**
80% to 90%	**1,761.9**	**112.6**	**1,604.9**	**3,479.4**
90% to 100%	**647.1**	**4.7**	**1,696.2**	**2,348.0**
Greater than 100%	**418.4**	**2.3**	**2,035.7**	**2,456.4**
	14,370.8	**1,422.1**	**7,934.2**	**23,727.1**

2010	Retail secured	Platform	Optimum	Total
Less than 50%	6,221.2	118.7	523.4	6,863.3
50% to 60%	2,124.3	131.5	406.6	2,662.4
60% to 70%	2,117.0	254.8	728.6	3,100.4
70% to 80%	2,281.1	306.5	1,196.5	3,784.1
80% to 90%	1,836.0	88.3	1,781.4	3,705.7
90% to 100%	735.5	3.8	1,827.4	2,566.7
Greater than 100%	482.1	0.1	1,981.2	2,463.4
	15,797.2	903.7	8,445.1	25,146.0

The table below shows the gross customer balances for residential mortgages analysed by asset class:

	2011			2010		
	Exposure	**Average LTV %**	**% Interest only**	Exposure	Average LTV %	% Interest only
Prime residential	**15,745.9**	**43.5**	**25.1**	17,126.3	43.3	25.4
Buy to let	**2,881.3**	**76.1**	**90.5**	2,557.0	77.5	90.6
Self-certified	**2,228.7**	**76.6**	**77.3**	2,386.2	75.7	77.2
Almost prime	**997.1**	**89.5**	**67.1**	1,058.7	89.1	68.2
Non-conforming	**1,874.1**	**77.1**	**65.7**	2,017.8	76.7	65.7
	23,727.1	**52.7**	**42.9**	25,146.0	52.0	42.0

Collateral

All mortgages are secured by a first charge over the property being purchased or remortgaged. Valuation of the property is normally assessed by a RICS certified valuer from the Group's approved panel of valuers. For low LTV remortgages, valuation may be assessed through the use of an automated valuation model (AVM). Performance of AVMs is monitored on a regular basis to ensure their ongoing accuracy.

It is not normal practice to reassess the valuation of collateral unless further lending is being considered, or the property has been repossessed, but on a quarterly basis the valuation will be restated using a regional property price index.

The table below analyses the fair value of property collateral held against mortgage portfolios:

	2011			2010		
	Impaired	**Non-impaired**	**Total**	Impaired	Non-impaired	Total
Exposure	**1,853.6**	**21,873.5**	**23,727.1**	2,025.8	23,120.2	25,146.0
Collateral	**1,785.8**	**21,751.2**	**23,537.0**	1,962.7	23,004.6	24,967.3
Cover	**96.3%**	**99.4%**	**99.2%**	96.9%	99.5%	99.3%

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Impairment

Loans and advances to customers are considered impaired where there is objective evidence of a loss event having occurred after the original advance. This indicates that the Group may be unable to collect all principal and interest outstanding according to the contractual terms of the agreements.

Objective evidence of a loss event is considered to have occurred when:

- arrears outstanding are equivalent to 90 days or more; or
- the loan is subject to litigation; or
- the loan has passed its due date for repayment but has not been repaid; or
- the value of the collateral on a roll up mortgage has reduced below the loan balance outstanding; or
- the loan is identified as being subject to forbearance.

In addition, a provision may be held when:

- the loan is in arrears by less than 90 days; or
- there has been a material deterioration in the borrower's external credit score in the last 12 months.

Loans meeting the latter criteria are collectively assessed for impairment when a loss is expected in the event of repossession.

Loans that have arrears of less than 90 days, but when a loss is not expected, are defined as past due but not impaired.

Impairment definitions were updated in the second half of 2011 to include mortgages subject to forbearance, or where collateral on roll up mortgages has reduced below the loan balance outstanding and mortgages which have past the due date for repayment but have not been repaid. These changes have resulted in a one off increase in impairment provisions of £2.8m.

The table below shows:

- impaired customer balances as a percentage of gross customer balances; and
- impairment coverage, ie impairment provisions and fair value adjustments as a percentage of impaired customer balances.

	2011			2010		
	Retail secured	**Platform**	**Optimum**	Retail secured	Platform	Optimum
Gross loans and advances to customers	**14,379.5**	**1,423.0**	**7,745.9**	15,830.2	897.7	8,138.5
Fair value adjustments	**6.7**	**–**	**138.2**	7.8	–	205.0
Other accounting adjustments	**(15.4)**	**(0.9)**	**50.1**	(40.8)	6.0	101.6
Gross customer balances	**14,370.8**	**1,422.1**	**7,934.2**	15,797.2	903.7	8,445.1
Impaired customer balances	**264.9**	**12.9**	**1,575.8**	237.7	11.1	1,777.1
Impaired as a % of gross customer balances	**1.8%**	**0.9%**	**19.9%**	1.5%	1.2%	21.0%
Credit protection						
Impairment provisions	**3.0**	**0.1**	**8.3**	3.0	–	5.6
Fair value adjustments	**6.7**	**–**	**138.2**	7.8	–	205.0
	9.7	**0.1**	**146.5**	10.8	–	210.6
Credit protection as a % of impaired customer balances	**3.7%**	**0.8%**	**9.3%**	4.5%	0.0%	11.9%

Forbearance

A number of options are available to borrowers in financial difficulty. Repossession of the property will only be considered when all other avenues have been explored. The precise treatment selected will depend on the borrower's individual circumstances, but may include:

- arrangements to repay outstanding arrears over a period of time, by making payments above the contractual amount. The loan will be deemed impaired, and arrears will continue to be reported, until the arrears have been cleared in full;
- short term concessions, where the borrower is allowed to make reduced repayments (or, in exceptional circumstances, no repayments) on a temporary basis to assist with a short term financial hardship. In these cases the shortfall on the repayments will accrue as arrears and the loan will be deemed to be impaired. Note that this treatment is distinct from a 'payment holiday', which is allowed as part of a customer's flexible mortgage contract. Payment holidays would not knowingly be allowed for customers experiencing financial hardship. However, in the absence of evidence to the contrary, loans that have had a payment holiday in the last two years have been treated as impaired within the year end accounts;
- temporary conversion of a mortgage to interest only repayments. This treatment has sometimes been used as an alternative to a concession for mortgage borrowers experiencing short term financial hardship. The capital repayments due in this period are added to the capital balance outstanding on the mortgage. These loans are identified as impaired;
- a permanent switch from capital and interest repayments to interest only repayments, provided the borrower declares they have an alternative means of repaying the capital at the end of the term. As the borrower is not required to prove they have an alternative repayment vehicle in place, there is a risk that borrowers have switched purely to reduce their repayments and may not in reality have a repayment vehicle. Consequently all loans that have switched to interest only after the origination of the loan are treated as impaired;
- an extension to the term of the mortgage to reduce the borrower's repayments. Term extensions may be offered proactively to a borrower experiencing financial hardship, or in response to a borrower's request. Loans that have had a term extension in the last two years are considered as impaired; and
- capitalisation, where outstanding arrears are added to the capital value of the loan to be repaid over the remaining term. This is only considered where it is appropriate for the borrower's circumstances, and where the borrower has been performing for at least six months. During 2011, 90 (2010: 605) loans had arrears capitalised of £0.3m (2010: £1.0m). These loans are not treated as impaired unless the borrower meets another impairment trigger (eg misses a mortgage payment).

1. Credit risk continued

The underlying basis for the calculation of residential mortgage impairment provisions remains unchanged. Mortgages subject to forbearance, once classified as impaired, are treated in the same way as all other impaired mortgages in the impairment provisions calculations.

The table below analyses retail mortgage forbearance by concession allowed:

	2011		2010	
	Exposure	**Impairment**	Exposure	Impairment
Arrangements	**546.6**	**26.0**	562.9	31.1
Concessions	**7.2**	**0.1**	6.5	0.1
Payment holidays	**175.8**	**–**	173.3	–
Interest only switches	**584.6**	**1.1**	569.4	–
Term extensions	**147.3**	**0.1**	176.7	–
Capitalisations	**9.8**	**–**	19.0	–
	1,471.3	**27.3**	1,507.8	31.2

1.4.1.4 Unsecured retail credit risk

Acquisition and account management

The Group offers unsecured lending through fixed repayment loans, credit cards and overdrafts. Borrowers are assessed using a combination of credit scoring and policy rules to ensure that expected delinquency levels are within the risk appetite of the business and deliver an appropriate level of return. Credit cards and overdrafts are subject to ongoing account management to increase or decrease credit limits and manage over limit authorisations.

The risk in the portfolio is re-evaluated monthly using internally developed behavioural scorecards to determine the amount of capital required to be held for individual loans.

The following table shows unsecured lending gross customer balances (including commitments) by product type:

	2011	2010
Loans	**751.0**	833.0
Credit cards	**2,841.4**	3,042.8
Overdrafts	**377.0**	363.5
	3,969.4	4,239.3

Impairment

Credit cards are identified as impaired immediately if the borrower fails to make the minimum payment by the due date.

Loans are identified as impaired if a monthly payment has not been made 15 days after it was due.

An overdraft is defined as impaired if the account has been overdrawn in excess of any agreed limit for 15 days, or if the agreed overdraft has expired but the account remains overdrawn.

Accounts identified as impaired will be segmented according to the number of days that the loan has been impaired. The provision for each segment is based on the probability of charge off. An account is charged off when all economical avenues to recover the debt have been exhausted.

The table below shows:

- gross customer balances (excluding commitments);
- impaired customer balances as a percentage of gross customer balances; and
- impairment coverage, ie impairment provisions and fair value adjustments as a percentage of impaired customer balances.

	2011	2010
Gross loans and advances to customers	**1,518.1**	1,613.1
Other accounting adjustments	**17.5**	41.2
Gross customer balances	**1,535.6**	1,654.3
Impaired customer balances	**296.5**	308.4
Impaired as a % of gross customer balances	**19.3%**	18.6%
Credit protection		
Impairment provisions	**163.3**	158.2
Credit protection as a % of impaired customer balances	**55.1%**	51.3%

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Forbearance

Where a borrower is unable to clear their arrears in full, the Group will endeavour to agree an arrangement with the borrower to repay the outstanding arrears over a period of time, or may agree to accept payments of less than the contractual amount during a period of temporary financial hardship. In these instances the loan continues to be reported as impaired until the arrears are cleared in full. Arrangements can be made directly with the customer or through a third party who they have chosen to represent them.

A negative disposable income account is where the customer's current financial situation means they are unable to make any monthly payments to their unsecured creditors. In such circumstances the Group may refrain from further action during a period of financial hardship. The customer's circumstances will be reviewed on a regular basis, with a view to resolving the situation once those circumstances improve. These loans continue to be reported as impaired, and will have a higher dedicated provision rate than the standard provisioning rates.

'Regular payers' are defined as accounts that are greater than 90 days in arrears and are making regular payments (irrespective of whether they are on a formal arrangement or not). These accounts continue to be reported as impaired, but the provision rate will reflect the specific probability of charge off for these accounts.

In 2010, the provisioning methodology used re-ages, rather than the 'regular payers' treatment criteria used for 2011. Re-ages applied only to accounts with early stage arrears, as opposed to 'regular payers' which includes all arrears stages.

The table below shows current exposure and provision by treatment type:

	2011		2010	
	Current exposure	**Impairment**	Current exposure	Impairment
Regular payers	**93.5**	**70.2**	–	–
Re-ages	**–**	**–**	23.9	11.4
Standard collections	**41.5**	**23.1**	117.1	88.3
Negative disposable income	**16.9**	**15.7**	10.5	10.0
Fraud	**5.3**	**4.8**	3.4	3.3
Individual voluntary arrangements	**55.5**	**49.5**	50.8	45.2
	212.7	**163.3**	205.7	158.2

When all internal activities to rehabilitate the borrower have been exhausted, accounts are charged off and referred to Debt Collection Agencies (DCAs) to seek full recovery of the debt. The loan balance remaining on balance sheet reflects the amount expected to be recovered.

	2011			2010		
	Original balance	**Charged off**	**Current exposure**	Original balance	Charged off	Current exposure
DCAs	**97.0**	**90.0**	**7.0**	116.4	111.1	5.3

1.4.1.5 Corporate credit risk

Acquisition and account management

New lending is approved by experienced staff within the centrally based credit underwriting team, independent from income generation. Lending discretions are based on the risk profile of the customer and the amount of exposure. The lending discretions of the Banking Risk Officer, the Chief Executive and the Exposure Committee are operated to sanction the largest credit applications.

The credit underwriting team uses the relevant 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, the financial stability of the counterparty and its ability to withstand such change.

The Group's corporate sector policy is to maintain a broad sectoral spread of exposures which reflect the Group's areas of expertise. Credit exposures to corporate and business banking customers are assessed individually. The quality of the overall portfolio is monitored using a credit grading system calibrated to expected loss.

The PCC and the RC receive regular reports on the performance of the portfolio. The Exposures Committee receives regular reports on new facilities and changes in facilities, sector exposures, bad debt provisions and the management of problem loans.

The following table shows the distribution of the corporate and business banking gross customer balances (including commitments) by sector and risk grade, where PD grades have been mapped to regulatory slotting categories for ease of interpretation in this report.

1. Credit risk continued

2011	Unrated	Strong	Good	Satisfactory	Weak	Default	Total
Accommodation, food and licensed services	**319.5**	**60.9**	**53.3**	**31.4**	**1.5**	**110.1**	**576.7**
Care	**177.0**	**29.1**	**19.3**	**26.9**	**2.9**	**–**	**255.2**
Education	**68.6**	**46.1**	**11.6**	**0.8**	**–**	**–**	**127.1**
Financial services	**82.1**	**54.1**	**40.3**	**4.8**	**–**	**3.7**	**185.0**
Football clubs	**–**	**41.6**	**–**	**0.9**	**15.1**	**5.7**	**63.3**
Housing associations	**1,132.8**	**–**	**0.5**	**–**	**–**	**–**	**1,133.3**
Manufacturing	**92.4**	**15.9**	**40.5**	**20.9**	**24.4**	**1.6**	**195.7**
Motor trade and garages	**34.1**	**39.9**	**22.8**	**1.9**	**8.6**	**4.0**	**111.3**
PFI	**0.8**	**–**	**1,260.8**	**–**	**14.6**	**–**	**1,276.2**
Professional services	**61.6**	**26.6**	**27.4**	**7.9**	**3.3**	**4.5**	**131.3**
Property and construction:							
Commercial investment	**123.2**	**174.4**	**1,466.4**	**767.7**	**584.4**	**562.7**	**3,678.8**
Residential investment	**11.0**	**59.1**	**229.0**	**116.3**	**24.1**	**154.7**	**594.2**
Commercial construction	**6.8**	**9.1**	**112.5**	**123.0**	**24.0**	**11.1**	**286.5**
Residential development	**1.7**	**1.8**	**65.3**	**35.1**	**13.4**	**3.9**	**121.2**
Public sector entities	**198.0**	**–**	**–**	**–**	**–**	**–**	**198.0**
Renewable energy	**437.5**	**–**	**–**	**–**	**–**	**10.3**	**447.8**
Retail and wholesale trade	**107.4**	**335.2**	**69.9**	**19.5**	**1.0**	**0.3**	**533.3**
Services	**460.3**	**103.3**	**50.5**	**60.8**	**8.4**	**21.6**	**704.9**
Transport, storage and communication	**168.5**	**53.5**	**11.0**	**7.4**	**15.0**	**23.9**	**279.3**
Utilities	**74.5**	**0.8**	**1.5**	**10.5**	**–**	**0.6**	**87.9**
Business banking	**0.8**	**32.6**	**7.5**	**3.3**	**0.9**	**0.5**	**45.6**
Other	**11.9**	**1.1**	**1.9**	**4.1**	**–**	**2.1**	**21.1**
	3,570.5	**1,085.1**	**3,492.0**	**1,243.2**	**741.6**	**921.3**	**11,053.7**

2010	Unrated	Strong	Good	Satisfactory	Weak	Default	Total
Accommodation, food and licensed services	185.9	54.2	29.5	36.2	2.0	26.0	333.8
Care	115.1	13.0	45.6	18.7	3.1	–	195.5
Education	53.7	36.1	11.1	1.2	–	–	102.1
Financial services	49.2	45.9	52.5	4.0	7.0	2.8	161.4
Football clubs	0.1	–	44.4	16.0	0.7	11.9	73.1
Housing associations	1,118.6	–	–	–	–	–	1,118.6
Manufacturing	95.3	12.4	37.6	23.2	22.5	8.4	199.4
Motor trade and garages	33.9	22.2	24.9	8.7	9.9	0.3	99.9
PFI	3.5	3.9	1,140.3	–	–	–	1,147.7
Professional services	71.3	25.0	16.8	20.2	4.1	4.4	141.8
Property and construction:							
Commercial investment	165.2	205.7	1,998.2	422.7	409.7	458.9	3,660.4
Residential investment	22.4	100.7	286.3	85.9	164.0	98.4	757.7
Commercial construction	2.6	9.6	150.3	92.6	33.5	17.6	306.2
Residential development	1.3	1.7	66.7	42.6	12.8	2.2	127.3
Public sector entities	185.4	–	–	–	–	–	185.4
Renewable energy	236.3	–	–	–	–	–	236.3
Retail and wholesale trade	102.4	161.7	276.8	33.2	0.3	0.3	574.7
Services	406.3	83.8	71.3	69.2	9.7	29.9	670.2
Transport, storage and communication	163.6	65.1	33.8	3.1	17.3	–	282.9
Utilities	60.1	–	–	0.6	–	0.6	61.3
Business banking	1.3	32.6	7.3	4.0	1.4	0.5	47.1
Other	9.9	1.9	1.8	4.4	–	2.1	20.1
	3,083.4	875.5	4,295.2	886.5	698.0	664.3	10,502.9

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued
Collateral

The Group uses guarantees and collateral to mitigate credit risk. Collateral is regularly revalued and guarantees are reviewed to ensure continuing effectiveness.

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.

The table below analyses the fair value of the property collateral held against assets in the property and construction sectors:

	2011		2010	
	Exposure	**Collateral**	Exposure	Collateral
Individually impaired	**732.4**	**386.3**	577.0	357.7
On watchlist	**1,252.6**	**1,068.6**	920.6	651.4
Neither individually impaired nor on watchlist	**2,695.7**	**2,444.3**	3,354.0	3,025.1
	4,680.7	**3,899.2**	4,851.6	4,034.2

Of the above, £48m is not held as first charge.

Impairment

Corporate customers are placed on a watchlist when they show signs of unsatisfactory performance and require close control, but are currently expected to continue trading and where no provision for bad debt is required.

The Group also reviews monthly all higher risk loans and considers the potential loss which might arise were the borrowers to fail (notwithstanding that continued trading remains the expectation). Events which may trigger higher risk status include a deteriorating balance sheet, material losses, trading difficulties (eg loss of material contracts or suppliers), breach of financial covenants, poor account conduct, arrears and material reduction in value of security. A collective impairment provision is raised against these loans based on the total estimated loss that may arise and the propensity for the borrower to fail. In such circumstances, the Group works with the customers to resolve their business problems and agree a clear strategy, often with the support of external, independent professional advisors.

Individual impairment provisions are raised at the point when business performance is assessed to have deteriorated to the extent that there is a real risk of loss of principal, interest or fees. Provisions will be required on some or all of the entire shortfall between the security held and the loan balance outstanding and represent a realistic assessment of the likely net loss after realisation of any security.

Objective evidence of impairment may include:

- an instalment on a loan account being overdue, or having been in excess of its limit (or being overdrawn without an agreed limit) for 90 days or more;
- an event likely to result in insolvency which may involve bankruptcy, or the appointment of an administrative receiver, liquidator or administrator; or
- if the Group considers that at some point (normally taken within the next 12 months) actions such as an issue of formal demand will be required in order to achieve full repayment.

For provisioning purposes, an up to date property valuation or selling agent's recommendation will be discounted to take into account selling and legal costs and also to build in a contingency to cover potential reductions in the selling price based upon the type of security and entity and the existence or otherwise of a contracted sale. In some cases, calculation of the provision will be based on an up to date assessment (often following an independent business review by a firm of accountants) of likely receivables from the business or a formal estimated outcome statement from an insolvency practitioner where the business has failed.

Provisioning adjustments are also recorded, as appropriate, against loans whose interest terms have changed such that revised future cash flows discounted at the original interest rate are less than the current carrying amount.

The table below shows:

- impaired customer balances as a percentage of gross customer balances; and
- credit protection, ie impairment provisions and fair value adjustments as a percentage of impaired customer balances.

1. Credit risk continued

	2011	2010
Gross loans and advances to customers	**8,991.5**	8,720.4
Fair value adjustments	**251.5**	265.4
Other accounting adjustments	**(99.9)**	(178.2)
Gross customer balances	**9,143.1**	8,807.6
Impaired customer balances	**960.5**	659.0
Impaired as a % of gross customer balances	**10.5%**	7.5%
Credit protection		
Impairment provisions	**117.3**	55.8
Fair value adjustments	**251.5**	265.4
	368.8	321.2
Credit protection as a % of impaired customer balances	**38.4%**	48.7%

Forbearance

If the Group is convinced of a customer's ability and commitment to address their financial difficulties, it may agree to grant concessions to the original contractual terms. Such concessions typically include:

- restructuring, waiving or reserving rights in the event of covenant breaches;
- postponement of principal payments;
- restructures of principal payments;
- extension of loan maturities;
- partial or full capitalisation of interest payments; or
- swap restructures.

For those customers that benefit from ongoing concessions (such as postponement of principal payments), the Group retains the forbearance status for as long as the concession remains in place and does not remove them from the watchlist until at least six months later. In the event of one off concessions (such as capitalisation of interest payments), the Group removes the forbearance status 12 months after their occurrence, and retains the customers on the watchlist for at least the same period of time.

Customers who stop exhibiting higher risk traits are removed from the watchlist. This is dependent upon the Group's satisfaction that the triggers leading to inclusion on the watchlist no longer apply, such as:

- balance sheet improvements (eg cash injection, agreement with creditors or funders on revised terms);
- return to an acceptable level of profitability and cash flow;
- improved account conduct;
- the loan to security value is restored, or additional security taken; or
- covenant breach cured or revised covenants agreed.

Removal from the watchlist usually requires the customer's management information to show that trading is achieving the revised plan with a reasonable expectation for this to continue. The internal guideline is for at least six months' satisfactory trading to have been evidenced.

In addition to the above, other forbearance concessions the Group may grant are considered to be objective evidence of impairment and include:

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

1.4.2 Investment securities

Policies are in place within Treasury with regard to the management and valuation of collateral, with daily monitoring undertaken. Repos and secured lending positions are revalued daily 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 II reporting purposes includes gilts held under reverse repo agreements and cash held under both repo agreements and collaterised swap arrangements. The guarantees relied upon are either parental guarantees held against subsidiary exposures within bank groups or sovereign guarantees.

At the balance sheet date, the Group has a total investment securities portfolio of £4,616.2m (2010: £4,988.4m) of which £46.4m (2010: £97.3m) is considered impaired and against which £45.2m (2010: £85.3m) of provisions are held.

1.4.2.1 Impaired assets

Investment securities are considered impaired where it is determined that the Group will be unable to collect all principal and interest outstanding, according to the contractual terms of the agreements.

At the balance sheet date, the Group assesses its investment securities for objective evidence that an impairment loss has occurred, for example this may be indicated by the disappearance of an active market. For available for sale debt securities particular consideration is given to evidence of any significant difficulty of the issuer or measurable decrease in the estimated cash flows from the investments.

1.4.2.2 Past due but not impaired

Investment securities are considered past due where the contractual interest or principal payments are in arrears and it is determined that the Group will be able to collect all principal and interest outstanding according to the contractual terms of the agreements.

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued
1.4.2.3 Neither past due nor impaired
The Group only invests in high quality treasury assets. Within the investment securities portfolio 89% (2010: 82%) of exposures have an external credit rating equivalent to Fitch A or above.

1.4.3 Loans and advances to banks
None of the Group's exposures to loans and advances to banks are impaired. The Group considers that its exposures to loans and advances to banks are all of low to medium risk.

1.5 Eurozone risk
The Group remains a low risk UK based operation. It has no sovereign exposure to 'peripheral' eurozone countries (Portugal, Ireland, Italy, Greece and Spain). As at 31 December 2011 the Group had a £90m (2010: £nil) exposure to the Government of Finland, repayable in over one year. It held no other European sovereign debt.

The Group has no direct exposure to Greek financial institutions or any other counterparties. Other peripheral eurozone country limits and counterparty limits have continued to be managed downwards. Higher risk eurozone exposures to financial institutions, namely those to the other peripheral eurozone countries and Belgium, continue to be closely monitored. Management action has been proactively taken and, where necessary, additional actions are taken in light of any downgradings.

1.5.1 Direct exposures
The analyses on the following pages set out the Group's exposures to financial institutions in European countries, both by asset maturity and by asset type.

The Group has exposures to financial institutions in the following European countries at 31 December 2011:

Country	Repayable within 30 days	Repayable within 1 year but more than 30 days	Repayable in over 1 year	Credit risk mitigation	Total exposure
2011					
Austria	**–**	**44.2**	**–**	**(4.1)**	**40.1**
Belgium	**–**	**20.0**	**34.0**	**(34.0)**	**20.0**
Denmark	**7.8**	**–**	**–**	**–**	**7.8**
Finland	**–**	**–**	**–**	**–**	**–**
France	**174.7**	**5.3**	**135.3**	**–**	**315.3**
Germany	**39.2**	**104.5**	**38.4**	**(15.7)**	**166.4**
Ireland	**5.0**	**25.0**	**–**	**–**	**30.0**
Italy	**–**	**–**	**–**	**–**	**–**
Netherlands	**0.1**	**40.2**	**210.6**	**–**	**250.9**
Portugal	**–**	**33.5**	**–**	**–**	**33.5**
Spain	**59.0**	**84.2**	**33.6**	**(31.5)**	**145.3**
Sweden	**10.2**	**10.0**	**7.3**	**–**	**27.5**
Switzerland	**73.1**	**10.0**	**413.8**	**(263.6)**	**233.3**
	369.1	**376.9**	**873.0**	**(348.9)**	**1,270.1**

Country	Repayable within 30 days	Repayable within 1 year but more than 30 days	Repayable in over 1 year	Credit risk mitigation	Total exposure
2010					
Austria	–	–	40.1	–	40.1
Belgium	98.1	43.0	45.8	–	186.9
Denmark	–	5.2	0.4	–	5.6
Finland	–	25.0	–	–	25.0
France	365.8	491.7	227.8	(273.5)	811.8
Germany	238.5	–	157.9	–	396.4
Ireland	–	98.8	32.9	–	131.7
Italy	260.8	150.8	–	–	411.6
Netherlands	10.1	–	–	–	10.1
Portugal	–	–	34.4	–	34.4
Spain	226.7	91.2	198.7	(32.7)	483.9
Sweden	–	–	–	–	–
Switzerland	0.5	17.0	140.3	(73.6)	84.2
	1,200.5	922.7	878.3	(379.8)	2,621.7

For the purposes of the above table, exposures to counterparties which comprise subsidiaries of larger banking groups have been aggregated at the group level with the associated risk country being that of the ultimate parent entity.

1. Credit risk continued

Credit risk mitigation takes the form of UK gilt collateral held in relation to reverse repo transactions, cash collateral held in relation to sold repo and derivative transactions, and Government guarantees (including £34.0m by the Belgian government) in relation to specific debt security holdings.

As at 31 December 2011, exposure to European multilateral development banks (not included in the above table given the supranational status associated with these institutions) stood at £529.0m (2010: £48.1m) before credit risk mitigation (£457.5m post-credit risk mitigation (2010: £48.1m)) of which £81.8m matures within a year.

Ongoing exposure to 'peripheral' eurozone counterparties is primarily restricted to short dated money market lending. Where investment assets are held for peripheral eurozone counterparties these are deemed to be in run-off, with associated counterparty and country limits reducing upon maturity or sale.

The table below shows the Group's exposure to financial institutions in European countries by asset type.

Country	Bank and money market balances	Bonds	Derivatives	Other	Total exposure
2011					
Austria	**–**	**40.1**	**–**	**–**	**40.1**
Belgium	**–**	**20.0**	**–**	**–**	**20.0**
Denmark	**1.0**	**–**	**–**	**6.8**	**7.8**
Finland	**–**	**–**	**–**	**–**	**–**
France	**–**	**63.2**	**24.4**	**227.7**	**315.3**
Germany	**0.2**	**103.3**	**23.9**	**39.0**	**166.4**
Ireland	**–**	**30.0**	**–**	**–**	**30.0**
Italy	**–**	**–**	**–**	**–**	**–**
Netherlands	**0.1**	**250.8**	**–**	**–**	**250.9**
Portugal	**–**	**33.5**	**–**	**–**	**33.5**
Spain	**–**	**126.3**	**19.0**	**–**	**145.3**
Sweden	**20.2**	**7.3**	**–**	**–**	**27.5**
Switzerland	**20.7**	**–**	**53.3**	**159.3**	**233.3**
	42.2	**674.5**	**120.6**	**432.8**	**1,270.1**

Country	Bank and money market balances	Bonds	Derivatives	Other	Total exposure
2010					
Austria	–	40.1	–	–	40.1
Belgium	124.3	62.6	–	–	186.9
Denmark	–	5.1	0.4	0.1	5.6
Finland	–	25.0	–	–	25.0
France	526.1	228.8	36.5	20.4	811.8
Germany	262.6	103.1	30.5	0.2	396.4
Ireland	10.5	118.4	2.8	–	131.7
Italy	290.8	120.8	–	–	411.6
Netherlands	10.0	–	–	0.1	10.1
Portugal	–	34.4	–	–	34.4
Spain	256.7	190.1	37.1	–	483.9
Sweden	–	–	–	–	–
Switzerland	–	17.0	66.7	0.5	84.2
	1,481.0	945.4	174.0	21.3	2,621.7

In addition to the above exposures to financial institutions, in the overseas European Economic Area (EEA as defined by the European Banking Authority) and Switzerland, corporate customer exposures at 31 December 2011 totalled £184.4m (2010: £194.6m). There are no exposures to retail customers based outside of the UK and Channel Islands.

The Group continues to monitor developments daily across all countries as they affect the Treasury portfolio. A number of pro-active management actions have been taken to reduce the risk, stress the portfolio and anticipate future downward rating actions. These include significant tenor reductions to improve flexibility, active limit management and revised strategy to take on more secured trading and lower risk business. Regular stress testing of the entire credit limits portfolio is undertaken.

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued
Treasury operates a risk based approach which monitors counterparty limits and exposure via a credit risk register. The counterparties or the assets held are monitored against a Board approved matrix of risk tolerance and associated RAG (Red, Amber, Green) indicators. The credit risk register is updated for rating actions, market events and financial results as they are announced which may influence a change in risk status and possible escalation requiring management actions and inclusion on the watchlist.

The Treasury risk team reviews the entire portfolio and watchlists monthly for appropriate risk status bandings. The Exposures Committee reviews the watchlist on a monthly basis and provide its observations and required management actions as appropriate.

Red watchlist exposures totalled £277m as at 31 December 2011, this comprised holdings in FRNs issued by German (£75m), Irish (£30m) and Portuguese (£34m) financial institutions. Of these, FRNs totalling £202m reached maturity and were repaid in full during January and February 2012, the remaining £75m Red watchlist exposures being to German (£25m) and Spanish (£50m) financial institutions with the latest maturity dates 1 June 2012 (Spain) and 24 August 2012 (Germany).

1.5.2 Indirect exposures
Treasury risk management monitoring extends beyond the direct risk incurred through counterparty trading, to the underlying exposures (eg to peripheral eurozone countries) which Treasury's counterparties may maintain on their own balance sheets. In analysing each counterparty's secondary exposure we assess the vulnerability and impact on that firm if it suffered different degrees of losses. We also perform stress testing to assess the impact of potential further downgrades on the credit risk of our exposure.

Where secondary sovereign exposure is deemed to undermine the performance of the counterparty, remedial management actions are taken in respect of Treasury's counterparty limits and exposure, often well ahead of any associated rating actions.

2. Liquidity risk
2.1 Capital and liquidity framework
The Group's capital and liquidity management framework comprises:

- an asset and liability management control programme;
- risk, capital and liquidity quantification and mitigation techniques and processes;
- management actions linked through to stress testing and capital and liquidity planning models, enabling a method of mitigating the effects of a severe but plausible economic stress;
- defined processes to invoke necessary management actions detailed in the Internal Capital Adequacy Assessment Process (ICAAP) submission document;
- 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;
- a defined risk appetite, controls and governance in the Group's capital and liquidity management policies; and
- detailed and documented ongoing development and embedding plans for capital adequacy, capital allocation and risk appetite development.

Impacts on capital and liquidity of a severe economic downturn are stress tested to ensure sufficient and proactive management actions, triggers, systems and controls are in place.

The risk appetite reflects the amount and type of risk that the Group is prepared to seek, accept or tolerate as defined in the following four capital objectives:

- maintain capital quantity and quality adequate to cover existing and projected risks in the business;
- maintain capital adequate to be confident of weathering extreme but plausible market scenarios;
- maintain operations such that we are confident that our customer service and our reputation are sustained in extreme but plausible scenarios; and
- generate good, stable returns for members.

The Group is progressing towards implementation of Basel III and other UK and EU risk and capital legislative requirements. These include the Capital Requirements Directive IV and considerations resulting from the reports issued by the Independent Commission on Banking.

2.2 Liquidity risk
2.2.1 Overview
Liquidity risk arising from the structure of the balance sheet (structural liquidity) is managed in line with policies developed by ALCO. The Group's liquidity management policies are reviewed and approved annually by the RC (on behalf of the Board) and compliance reviewed monthly by ALCO. The Group's policy is to ensure that sufficient funds are available at all times to meet demands from depositors, to fund agreed advances, to meet other commitments as and when they fall due, and to ensure the Board's risk appetite is met.

The Group operates within a liquidity risk framework of stress testing combined with a number of strategic and tactical measures which feed into an overall liquidity status score. This is supported with detailed contingency funding plans which are tested and reviewed on a regular basis. The Group's liquidity management framework is designed in line with FSA BIPRU regulations and industry guidelines, including Institute of International Finance and Bank for International Settlements recommendations.

The Board's risk appetite for liquidity risk is defined as survival in a number of stress scenarios, adherence to specific ratios and compliance with all regulatory limits. The stress tests encompass survival across various timescales and a range of adverse liquidity events, both firm specific and market wide, which cover all aspects of the liquidity risk to which the Group is exposed.

The Group monitors its liquidity position on a daily basis against the Board approved liquidity risk appetite and stress scenario. It also monitors the adequacy of its controls to provide assurance that liquidity risk is being appropriately managed, and regularly assesses its funding position.

2. Liquidity continued

The Group manages liquidity risk by applying:

- a systematic control process embedded in the Group's operations; and
- controlled end to end liquidity management with:
  - net outflows monitored to ensure they are within FSA limits;
  - maintenance of a diversified funding base;
  - management of liquid assets: high quality primary liquidity including cash and gilts, along with secondary liquidity including certificates of deposit;
  - target strategic ratios; and
  - stress testing.

The strategic measures approved by the Board and monitored monthly are:

- wholesale borrowing ratio, 17.8% (2010: 17.2%) – the amount of wholesale borrowing compared to total liabilities;
- liquid asset ratio, 15.5% (2010: 9.8%) – amount of total assets that are unencumbered high quality liquid assets as defined under BIPRU; and
- customer loan/deposit ratio, 93.9% (2010: 102.5%) – the ratio of customer loans to customer deposits.

Day to day cash flow (tactical liquidity) is managed within guidelines laid down by ALCO and in accordance with the standards established for all banks by the FSA.

The Group has a high proportion of retail assets funded by retail deposits demonstrated by the loan/deposit ratio which averaged 99.3% during 2011, ensuring there is no over reliance on wholesale funding. There are customer funding and wholesale funding target ratios as described above which are set in line with the Board approved strategic plan. The Group's structural liquidity risk management is therefore retail based and is dependent on behavioural analysis of both customer demand and deposit and loan drawdown profiles by product category, based on experience over the last ten years. The behaviour of retail products is reviewed by ALCO and, in addition, the Group has maturity mismatch limits to control the exposure to longer term mismatches.

The Group continually reviews its structural funding position and is confident that current funding plans will ensure that it will meet the requirements of the net stable funding ratio proposed by Basel III.

Marketable assets are maintained as a liquidity pool against potential retail outflows. The liquidity pool is the highest quality debt and consists of government issued debt and cash at the Bank of England. Liquid assets increased at the end of 2011 as demonstrated by a liquid asset ratio of 15.5%, having averaged 12.1% during 2011 as a whole.

The table below shows the market value and composition of the liquid asset buffer:

	2011	2010
Qualifying stock		
Operational balances with central banks (note 13)	**6,378.3**	1,443.7
Treasury bills	**–**	1,997.6
Gilts	**1,085.5**	903.3
Multilateral development banks	**162.1**	50.9
	7,625.9	4,395.5

The Group has access to a variety of medium term wholesale funding sources: securitisation, regulated covered bond and Euro Medium Term Notes. The Group will issue from the programmes as funding requirements and market conditions permit.

ALCO discusses the actual liquidity position and projected position incorporating business plans. More frequent meetings are held if necessary, when the markets have a heightened period of stress or liquidity shortage. The meetings ensure that the business plans are accurate and can be flexed as required.

The Group's primary objective in respect of secured funding is to raise longer term funds (over one year in duration) and to diversify the source of funds from wholesale means to support the business plan of the Group. The Group ensures that sufficient eligible and unencumbered assets are available at all times to meet the needs of its secured funding programmes. For further details of encumbered assets see note 15 and note 35 regarding assets pledged.

2.2.2 Liquidity gap

The Group's liquidity position is monitored on a daily basis and reported to ALCO. Treasury holds a pool of liquid assets on behalf of the Group, and management actions are in place to provide additional liquidity when required. These sources of liquidity are held in order to be available to meet unexpected liquidity requirements.

The Group manages liquidity on a behavioural rather than contractual basis, reflecting where actual behaviour differs from contractual maturity:

- retail and corporate deposit bases are very stable, with deposits being attracted to the Group by good customer service and its ethical policy. As a result, the deposit base remains stable although the contractual maturity is immediate for instant access deposits; and
- personal loan and visa balances are repaid earlier than their contractual maturity date.

2.2.3 Gross cashflow maturity analysis

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

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

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

2. Liquidity continued

2011 Group Contractual cash flows	Carrying value	Gross nominal outflow	Less than 1 month	1–3 months	3–12 months	1–5 years	Over 5 years
Non-derivative liabilities							
Deposits by banks	**3,302.7**	**3,397.1**	**1,591.2**	**583.9**	**323.1**	**898.9**	**–**
Customer accounts	**34,990.6**	**35,109.5**	**23,457.6**	**2,540.4**	**7,126.5**	**1,985.0**	**–**
Customer accounts – capital bonds	**1,429.8**	**1,420.3**	**–**	**97.9**	**425.3**	**892.4**	**4.7**
Debt securities in issue	**4,164.8**	**5,187.2**	**147.8**	**138.7**	**186.9**	**3,264.7**	**1,449.1**
Other borrowed funds	**1,258.8**	**2,305.8**	**7.2**	**4.6**	**77.1**	**878.6**	**1,338.3**
Amounts owed to other Co-operative Group undertakings	**132.3**	**132.3**	**132.3**	**–**	**–**	**–**	**–**
	45,279.0	**47,552.2**	**25,336.1**	**3,365.5**	**8,138.9**	**7,919.6**	**2,792.1**
Derivative liabilities							
Net outflow	**1,087.9**	**2,137.0**	**284.5**	**31.3**	**204.9**	**559.7**	**1,056.6**
	46,366.9	**49,689.2**	**25,620.6**	**3,396.8**	**8,343.8**	**8,479.3**	**3,848.7**
Other liabilities	**315.6**	**–**	**–**	**–**	**–**	**–**	**–**
Total recognised liabilities	**46,682.5**	**49,689.2**	**25,620.6**	**3,396.8**	**8,343.8**	**8,479.3**	**3,848.7**
Unrecognised loan commitments	**4,752.7**	**4,752.7**	**4,571.3**	**160.6**	**20.8**	**–**	**–**
Total liabilities	**51,435.2**	**54,441.9**	**30,191.9**	**3,557.4**	**8,364.6**	**8,479.3**	**3,848.7**
Behavioural adjustments							
Customer accounts	**–**	**–**	**(20,526.5)**	**464.1**	**1,230.3**	**18,832.1**	**–**
Debt securities in issue	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Total liabilities – behavioural	**51,435.2**	**54,441.9**	**9,665.4**	**4,021.5**	**9,594.9**	**27,311.4**	**3,848.7**

2010 Group Contractual cash flows	Carrying value	Gross nominal outflow	Less than 1 month	1–3 months	3–12 months	1–5 years	Over 5 years
Non-derivative liabilities							
Deposits by banks	2,938.6	2,931.0	776.3	415.8	774.4	964.5	–
Customer accounts	32,320.0	32,588.8	20,347.0	1,856.8	6,811.5	3,573.5	–
Customer accounts – capital bonds	1,794.7	1,749.4	11.4	64.1	254.8	1,362.6	56.5
Debt securities in issue	4,212.2	5,006.4	303.9	695.6	397.4	1,172.4	2,437.1
Other borrowed funds	975.4	1,799.6	45.8	4.7	58.0	420.8	1,270.3
Amounts owed to other Co-operative Group undertakings	188.5	188.5	188.5	–	–	–	–
	42,429.4	44,263.7	21,672.9	3,037.0	8,296.1	7,493.8	3,763.9
Derivative liabilities							
Net outflow	702.4	794.2	139.5	37.5	121.6	295.5	200.1
	43,131.8	45,057.9	21,812.4	3,074.5	8,417.7	7,789.3	3,964.0
Other liabilities	376.4	–	–	–	–	–	–
Total recognised liabilities	43,508.2	45,057.9	21,812.4	3,074.5	8,417.7	7,789.3	3,964.0
Unrecognised loan commitments	4,759.5	4,759.5	4,499.3	62.5	188.2	9.5	–
Total liabilities	48,267.7	49,817.4	26,311.7	3,137.0	8,605.9	7,798.8	3,964.0
Behavioural adjustments							
Customer accounts	–	–	(18,159.2)	234.3	(2,597.7)	20,522.6	–
Debt securities in issue	–	(25.7)	–	(25.7)	–	–	–
Total liabilities – behavioural	48,267.7	49,791.7	8,152.5	3,345.6	6,008.2	28,321.4	3,964.0

The Bank's gross cashflow maturity analysis has not been disclosed as it is not materially different from the above Group disclosure.

3. Market risk

The Group's market risk includes interest rate risk, interest basis risk and currency risk. The majority of the Group's market risk arises from changes in interest rates.

3.1 Interest rate risk

Interest rate risk policy statements, approved by the RC on behalf of the Board, specify the scope of the Group's wholesale market activity, market risk limits and delegated authorities. The policy is managed by ALCO. Its prime task is to assess the interest rate risk inherent in the maturity and repricing characteristics of the Group's assets and liabilities. The Group seeks to minimise the volatility of future earnings from interest rate changes and all interest rate risk exposure is removed from the retail and CABB 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 Group. 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 ALCO reviews the balance sheet risk position and the utilisation of wholesale market risk limits.

3.1.1 Non-treasury interest rate risk

The Group (excluding wholesale) uses a gap report and earnings approach for managing interest rate risk, focusing in detail on the sensitivity of assumed changes in interest rates on net interest income for one year. Higher level analysis is performed for subsequent years.

ALCO monitors the non-trading interest rate risk which is split between certain wholesale portfolios, banking and investment books, and the rest of the Group's balance sheet. The following describes the Group 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 (including non-maturity deposits) is no more than a set limit.

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. Drawdown risk, in particular for fixed rate mortgages, is managed through weekly balance sheet meetings. The balance sheet management team undertakes 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 Group to income volatility if indices do not move in a ratio of one to one. This risk is managed by performing a future simulation of the balance sheet to establish what the Group's income volatility would be if the rates do not move in a one for one ratio. Cash placements are then undertaken with the Treasury markets team to reduce the income volatility. The Treasury markets team executes external trades as required.

The table below illustrates the sensitivity analysis relating to the Group, a primary measure in the approach to managing interest rate risk.

The table illustrates the greater than 12 month net gap position at the end of the year on the Group'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 Group is not exposed to sudden rate movement. The net position shows the amount that the Group is either over or under invested in the month. A £100m gap position would equate to the Group being exposed to income variation of £1m per annum if rates moved by 1%, so the maximum position equates to approximately £8m income exposure if rates moved by 1%.

	Net greater than 12 month position	
	2011	2010
At the year end	**(279)**	(204)
Average for the period	**(330)**	(69)
Maximum sensitivity for the period	**806**	(876)
Minimum sensitivity for the period	**(51)**	56

3.1.2 Treasury interest rate risk

Treasury executes short term funding and hedging transactions with the wholesale markets on behalf of the Group and its customers. It also generates incremental income from proprietary trading within strict risk limits. There are two prime measures of risk supplemented by additional controls such as maturity and stop loss limits.

3.1.2.1 Value at risk (VaR)

VaR measures the daily maximum potential gain or loss due to market volatility within a statistical confidence level of 95% and a one day holding period. The VaR methodology used is historical simulation using a time series of one year to latest day and was £0.35m at 31 December 2011 for the Treasury traded portfolios. The VaR methodology has inherent limitations in that market volatility in the past may not be a reliable predictor of the future, and may not reflect the time required to hedge or dispose of the position. Hence VaR is not used as the sole measure of risk.

3.1.2.2 PV100

This illustrates the change in valuation on a fixed income portfolio experienced given a 1% increase and decrease in interest rates for Treasury, representing Treasury banking book and trading book combined. PV100 is the effect on the net present value (NPV) of the Treasury portfolio to a parallel shift of 100 basis points upon the base yield curve. The effects of a 1% increase in interest rates are £15.1m (2010: (£11.0m)) and a 1% decrease (£16.0m) (2010: £9.1m).

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

3. Market risk continued
3.2 Currency risk
The Group's treasury foreign exchange activities primarily:

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

The table below provides an analysis of the Group's assets and liabilities by currency:

	31 December 2011					31 December 2010				
Group	**£**	**$**	**€**	**Other**	**Total**	£	$	€	Other	Total
Assets										
Cash and balances at central banks	**6,696.6**	**–**	**–**	**–**	**6,696.6**	1,735.6	–	–	–	1,735.6
Loans and advances to banks	**1,568.1**	**59.5**	**373.4**	**5.5**	**2,006.5**	1,879.9	35.4	475.3	3.5	2,394.1
Loans and advances to customers	**33,513.4**	**54.7**	**157.3**	**40.6**	**33,766.0**	34,797.5	50.3	114.4	15.1	34,977.3
Fair value adjustments for hedged risk	**366.3**	**–**	**–**	**–**	**366.3**	166.8	–	–	–	166.8
Investment securities – loans and receivables	**656.8**	**16.2**	**131.9**	**–**	**804.9**	1,500.0	68.1	294.0	55.2	1,917.3
Investment securities – available for sale	**3,127.8**	**124.7**	**170.5**	**–**	**3,423.0**	1,871.7	379.8	444.9	260.7	2,957.1
Investment securities – at fair value through income or expense	**335.8**	**–**	**7.3**	**–**	**343.1**	28.7	–	–	–	28.7
Derivative financial instruments	**975.3**	**0.2**	**0.3**	**–**	**975.8**	975.2	0.1	0.3	–	975.6
Equity shares	**5.7**	**–**	**–**	**–**	**5.7**	7.2	–	–	–	7.2
Investments in Group undertakings	**2.7**	**–**	**–**	**–**	**2.7**	2.5	–	–	–	2.5
Goodwill	**0.6**	**–**	**–**	**–**	**0.6**	0.6	–	–	–	0.6
Intangible fixed assets	**40.7**	**–**	**–**	**–**	**40.7**	45.1	–	–	–	45.1
Investment properties	**172.7**	**–**	**–**	**–**	**172.7**	162.3	–	–	–	162.3
Property, plant and equipment	**80.1**	**–**	**–**	**–**	**80.1**	98.5	–	–	–	98.5
Amounts owed by other Co-operative Group undertakings	**179.2**	**–**	**–**	**–**	**179.2**	0.6	–	–	–	0.6
Other assets	**44.9**	**0.2**	**1.5**	**–**	**46.6**	3.5	0.7	2.9	1.7	8.8
Prepayments and accrued income	**18.7**	**–**	**–**	**–**	**18.7**	16.2	–	–	–	16.2
Deferred tax assets	**26.4**	**–**	**–**	**–**	**26.4**	87.0	–	–	–	87.0
Total assets	**47,811.8**	**255.5**	**842.2**	**46.1**	**48,955.6**	43,378.9	534.4	1,331.8	336.2	45,581.3
Liabilities										
Deposits by banks	**2,567.3**	**260.6**	**474.7**	**0.1**	**3,302.7**	1,480.8	473.0	840.4	144.4	2,938.6
Customer accounts	**34,899.1**	**35.5**	**52.3**	**3.7**	**34,990.6**	32,205.8	23.6	88.9	1.7	32,320.0
Customer accounts – capital bonds	**1,429.8**	**–**	**–**	**–**	**1,429.8**	1,794.7	–	–	–	1,794.7
Debt securities in issue	**4,039.4**	**–**	**125.4**	**–**	**4,164.8**	4,007.4	–	204.8	–	4,212.2
Derivative financial instruments	**1,083.7**	**1.3**	**2.9**	**–**	**1,087.9**	689.2	5.2	6.8	1.2	702.4
Other borrowed funds	**1,229.5**	**–**	**29.3**	**–**	**1,258.8**	975.4	–	–	–	975.4
Amounts owed to other Co-operative Group undertakings	**132.3**	**–**	**–**	**–**	**132.3**	188.5	–	–	–	188.5
Other liabilities	**172.9**	**0.3**	**0.5**	**–**	**173.7**	141.3	1.5	2.8	1.2	146.8
Accruals and deferred income	**39.9**	**–**	**–**	**–**	**39.9**	131.3	–	–	–	131.3
Provisions for liabilities and charges	**102.0**	**–**	**–**	**–**	**102.0**	55.8	–	–	–	55.8
Current tax liabilities	**–**	**–**	**–**	**–**	**–**	42.5	–	–	–	42.5
Total liabilities	**45,695.9**	**297.7**	**685.1**	**3.8**	**46,682.5**	41,712.7	503.3	1,143.7	148.5	43,508.2
Net on balance sheet position	**2,115.9**	**(42.2)**	**157.1**	**42.3**	**2,273.1**	1,666.2	31.1	188.1	187.7	2,073.1

The Bank's currency analysis has not been disclosed as it is not materially different from the above Group disclosure.

At 31 December 2011 the Group and Bank's open position was £0.4m (2010: £0.4m) representing a potential loss of £nil given a 3% depreciation in sterling (2010: £nil). The open position is monitored against limits in addition to limits in place on individual currencies. All figures are in £ sterling equivalent.

Unaudited risk management disclosures

The following risk management disclosures, operational risk and additional risks, do not form part of the audited accounts and are not audited.

4. Operational risk

Operational risk includes internal and external fraud, loss or theft of confidential customer information, loss of key personnel, system capacity issues or programme failure and external events over which the Banking Group has limited controls such as terrorist attack.

In order to meet the Banking Group's appetite for operational risk, it ensures appropriate controls are in place to minimise the chance of any significant disruption and to protect our reputation.

Operational risks are identified, managed and mitigated through ongoing risk management practices including risk assessments, formal control procedures and contingency planning. Operational risks and key controls are formally reviewed on a regular basis. Significant operational risks and the associated capital requirements are regularly reported to the ORC, and the RC. These meet regularly to monitor the suitability of the risk management framework and management of significant risks within the Banking Group.

Business continuity is managed by the Operational Risk function and sets out to minimise the risk of disruption in the event of a sudden, unplanned occurrence that could seriously disrupt business operations. This includes developing and exercising crisis and incident management teams to maintain appropriate preparedness in the event of a major operational disruption.

The Banking Group also has a corporate insurance programme to transfer specific risks to insurers as part of its risk management approach.

The Banking Group has a significant change agenda to transform the business. To support this agenda, a transformation risk category has been created to ensure that the management of risks around the design, development and implementation of change is in line with risk appetite.

5. Additional risks

In addition to the significant risks covered above, the following risks are also reported and managed in the Banking Group's risk management framework:

- Co-operative group-wide risks, to include pension, reputation and contagion risk;
- business model and external risk;
- securitisation risk; and
- conduct risk.

5.1 Co-operative group-wide risks

5.1.1 Pension risk

Pension risk is the risk of the Group being unable to meet its pension scheme commitments. Risks are identified at The Co-operative Group level, with the impact of any potential changes to contribution assessed under the Group's risk management framework.

The combined entity is exposed to two distinct areas of pension risk:

- PACE – CFS Management Services Ltd (CFSMS) and the Bank are participating members of The Co-operative Group Pension (Average Career Earnings) – defined benefit scheme; and
- Britannia Pension Scheme – the Group is a participating member of the Britannia Pension Scheme – defined benefit and contribution sections (defined benefit section closed to new members since 2001).

The Co-operative Group, alongside the scheme trustee, is responsible for the risk management arrangements for PACE, agreeing suitable contribution rates, investment strategies and for taking professional advice as appropriate.

CFSMS, alongside the scheme trustee, is responsible for the risk management arrangements for the Britannia Pension Scheme, agreeing suitable contribution rates, investment strategies and for taking professional advice as appropriate.

The Group is therefore exposed to potential future increases in required contributions.

5.1.2 Reputation risk

We define reputation risk as a failure to proactively develop, protect and optimise the value of the brands of The Co-operative Banking Group of companies through inappropriate strategic decisions, poor business performance, operational failure or negative external perception.

As part of the assessment and control of this risk, our business performance and risk profile across all of our risk themes are closely monitored and reviewed. We also proactively monitor and manage media coverage and public and customer opinion, and work closely with external rating agencies to ensure a fair and balanced representation. We believe this approach helps maintain member, customer and market confidence.

5.1.3 Contagion risk

Contagion risks are those risks that could originate from elsewhere in the Group impacting upon entities within the Banking Group.

The Banking Risk Officer for the Group reports directly to the Chief Risk Officer (CRO) for The Co-operative Banking Group, who also acts as the Group Risk Director for the wider Co-operative Group. In addition to attending the Banking Group Risk Committee, the CRO also attends The Co-operative Group Risk and Audit Committee. This allows the CRO to have an independent and holistic view of the risk profile across The Co-operative Group.

5.2 Business model and external risk

Business model and external risk arises from changes to the Banking Group's business and the environment in which it operates, specifically the risk of not being able to carry out the Banking Group's business plan and desired strategy.

The Group's strategy is to grow our business in order to achieve the Banking Group's vision of becoming the compelling, co-operative alternative in the markets in which we compete.

The main challenges to the business plan and strategy are the uncertain economic environment, the changing regulatory environment and the significant internal change programme being managed within the Group and the wider Co-operative Group.

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

5. Additional risks continued
The Board and Executive set and monitor the strategic plan in light of this background having considered the stresses that extreme but plausible scenarios could have upon it.

5.3 Securitisation risk
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 (SPEs). The pool of mortgage loans is used to back the issuance of new securities, allowing the credit rating of the securities to be separated from the credit rating of the original company. The Group 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 Group.

Asset based securitisation investment is 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.

Securitisation risk is the residual credit risk arising from retaining an interest in the Group's securitisation companies through the provision of subordinated debt or start up expense loans and liquidity facilities where applicable. However, the majority of the risk and rewards in respect of the underlying mortgage loan pools are retained by the Group. SPEs are included as subsidiaries in the consolidated financial statements with the Group 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 Group has only acted as mortgage originator, servicing agent, and liquidity facility provider in respect of its own securitisations. The Group 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 rules.

The Group had previously claimed regulatory capital relief in relation to Leek Finance Number Eighteen plc (Leek 18) and Leek Finance Number Nineteen plc (Leek 19) in accordance with the terms of the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU9). Following the restructuring of these transactions, initially announced in March 2011, the Group was regarded as providing non-contractual support to Leek 18 and Leek 19. Regulatory capital relief for Leek 18 and Leek 19 was therefore discontinued from June 2011 and in respect of future securitisations for the foreseeable future. No outstanding securitisations afford the Group regulatory capital relief.

5.4 Conduct risk
Conduct risk is the failure to ensure the fair treatment of customers leading to poor outcomes for customers.

The environment could create new risks in different ways. New risks could arise through neglecting post sales service and in not properly considering the intended audience in complex new product design, development and sales processes.

The Banking Group mitigates and prevents emerging conduct risk through the application of appropriate risk management, controls and ongoing oversight and monitoring provided by established Risk and Compliance functions.

Significant conduct risks are regularly monitored and reported up to and challenged by the Risk Committee.

Capital management

For the year ended 31 December 2011

All the amounts are stated in £m unless otherwise indicated

Capital resources

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. However, the Group still recognises the need to maintain a balance between the potential higher returns that might be achieved with greater gearing, and the advantages and security afforded by a sound capital position.

Our submissions to the FSA in the period have shown that the Bank and its individually regulated operations have complied with all externally imposed capital requirements.

The Group's capital position remains resilient with a year end core tier one position of 9.6% (2010: 9.6%).

Adequate capitalisation can be maintained at all times even under the most severe stress scenarios including the revised FSA 'anchor' stress scenario.

A capital buffer above Individual Capital Guidance (ICG) is being maintained, demonstrating that there is currently more than sufficient surplus capital to cover the Group's PPI risk.

During the year a number of management actions have been implemented to maintain a sufficient level of capital. These include a £87.0m capital contribution from The Co-operative Banking Group, the restructuring of certain securities issued under a securitisation programme (Leeks 17, 18 and 19) and the exchange and issuance of subordinated debt.

The Group's regulatory capital is analysed into two tiers:

Tier one capital

Tier one capital includes share capital, retained earnings, and non-cumulative irredeemable preference shares. Retained earnings exclude gains or losses on cashflow hedges and available for sale assets.

Tier two capital

Revaluation reserves relating to net gains on equity held in the available for sale financial assets category are included in tier two capital.

The tier two capital includes six subordinated debt issues and two tranches of perpetual subordinated bonds (PSBs). The rights of payment to the holders of this debt are subordinated to the claims of depositors and other creditors of the Bank. More information on these can be found in note 29.

	2011	2010
Reconciliation of equity per balance sheet to core tier one capital		
Total equity per balance sheet	**2,273.1**	2,073.1
Regulatory adjustments		
Minority interests	**(1.2)**	(1.4)
Retained earnings	**(49.8)**	(18.6)
Available for sale reserve	**(19.5)**	13.1
Cashflow hedging reserve	**(67.6)**	(36.9)
Core tier one capital before regulatory deductions	**2,135.0**	2,029.3

Capital management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

Capital resources continued

	2011	2010
Core tier one capital		
Permanent share capital	**410.0**	410.0
Retained earnings	**1,686.0**	1,562.8
Minority interests	**30.2**	31.6
Interim profit	**–**	16.1
Share premium account	**8.8**	8.8
	2,135.0	2,029.3
Other tier one capital		
Non-cumulative irredeemable preference shares	**60.0**	60.0
Total tier one capital before regulatory deductions	**2,195.0**	2,089.3
Intangible assets	**(71.1)**	(69.0)
Expected loss shortfall	**(114.2)**	(50.9)
Securitisation positions	**(2.3)**	(34.4)
Material holdings	**(1.3)**	(1.3)
Total tier one capital after regulatory deductions	**2,006.1**	1,933.7
Tier two capital		
Revaluation reserves	**2.9**	2.9
Collective provisions	**0.7**	–
Subordinated notes and perpetual subordinated bonds	**1,084.0**	884.6
Total tier two capital before regulatory deductions	**1,087.6**	887.5
Expected loss shortfall	**(114.2)**	(50.9)
Securitisation positions	**(2.3)**	(34.4)
Material holdings	**(1.3)**	(1.3)
Total tier two capital after regulatory deductions	**969.8**	800.9
Total capital resources	**2,975.9**	2,734.6

The capital ratios reported in the business and financial review are based on the Pillar 1 capital requirement.

Capital allocation
The allocation of capital among specific operations and activities is driven by optimisation of the return achieved on the capital allocated, and is based upon the regulatory capital. Capital allocation is undertaken independently of those responsible for capital management, and is reviewed by ALCO. Each new product must earn at least the Bank's minimum target return on equity.

Basel III
The Group is working towards compliance with the lastest banking accord, Basel III. It expects to be able to comply fully with the new requirements when they become applicable, including the minimum leverage ratio of 3%.

Critical judgments and estimates

For the year ended 31 December 2011

All the amounts are stated in £m unless otherwise indicated

1. Overview

The Group makes critical judgments and estimates which affect its reported assets, liabilities and profits. Estimates are calculated using various assumptions. Critical judgments and the assumptions used in calculating estimates are continually assessed and reviewed, and are based on historical experience and reasonable expectations of future events. Actual results may differ from these judgments and estimates.

2. Loans and advances

a. Overview

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

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

Where loans are subject to forbearance they may be treated as impaired.

b. Collective provisions

i. Retail

Personal advances are identified as impaired by taking account of the age of the debt's delinquency, the product type and the regularity of payments made whilst in arrears. The provision is calculated by applying a percentage rate to different categories and ages of impairment debt. The provision rates reflect the likelihood that the debt in that category/age will be written off or charged off at some point in the future. The rates are based on historical experience and current trends, incorporate the effects of discounting at the customer interest rate and are subject to regular review. The provision is the product of the rate and the balance for the relevant arrears band.

A key estimate within the provisioning model is the percentage of accounts that will be charged off. A 1% change would change the collective provision by £1.2m.

ii. Corporate

A new corporate collective provision, comprising £10.4m for Group and £4.7m for Bank, has been raised in 2011 reflecting the continuing difficulties and uncertainties currently being experienced in this sector. This provision is based upon a pool of accounts which have been identified as having higher levels of risk. These accounts have been assessed across a risk scale with risk factors of either 30% or 100% attached to each case depending on their position in the scale.

A key estimate within the corporate collective model is collateral valuation. A 10% movement in this estimate would change the provision by £3.0m.

c. Individual provisions

i. Retail

Mortgage accounts are identified as impaired and provided for on an individual basis by taking account of the age of the debt's delinquency on a case by case basis.

A total of £5.3bn of impaired Britannia loans and advances to customers were acquired at a deep discount due to estimated future credit losses. This discount is realised on the actual redemptions of the associated mortgages (mainly in Optimum). A key assumption in the judgment of estimated future credit losses is our estimate of future HPI movements. If future HPI movements were to differ from expectations by 5%, the impact on the estimate would be £7.6m.

A write back of £20.0m of the deep discount has been recognised during 2011 (2010: £15.0m) following a review of the other parameters of the model. Other parameters include forecasts of employment levels, interest rates and the number of accounts in arrears. Because of its steadily improving management of arrears levels, the Group believes there is potential for further write backs. However the level of write back recognised is prudent due to the remaining uncertainties in the exact timing of economic recovery.

ii. Corporate

Each corporate account is assessed and allocated a 'risk grade' to enable the Group to monitor the overall quality of its lending assets. Those of lesser quality, where the lending is potentially at risk and provisions for loss may be required, are centrally monitored with specific management actions taken at each stage within laid down procedures and specific provisioning criteria. Provisions represent the likely net loss after realisation of any security.

A key estimate within the corporate individual model is collateral valuation. A 10% movement in this estimate would change the provision by £7.0m.

For further information on credit risk and impairment see the risk management section on pages 48 to 64.

3. Effective interest rate

IAS 39 requires interest income to be recognised on an effective interest rate (EIR) basis, inclusive of directly attributable incremental transaction costs and fees, and discounts and premiums where appropriate.

The EIR basis spreads the interest income over the expected life of the instrument. The expected life of an instrument is the period from its inception up to its redemption or maturity date, ie for the mortgage portfolio it would be its redemption date, whilst for the non-mortgage portfolio it would be its maturity date.

On applying this approach to the mortgage portfolio, judgments are made in relation to estimating its average life. These judgments are made based on specific factors including product terms and historical repayment data. The estimates are updated in each reporting period to reflect actual performance. Key judgment areas, regularly reviewed for both current and expected levels of mortgage balance experience, are the average and total lives of the mortgage portfolio.

An increase or decrease in the average life by one year would increase or decrease gross interest income by 0.5% respectively.

During 2011, the Group's Optimum mortgage portfolio was remodelled to reflect current experience of rising average lives, ie higher mortgage balances than predicted. In updating for this trend, the Group expects a higher level of mortgage balances in the medium term but maintains its view that the total portfolio life will end by the year 2023. Extending the average mortgage lives also impacts on redemption rates of the debt securities in issue. The impact of increasing the mortgage redemptions by 10% per annum relating to debt securities in issue fair value adjustments is to decrease profits by a total of £5.7m in the years up to 2013 and to increase profits by the same amount in the following years up to 2017.

Critical judgments and estimates continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

4. Provisions for liabilities and charges
Provisions are carried in respect of certain known or forecast future expenditure, as described in note 32.

a. Financial Services Compensation Scheme levy
i. Background
The Financial Services Compensation Scheme (FSCS) provides compensation to customers of financial institutions in the event that an institution is unable to pay claims against it. As a result of a number of institutions' failures during 2008, the FSCS borrowed £19.7bn on an interest only basis initially until March 2012 from HM Treasury (HMT) in order to meet its obligations to the depositors. These borrowings are anticipated to be repaid wholly or substantially from the realisation of the assets of the failed institutions. The FSCS raises annual levies from the banking industry in order to meet its management expenses and compensation cost. The Group has provided £25.0m for its share of levies that will be raised by the FSCS including the interest on the loan from HMT in respect of the levy years to 31 March 2013. The provision includes estimates for the interest that the FSCS will pay on the loan and of the Group's market participation in the relevant periods.

ii. Current expectations of performance
The FSCS has announced new terms for the calculation of the interest being charged on the loan to the FSCS from HMT for the period commencing 1 April 2012 and thereafter. A rate of 12 month LIBOR plus 100bps will be charged.

For every 50bps that 12 month LIBOR is increased, the Group's year end provision for the FSCS levy would increase by £4.6m.

The FSCS has announced that it expects an additional capital levy totalling £802.0m will be charged in three roughly equal instalments beginning in 2013/14. We have complied with FSA guidance in not providing for such costs at this stage.

b. Payment protection insurance (PPI) provision
i. Background
In October 2010 a Judicial Review proceeding was brought by the British Bankers' Association against the FSA and the Financial Ombudsman Service with regard to the assessment and redress of PPI complaints. On 20 April 2011 the review concluded that cases of PPI complaints should be upheld. The Group subsequently announced it would not participate in any appeal against the UK High Court's judgment (note 32).

ii. Current position and expectations of PPI exposure
The Group has recognised a charge in 2011 of £90.0m (2010: £4.3m) for compensation relating to past sale of PPI policies. This provision represents management's best estimate of the anticipated costs of related customer contact and redress, including administration expenses. At 31 December 2011, after redress and operating costs paid during the year, the remaining provision was £61.7m.

The initial provision was based on the FSA's policy statement and industry claims experience. Its calculation required significant judgment by management in determining appropriate assumptions, which include the level of complaints, uphold rates, proactive contact and response rates and Financial Ombudsman Service referral and uphold rates. The remaining provision is currently management's best estimate of future settlements.

A 1% increase in the expected level of complaints would increase the provision by £0.4m.

5. Contingent consideration
At merger, a commitment was made to all former Britannia members that they would receive in their Co-operative dividend payment an amount equal to or above the amount they would have received in Britannia membership reward had Britannia remained a standalone entity. The Group accrued £47.8m for potential supplementary payments, which was treated as contingent purchase consideration, and paid out £9.4m in respect of 2010. The Group has reviewed the assumptions used to calculate the accrual and concluded that, in reasonably foreseeable circumstances, the expected Co-operative dividends are now more than sufficient to meet this commitment. As a consequence, the Group has released £37.3m of the accrual.

The remaining accrual of £1.1m will be used to pay dividends to former Britannia members under the age of 16 who cannot, legally, become members of The Co-operative Group.

6. Perpetual subordinated bonds
The Group's perpetual subordinated bonds are regularly reviewed for their most relevant effective life. The nature of perpetual bonds indicates an infinite life. However, judgment is required in order to fully amortise their associated fair value adjustments arising on merger.

The 2005 £200.0m issue includes an optional call date in 2015. The Group has made no determination as to whether this call date will be exercised. The Group will make any future call decision on an economic basis and with regards to prevailing market conditions subject to appropriate regulatory approval and in accordance with the terms and conditions of the notes. During 2011, given the Group's unconfirmed call intention, a change of effective life from 2029 to 2015 on the 2005 callable issue has been made. The impact of this change is to reduce profit to 2011 by £21.4m and to increase profit by the same amount in the subsequent periods to 2029. Consequently, as at 2011, the sensitivity of reamortising the 14 years between 2029 and 2015 is on average £1.5m per annum.

For the remaining bonds, the impact of a five year reduction in their effective lives as at 31 December 2011 would reduce profit to 2011 by £5.0m and increase profit by the same amount in the subsequent periods to 2029.

Notes to the financial statements

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

1. Segmental information

During 2010, the Group reported its operating segments as Retail, Corporate and Markets (CAM) and Other, with CAM being further split into Corporate, Wholesale, Optimum and Platform, and Business Services. This split was in line with the information presented to the Board, the chief operating decision making body of the Group. The Group's internal reporting structure and transfer pricing methodology has been revised in 2011. The Group is now split into Retail, Corporate and Business Banking (CABB) and Other, based on differences in products and services. This level of information is regularly presented to the Board. Revenues are attributed to the segment in which they are generated. Transactions between the reportable segments are on normal commercial terms. Internal charges and transfer pricing adjustments have been reflected in each segment. The comparative information as at 31 December 2010 has been restated as appropriate.

The Bank is comprised of the following main reportable segments:

- **Retail** – customer focused products and services for individuals, sole traders and small businesses. This includes mortgages, credit cards, consumer loans, current accounts and savings products;
- **CABB** – customer focused products and services for businesses and mortgage lending via intermediaries. This includes large corporate and commercial entities. It includes loans, asset finance, current accounts and savings products. It also includes the Optimum closed book of acquired mortgage portfolios and mortgages originated via intermediaries by Britannia prior to its merger with the Bank; and
- **Other** – includes Treasury, other central costs and Unity Trust Bank. Treasury comprises asset and liability management across the balance sheet, including trading activities. Unity Trust is a subsidiary bank operating in the corporate banking and social economy sectors on behalf of trade unions.

	Retail	CABB excluding Optimum	Optimum	**CABB**	Treasury	Other	**Total Other**	**Total**
2011								
Interest margin	**387.4**	96.1	65.4	**161.5**	59.2	10.7	**69.9**	**618.8**
Non-interest income	**150.2**	56.1	12.1	**68.2**	(20.6)	1.0	**(19.6)**	**198.8**
Operating income	**537.6**	152.2	77.5	**229.7**	38.6	11.7	**50.3**	**817.6**
Operating expenses	**(408.7)**	(103.0)	(27.6)	**(130.6)**	(15.3)	(7.0)	**(22.3)**	**(561.6)**
Impairment losses on loans and advances	**(34.3)**	(87.4)	2.8	**(84.6)**	–	(1.6)	**(1.6)**	**(120.5)**
Impairment gains on investments	**–**	–	–	**–**	5.6	–	**5.6**	**5.6**
Operating profit	**94.6**	(38.2)	52.7	**14.5**	28.9	3.1	**32.0**	**141.1**
Significant items								**(53.3)**
Payment protection insurance provision								**(90.0)**
Share of post tax profits from joint ventures								**0.2**
Financial Services Compensation Scheme levies								**(14.5)**
Fair value amortisation								**86.3**
Profit based payments to members of The Co-operative Group								**(15.6)**
Profit before taxation								**54.2**
Income tax								**(4.4)**
Profit for the financial year								**49.8**

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

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

1. Segmental information continued

Reconciliation to statutory income statement	**2011**
Interest margin	
Total interest margin for reportable segments	**618.8**
Gains on sale of investment securities – loans and receivables	**(37.2)**
Fair value amortisation	**53.4**
Net interest income	**635.0**
Non-interest income	
Total non-interest income for reportable segments	**198.8**
Gains on sale of investment securities – loans and receivables	**37.2**
Fair value amortisation	**–**
Non-interest income	**236.0**
Operating expenses	
Total operating expenses for reportable segments	**(561.6)**
Fair value amortisation	**32.9**
Operating expenses	**(528.7)**
Fair value amortisation	
Total interest unwind for reportable segments	**86.3**
Interest margin unwind	**(53.4)**
Operating expenses unwind	**(32.9)**
Fair value amortisation	**–**

	Retail	CABB excluding Optimum	Optimum	CABB	Treasury	Other	Total Other	Total
2010								
Interest margin	389.1	69.5	76.9	146.4	87.5	9.3	96.8	632.3
Non-interest income	147.2	56.2	10.0	66.2	(25.4)	1.5	(23.9)	189.5
Operating income	536.3	125.7	86.9	212.6	62.1	10.8	72.9	821.8
Operating expenses	(426.1)	(100.8)	(27.1)	(127.9)	(21.2)	(6.3)	(27.5)	(581.5)
Impairment losses on loans and advances	(62.8)	(31.4)	1.4	(30.0)	–	(4.5)	(4.5)	(97.3)
Impairment gains on investments	–	–	–	–	1.5	–	1.5	1.5
Operating profit	47.4	(6.5)	61.2	54.7	42.4	–	42.4	144.5
Significant items								(55.5)
Payment protection insurance provision								(4.3)
Share of post tax profits from joint ventures								0.7
Financial Services Compensation Scheme levies								(11.5)
Fair value amortisation								(14.2)
Profit based payments to members of The Co-operative Group								(10.8)
Profit before taxation								48.9
Income tax								(13.1)
Profit for the financial year								35.8

1. Segmental information continued

Reconciliation to statutory income statement	2010
Interest margin	
Total interest margin for reportable segments	632.3
Reclassification of gains less losses on derivatives	(1.6)
Fair value amortisation	(22.3)
Net interest income	608.4
Non-interest income	
Total non-interest income for reportable segments	189.5
Reclassification of gains less losses on derivatives	1.6
Fair value amortisation	(1.5)
Non-interest income	189.6
Operating expenses	
Total operating expenses for reportable segments	(581.5)
Fair value amortisation	9.6
Operating expenses	(571.9)
Fair value amortisation	
Total interest unwind for reportable segments	(14.2)
Interest margin unwind	22.3
Non-interest income unwind	1.5
Operating expenses unwind	(9.6)
Fair value amortisation	–

	Retail	CABB excluding Optimum	Optimum	Treasury	Total
2011					
Segment assets	**16,217.2**	**9,952.5**	**7,662.4**	**12,342.0**	**46,174.1**
Unallocated assets					**2,186.7**
Total assets for reportable segments					**48,360.8**
Statutory reclassifications					**594.8**
Consolidated total assets					**48,955.6**

	Retail	CABB excluding Optimum	Optimum	Treasury	Total
Segment liabilities	**27,859.2**	**7,657.9**	**–**	**9,004.9**	**44,522.0**
Unallocated liabilities					**1,426.4**
Total liabilities for reportable segments					**45,948.4**
Statutory reclassifications					**734.1**
Consolidated total liabilities					**46,682.5**

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

1. Segmental information continued

	Retail	CABB excluding Optimum	Optimum	Treasury	Total
2010					
Segment assets	17,314.6	9,095.7	8,111.3	8,556.0	43,077.6
Unallocated assets					1,679.3
Total assets for reportable segments					44,756.9
Statutory reclassifications					824.4
Consolidated total assets					45,581.3

	Retail	CABB excluding Optimum	Optimum	Treasury	Total
Segment liabilities	27,738.7	5,340.4	–	8,647.1	41,726.2
Unallocated liabilities					1,009.2
Total liabilities for reportable segments					42,735.4
Statutory reclassifications					772.8
Consolidated total liabilities					43,508.2

2. Profit before taxation

	2011 £'000	2010 £'000
Profit before taxation is stated after:		
Audit of these financial statements	**356**	457
Amounts receivable by auditors and their associates in respect of:		
Audit of financial statements of subsidiaries pursuant to legislation	**335**	392
Other services pursuant to such legislation	**11**	87
Other services relating to taxation	**311**	7
Services relating to litigation	**2**	2
Services relating to information technology	**147**	92
Services relating to corporate finance transactions	**90**	15
All other services	**365**	822
	1,617	1,874

Amounts paid to the Bank's auditor in respect of services to the Bank, other than the audit of the Bank's financial statements, have not been disclosed as the information is required instead to be disclosed on a consolidated basis. Amounts capitalised are not disclosed above.

3. Directors' emoluments

	2011 £'000	2010 £'000
Executive directors	**1,645**	4,002
Compensation for loss of office	**926**	–
	2,571	4,002

Directors' activities are undertaken across The Co-operative Banking Group. The figures above reflect the Group's share of these services.

Retirement benefits are accruing to one director (2010: five) under defined benefit schemes.

The aggregate of emoluments and amounts receivable under incentive schemes of the highest paid director was £549k (2010: £1,196k). Accrued pension under defined benefit pension schemes at the year end was £15k (2010: £140k).

All non-executive directors are appointed and their directors' fees are determined and paid by The Co-operative Group and therefore no amounts are shown above (2010: £nil). Further details of directors' emoluments are included in the remuneration report on pages 19 to 28. The remuneration report is unaudited.

4. Net interest income

	2011	2010
Interest receivable and similar income		
On financial assets not at fair value through income or expense:		
On loans and advances to customers	**1,482.4**	1,605.0
On loans and advances to banks	**14.3**	9.3
On investment securities	**210.6**	277.5
	1,707.3	1,891.8
On financial assets at fair value through income or expense:		
Net interest expense on financial instruments hedging assets	**(128.1)**	(168.9)
Net interest income/(expense) on financial instruments not in a hedging relationship	**4.5**	(9.6)
	1,583.7	1,713.3

Included within interest receivable is £9.9m (2010: £9.8m) relating to profit on sale of investment securities – available for sale.

Interest income accrued on impaired financial assets during the year was £32.3m (2010: £90.5m). Interest due to unwinding of discount on impairment provisions relating to impaired financial assets amounted to £2.4m (2010: £2.2m).

In the year, the Optimum credit fair value adjustment has been revalued resulting in additional income of £20.0m (2010: £15.0m).

	2011	2010
Interest expense and similar charges		
On financial liabilities not at fair value through income or expense:		
On customer accounts	**524.4**	471.9
On bank and other deposits	**230.9**	515.5
On subordinated liabilities	**98.5**	43.9
On perpetual subordinated bonds	**42.0**	17.2
	895.8	1,048.5
On financial liabilities at fair value through income or expense:		
Net interest expense on financial instruments hedging liabilities	**52.0**	56.4
Net interest expense on financial instruments not in a hedging relationship	**0.9**	–
	948.7	1,104.9

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

5. Net fee and commission income

	Before significant items 2011	Significant items 2011	After significant items 2011	Before significant items 2010	Significant items 2010	After significant items 2010
Fee and commission income						
On items not at fair value through income or expense	**238.5**	**(90.0)**	**148.5**	235.9	(13.1)	222.8
On trust or fiduciary activities that result from holding or investing in assets on behalf of others	**1.1**	**–**	**1.1**	1.3	–	1.3
	239.6	**(90.0)**	**149.6**	237.2	(13.1)	224.1
Fee and commission expense						
On items not at fair value through income or expense	**46.0**	**–**	**46.0**	52.2	–	52.2
On items at fair value through income or expense	**8.4**	**–**	**8.4**	8.1	–	8.1
	54.4	**–**	**54.4**	60.3	–	60.3

The significant item in 2011 of £90.0m (2010: £4.3m) is a provision for customer compensation relating to past sales of PPI in response to the FSA's policy statement published on 10 August 2010. The Bank stopped selling non-mortgage PPI at the beginning of 2009. The remaining significant item in 2010 of £8.8m relates to provisions made for customer redress.

6. Net trading income

	2011	2010
Foreign exchange	**3.7**	6.5
Other interest rate instruments	**0.8**	(1.9)
	4.5	4.6

Foreign exchange net trading income includes gains less losses from spot forward and forward contracts, options, futures and translated foreign currency assets and liabilities.

Other interest rate instruments include the result of transacting in government securities, money market instruments, interest rate and currency swaps, options and other derivatives.

7. Other operating income

	2011	2010
Profit on sale of investment securities – loans and receivables	**37.2**	–
Rent receivable from investment properties (note 21)	**7.9**	6.5
Other rent receivable	**1.3**	1.7
Change in fair value of investment properties (note 21)	**(0.1)**	(0.1)
	46.3	8.1

The profit on sale of investment securities arose from the restructuring of a portfolio of assets. Profit on smaller disposals in the normal course of business is included in net interest income.

8. Operating expenses

	Before significant items 2011	Significant items 2011	After significant items 2011	Before significant items 2010	Significant items 2010	After significant items 2010
Staff costs (note 9)	**294.7**	**34.8**	**329.5**	292.6	29.6	322.2
Administrative expenses	**175.6**	**18.5**	**194.1**	224.9	17.1	242.0
Depreciation of property, plant and equipment (note 22)	**19.6**	**–**	**19.6**	24.8	–	24.8
Amortisation of intangible fixed assets (note 20)	**6.4**	**–**	**6.4**	4.1	–	4.1
Loss on sale of property, plant and equipment	**0.3**	**–**	**0.3**	0.8	–	0.8
Operating lease rentals	**28.4**	**–**	**28.4**	27.7	–	27.7
Property provisions for liabilities and charges provided in the year (note 32)	**0.4**	**–**	**0.4**	3.4	–	3.4
Property provisions for liabilities and charges released during the year (note 32)	**(0.3)**	**–**	**(0.3)**	(0.3)	–	(0.3)
Other provisions for liabilities and charges provided in the year (note 32)	**0.1**	**–**	**0.1**	3.5	–	3.5
Other provisions for liabilities and charges released during the year (note 32)	**(0.1)**	**–**	**(0.1)**	(12.3)	–	(12.3)
Direct expenses from investment properties that generated rental income in the year	**3.5**	**–**	**3.5**	2.6	–	2.6
Direct expenses from investment properties that did not generate rental income in the year	**0.1**	**–**	**0.1**	0.1	–	0.1
	528.7	**53.3**	**582.0**	571.9	46.7	618.6

The significant items in 2011 and 2010 relate to a programme of investment and integration.

No expenditure has been incurred in respect of the Government's Bank Levy since the relevant aggregate liabilities of the Group are below the qualifying threshold.

9. Staff costs

	Before significant items 2011	Significant items 2011	After significant items 2011	Before significant items 2010	Significant items 2010	After significant items 2010
Wages and salaries	**210.8**	**14.1**	**224.9**	221.0	16.5	237.5
Social security costs	**20.9**	**0.7**	**21.6**	20.6	0.3	20.9
Pension costs:						
Defined benefit plans (note 34)	**0.2**	**–**	**0.2**	0.2	–	0.2
Defined contribution plans (note 34)	**29.0**	**0.8**	**29.8**	28.2	0.5	28.7
Other staff costs	**33.8**	**19.2**	**53.0**	22.6	12.3	34.9
	294.7	**34.8**	**329.5**	292.6	29.6	322.2

The Bank staff costs included above are £262.5m before significant items and £297.4m after significant items (2010: £265.2m before significant items, £294.8m after significant items).

Average number of employees

The average number of persons working for the Group and the Bank during the year is as follows:

	Group		Bank	
	No. of employees 2011	No. of employees 2010	**No. of employees 2011**	No. of employees 2010
Full time	**6,260**	6,499	**5,751**	5,843
Part time	**2,104**	2,247	**1,988**	2,117
	8,364	8,746	**7,739**	7,960

Employee activities are undertaken across The Co-operative Banking Group and the figures above reflect the Group and Bank's share of these services.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

10. Income tax

	Before significant items 2011	Significant items 2011	After significant items 2011	Before significant items 2010	Significant items 2010	After significant items 2010
Current tax – current year	**(3.4)**	**(38.0)**	**(41.4)**	28.6	(16.7)	11.9
Current tax – prior year	**(6.2)**	**–**	**(6.2)**	0.8	–	0.8
Deferred tax – current year (note 33)	**61.7**	**–**	**61.7**	2.5	–	2.5
Deferred tax – prior year (note 33)	**(9.7)**	**–**	**(9.7)**	(2.1)	–	(2.1)
	42.4	**(38.0)**	**4.4**	29.8	(16.7)	13.1

Further information about deferred income tax is presented in note 33. The tax on the Group's profit before taxation differs from the theoretical amount that would arise using the corporation tax rate in the UK as follows:

	2011	2010
Profit before taxation	**54.2**	48.9
Tax calculated at a rate of 26.49% (2010: 28%)	**14.4**	13.7
Effects of:		
Preference share interest not deductible for tax purposes	**1.5**	1.6
Expenses not deductible for tax purposes	**0.1**	(2.3)
Depreciation of expenditure not qualifying for capital allowances	**1.2**	2.2
Profits taxed at lower rates	**(1.2)**	(3.7)
Non-taxable income	**(0.1)**	(1.2)
Adjustments to tax charge in respect of prior periods	**(15.9)**	(1.3)
Change in rate of deferred tax (note 33)	**4.7**	4.3
Other differences	**(0.3)**	(0.2)
	4.4	13.1

The adjustments to tax charge in respect of prior periods of £15.9m includes £13.0m relating to the taxation of contingent consideration (page 74).

11. Group profit attributable to equity shareholders dealt with in the accounts of The Co-operative Bank plc

	Before significant items 2011	Significant items 2011	After significant items 2011	Before significant items 2010	Significant items 2010	After significant items 2010
Net profit/(loss) attributable to equity shareholders of the Bank	**11.9**	**(105.2)**	**(93.3)**	108.1	(35.0)	73.1

As permitted by Section 408 of the Companies Act 2006, the income statement of The Co-operative Bank plc has not been presented separately.

12. Earnings per share

Basic earnings per share is calculated by dividing the net profit attributable to equity shareholders of the Bank by the weighted average number of ordinary shares in issue during the year.

	Before significant items 2011	Significant items 2011	After significant items 2011	Before significant items 2010	Significant items 2010	After significant items 2010
Profit attributable to equity shareholders of the Bank	**153.3**	**(105.3)**	**48.0**	79.5	(43.1)	36.4
Ordinary shares in issue (millions)						
At the beginning of the year	**8,200.0**	**8,200.0**	**8,200.0**	4,600.0	4,600.0	4,600.0
Issued in the year (note 38)	**–**	**–**	**–**	3,600.0	3,600.0	3,600.0
At the end of the year	**8,200.0**	**8,200.0**	**8,200.0**	8,200.0	8,200.0	8,200.0
Weighted average number of ordinary shares in issue (millions)	**8,200.0**	**8,200.0**	**8,200.0**	4,767.7	4,767.7	4,767.7
Basic earnings per share (expressed in pence per share)	**1.87**	**(1.28)**	**0.59**	1.67	(0.90)	0.77

13. Cash and balances at central banks

	Group		Bank	
	2011	2010	**2011**	2010
Cash in hand	**280.3**	255.8	**280.3**	255.8
Balances with the Bank of England other than mandatory reserve deposits	**6,378.3**	1,443.7	**6,378.3**	1,443.7
Included in cash and cash equivalents	**6,658.6**	1,699.5	**6,658.6**	1,699.5
Mandatory reserve deposits with the Bank of England (note 35)	**38.0**	36.1	**38.0**	36.1
	6,696.6	1,735.6	**6,696.6**	1,735.6

Mandatory reserve deposits are not available for use in the Group and Bank's day to day operations, are non-interest bearing and are not included in cash and cash equivalents.

14. Loans and advances to banks

	Group		Bank	
	2011	2010	**2011**	2010
Items in course of collection from other banks	**123.2**	139.9	**123.2**	139.7
Placements with other banks	**896.6**	1,338.8	**885.1**	1,326.8
Included in cash and cash equivalents	**1,019.8**	1,478.7	**1,008.3**	1,466.5
Other loans and advances to banks	**986.7**	915.4	**291.8**	262.1
	2,006.5	2,394.1	**1,300.1**	1,728.6

15. Loans and advances to customers

	Group		Bank	
	2011	2010	**2011**	2010
Gross loans and advances	**34,058.0**	35,199.9	**22,993.1**	24,055.4
Less: allowance for losses on loans and advances to customers	**(292.0)**	(222.6)	**(258.1)**	(210.5)
	33,766.0	34,977.3	**22,735.0**	23,844.9

Group and Bank loans and advances to customers include £114.1m (2010: £74.1m) of financial assets at fair value through income or expense designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency. Of these, £36.7m (2010: £20.0m) are secured by real estate collateral.

Loans and advances to customers include £9,099.8m (2010: £10,611.1m) securitised under the Group's securitisation and covered bond programmes. The Group remains exposed to substantially all of the risks and rewards of ownership of these assets. Included within Group deposits by banks (note 25) are £61.9m (2010: £67.2m) of loans from external third parties and within Group debt securities in issue (note 28) are £3,989.4m (2010: £3,099.8m) of fixed and floating rate notes, all secured on these mortgage assets. Included within the Bank amounts owed by other Co-operative Group undertakings are £4,749.5m (2010: £4,368.4m) of floating rate notes issued to the Bank and £1,000.3m (2010: £2,796.7m) of other loans, secured on these mortgage assets.

Concentration of exposure

The Group's exposure is virtually all within the UK. The following industry concentrations of gross advances before provisions are considered significant:

	Group		Bank	
	2011	2010	**2011**	2010
Property and construction	**4,247.1**	4,544.6	**4,273.2**	2,606.9
Retail distribution and services	**391.6**	500.1	**268.6**	357.0
Business and other services	**4,445.1**	3,808.1	**2,541.2**	3,683.5
Personal – unsecured	**1,518.1**	1,613.1	**1,518.1**	1,613.1
Personal – secured	**23,456.1**	24,734.0	**14,392.0**	15,794.9
	34,058.0	35,199.9	**22,993.1**	24,055.4

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

15. Loans and advances to customers continued
Allowance for losses on loans and advances

Group	Individual retail	Individual corporate	Collective retail	Collective corporate	Total
2011					
At the beginning of the year	**8.6**	**55.8**	**157.8**	**0.4**	**222.6**
Charge against profits	**4.9**	**76.6**	**36.4**	**12.6**	**130.5**
Amounts written off	**(4.5)**	**(27.1)**	**(26.6)**	**(0.8)**	**(59.0)**
Unwind of discount allowance	**–**	**(0.5)**	**(1.9)**	**–**	**(2.4)**
Interest charged on impaired loans	**–**	**0.3**	**–**	**–**	**0.3**
At the end of the year	**9.0**	**105.1**	**165.7**	**12.2**	**292.0**
2010					
At the beginning of the year	2.3	51.3	139.8	0.6	194.0
Charge against profits	7.2	35.5	63.1	0.8	106.6
Amounts written off	(0.9)	(30.5)	(43.9)	(1.0)	(76.3)
Unwind of discount allowance	–	(1.0)	(1.2)	–	(2.2)
Interest charged on impaired loans	–	0.5	–	–	0.5
At the end of the year	8.6	55.8	157.8	0.4	222.6

Bank	Individual retail	Individual corporate	Collective retail	Collective corporate	Total
2011					
At the beginning of the year	**2.9**	**49.4**	**157.8**	**0.4**	**210.5**
Charge against profits	**0.5**	**62.4**	**34.4**	**6.1**	**103.4**
Amounts written off	**(0.8)**	**(25.6)**	**(26.6)**	**(0.8)**	**(53.8)**
Unwind of discount allowance	**–**	**(0.4)**	**(1.9)**	**–**	**(2.3)**
Interest charged on impaired loans	**–**	**0.3**	**–**	**–**	**0.3**
At the end of the year	**2.6**	**86.1**	**163.7**	**5.7**	**258.1**
2010					
At the beginning of the year	2.3	49.3	139.8	0.6	192.0
Charge against profits	0.9	31.0	63.1	0.8	95.8
Amounts written off	(0.3)	(30.4)	(43.9)	(1.0)	(75.6)
Unwind of discount allowance	–	(1.0)	(1.2)	–	(2.2)
Interest charged on impaired loans	–	0.5	–	–	0.5
At the end of the year	2.9	49.4	157.8	0.4	210.5

A new corporate collective provision for Group of £10.4m and for Bank of £4.7m has been recognised in 2011 reflecting the continuing difficulties and uncertainties currently being experienced in this sector (refer to page 7).

The net impairment charge in the Group income statement is £120.5m (2010: £97.3m). This includes amounts recovered by the Group of £10.0m (2010: £9.3m) against amounts previously written off. The recoveries have been made from the mortgagors and from other parties involved in the origination or acquisition of the mortgages.

15. Loans and advances to customers continued

Loans and advances to customers include finance lease receivables:

	Group		Bank	
	2011	2010	**2011**	2010
Gross investment in finance leases may be analysed as follows:				
No later than one year	**26.1**	28.4	**20.2**	22.4
Later than one year and no later than five years	**62.8**	66.2	**41.9**	44.8
Later than five years	**82.2**	78.7	**65.6**	56.5
	171.1	173.3	**127.7**	123.7
Unearned future finance income on finance leases	**(47.7)**	(44.2)	**(35.4)**	(29.1)
Net investment in finance leases	**123.4**	129.1	**92.3**	94.6
The net investment in finance leases may be analysed as follows:				
No later than one year	**19.1**	21.2	**15.6**	18.0
Later than one year and no later than five years	**40.9**	44.9	**27.5**	32.0
Later than five years	**63.4**	63.0	**49.2**	44.6
	123.4	129.1	**92.3**	94.6

There are no unguaranteed residual values for any of the finance leases. The Group enters into finance lease and hire purchase arrangements with customers in a wide range of sectors including transport, retail and utilities. The accumulated allowance for uncollectible minimum lease payments receivable is £0.1m (2010: £0.8m).

Fair value adjustments for hedged risk

The Group has entered into interest rate swaps that protect it from changes in interest rates on the floating rate liabilities that fund its portfolio of fixed rate mortgages. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed rate mortgages. The changes in fair value of fixed rate mortgages are disclosed on the balance sheet as fair value adjustments for hedged risk immediately below the loans and advances to customers.

Fair value adjustments to loans and advances to customers attributable to portfolio hedged risk in the Group are £366.3m (2010: £166.8m) and in the Bank are £365.8m (2010: £164.6m).

16. Investment securities

Loans and receivables

	Group		Bank	
	2011	2010	**2011**	2010
Loans and receivables				
Listed	**113.5**	164.6	**113.5**	164.6
Unlisted	**694.1**	1,765.7	**755.3**	1,835.2
	807.6	1,930.3	**868.8**	1,999.8
Less: allowance for losses	**(2.7)**	(13.0)	**(2.7)**	(13.0)
	804.9	1,917.3	**866.1**	1,986.8
Included in cash and cash equivalents	**–**	–	**–**	–

The movement in investment securities – loans and receivables excluding interest amounts may be summarised as follows:

	Group		Bank	
	2011	2010	**2011**	2010
At the beginning of the year	**1,914.7**	2,483.5	**1,984.2**	2,552.8
Acquisitions	**107.5**	–	**107.5**	–
Disposals and maturities	**(1,426.6)**	(735.8)	**(1,430.2)**	(748.9)
Exchange adjustments	**1.6**	0.4	**1.6**	0.4
Fair value movements through income or expense	**–**	–	**(0.3)**	11.7
Amortisation	**195.8**	165.1	**191.4**	166.7
Utilisation and release of impairment provision	**10.3**	1.5	**10.3**	1.5
At the end of the year	**803.3**	1,914.7	**864.5**	1,984.2

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

16. Investment securities continued
Impairment analysis of investment securities – loans and receivables

	Group		Bank	
	2011	2010	**2011**	2010
At the beginning of the year	**13.0**	14.5	**13.0**	14.5
Release for the year	**(5.6)**	(1.5)	**(5.6)**	(1.5)
Utilised during the year	**(4.7)**	–	**(4.7)**	–
At the end of the year	**2.7**	13.0	**2.7**	13.0

Available for sale

	Group		Bank	
	2011	2010	**2011**	2010
Available for sale				
Listed	**3,098.6**	2,389.0	**3,098.6**	2,389.0
Unlisted	**366.9**	640.4	**51.3**	304.7
	3,465.5	3,029.4	**3,149.9**	2,693.7
Less: allowance for losses	**(42.5)**	(72.3)	**(42.5)**	(72.3)
	3,423.0	2,957.1	**3,107.4**	2,621.4
Included in cash and cash equivalents	**210.0**	225.0	**–**	225.0

The movement in investment securities – available for sale excluding interest amounts may be summarised as follows:

	Group		Bank	
	2011	2010	**2011**	2010
At the beginning of the year	**2,948.1**	4,444.1	**2,613.0**	4,049.0
Acquisitions	**8,251.3**	9,868.6	**6,811.3**	8,488.6
Disposals and maturities	**(8,091.4)**	(11,437.4)	**(6,631.3)**	(9,997.4)
Exchange adjustments	**(12.6)**	20.2	**(12.6)**	20.2
Fair value movements through equity	**101.6**	(19.8)	**101.6**	(19.8)
Fair value movements through income or expense	**124.9**	43.9	**124.9**	43.9
Amortisation	**27.1**	28.5	**27.1**	28.5
Utilisation of impairment provision	**29.6**	–	**29.6**	–
At the end of the year	**3,378.6**	2,948.1	**3,063.6**	2,613.0

Impairment analysis of investment securities – available for sale

	Group		Bank	
	2011	2010	**2011**	2010
At the beginning of the year	**72.3**	71.9	**72.3**	71.9
Utilised during the year	**(29.6)**	–	**(29.6)**	–
Exchange adjustments	**(0.2)**	0.4	**(0.2)**	0.4
At the end of the year	**42.5**	72.3	**42.5**	72.3

16. Investment securities continued

Fair value through income or expense

	Group		Bank	
	2011	2010	**2011**	2010
Fair value through income or expense				
Listed	**343.1**	28.7	**343.1**	28.7
	343.1	28.7	**343.1**	28.7
Less: allowance for losses	**–**	–	**–**	–
	343.1	28.7	**343.1**	28.7
Included in cash and cash equivalents	**–**	–	**–**	–

The movement in investment securities – fair value through income or expense excluding interest amounts may be summarised as follows:

	Group		Bank	
	2011	2010	**2011**	2010
At the beginning of the year	**26.5**	–	**26.5**	–
Acquisitions	**323.3**	26.6	**323.3**	26.6
Disposals and maturities	**(25.0)**	–	**(25.0)**	–
Fair value movements through income or expense	**(1.0)**	–	**(1.0)**	–
Amortisation	**15.7**	(0.1)	**15.7**	(0.1)
At the end of the year	**339.5**	26.5	**339.5**	26.5

Analysis of investment securities by issuer

	Group		Bank	
	2011	2010	**2011**	2010
Investment securities issued by public bodies:				
Government securities	**1,834.5**	903.0	**1,834.5**	903.0
Other public sector securities	**563.6**	57.3	**563.6**	57.3
	2,398.1	960.3	**2,398.1**	960.3
Investment securities issued by other issuers:				
Bank and building society certificates of deposits	**315.7**	560.8	**–**	225.1
Other debt securities:				
Credit trading funds	**–**	16.5	**–**	16.5
Other floating rate notes	**1,165.9**	1,624.9	**1,165.9**	1,624.9
Mortgage backed securities	**691.3**	1,740.6	**752.6**	1,810.1
	1,857.2	3,382.0	**1,918.5**	3,451.5
	4,571.0	4,903.1	**4,316.6**	4,636.9

Other floating rate notes (FRNs) relate to sterling, euro and US dollar denominated FRNs with maturities ranging from one month to four years from the balance sheet date.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

17. Derivative financial instruments
The Bank, as principal, has entered into various derivatives either as a trading activity, which includes proprietary transactions and customer facilitation, or as a hedging activity for the management of interest rate risk, equity risk and foreign exchange rate risk. Positive and negative fair values have not been netted as the Group does not have a legal right of offset.

Derivatives held for trading purposes
The trading transactions are wholly interest rate related contracts including swaps, caps and floors, forward rate agreements and exchange traded futures. Trading transactions include derivatives where the Bank enters into a transaction to accommodate a customer together with the corresponding hedge transaction.

Non-trading derivatives
Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions of the Group. Derivatives used to manage interest rate related positions include swaps, caps and floors, forward rate agreements and exchange traded futures. The foreign exchange rate positions are managed using forward currency transactions and swaps. Equity risk is managed using equity swaps.

During the year the Bank has entered into fair value hedges to mitigate price movements due to interest rate sensitivities.

	Group Fair value		Bank Fair value	
	Assets	Liabilities	Assets	Liabilities
2011				
Derivatives held for trading purposes				
Interest rate derivatives:				
Interest rate swaps	**162.0**	**(141.8)**	**164.7**	**(144.3)**
Over The Counter (OTC) interest rate options	**1.7**	**(1.7)**	**1.7**	**(1.7)**
Total derivative assets/(liabilities) held for trading purposes	**163.7**	**(143.5)**	**166.4**	**(146.0)**
Derivatives held for non-trading purposes				
Derivatives designated as cashflow hedges:				
Interest rate swaps	**218.5**	**(106.2)**	**218.4**	**(106.3)**
Derivatives designated as fair value hedges:				
Interest rate swaps	**137.3**	**(670.5)**	**120.1**	**(666.3)**
Cross currency interest rate swaps	**0.1**	**(60.7)**	**0.1**	**(60.7)**
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	**13.7**	**(50.6)**	**12.1**	**(51.0)**
Embedded derivatives – options	**28.6**	**(0.4)**	**28.6**	**(0.4)**
Forward currency transactions	**300.9**	**(52.1)**	**46.9**	**(16.9)**
OTC interest rate options	**–**	**(3.5)**	**–**	**(3.5)**
Equity swaps	**113.0**	**(0.4)**	**111.8**	**(0.4)**
Total derivative assets/(liabilities) held for non-trading purposes	**812.1**	**(944.4)**	**538.0**	**(905.5)**
Total recognised derivative assets/(liabilities)	**975.8**	**(1,087.9)**	**704.4**	**(1,051.5)**

17. Derivative financial instruments continued

	Group Fair value		Bank Fair value	
	Assets	Liabilities	Assets	Liabilities
2010				
Derivatives held for trading purposes				
Interest rate derivatives:				
Interest rate swaps	65.1	(51.0)	68.5	(54.4)
Over The Counter (OTC) interest rate options	1.9	(1.9)	1.9	(1.9)
Total derivative assets/(liabilities) held for trading purposes	67.0	(52.9)	70.4	(56.3)
Derivatives held for non-trading purposes				
Derivatives designated as cashflow hedges:				
Interest rate swaps	218.8	(161.9)	218.8	(161.9)
Derivatives designated as fair value hedges:				
Interest rate swaps	75.0	(411.0)	75.0	(403.8)
Cross currency interest rate swaps	–	(1.2)	–	(1.2)
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	23.1	(32.5)	37.7	(31.3)
Embedded derivatives – options	19.3	(17.8)	19.3	(17.8)
Forward currency transactions	431.4	(23.6)	147.4	(23.6)
OTC interest rate options	–	(1.2)	–	(1.2)
Equity swaps	141.0	(0.3)	136.1	(0.3)
Total derivative assets/(liabilities) held for non-trading purposes	908.6	(649.5)	634.3	(641.1)
Total recognised derivative assets/(liabilities)	975.6	(702.4)	704.7	(697.4)

The derivatives designated as cashflow hedges are interest rate swaps used to hedge interest rate risk in the Bank's retail lending operations. Cash flows are hedged by quarterly time periods for durations up to ten years. During the year there were no forecast transactions for which hedge accounting had previously been used but are no longer expected to occur.

The number of non-margin exchange traded contracts held by the Bank as at 31 December 2011 was nil (2010: nil).

During 2011, in line with industry best practice, the Bank moved from using LIBOR yield curves to using overnight indexed swap (OIS) yield curves in the valuation of cash collateralised derivatives. The net loss in the year relating to this change was £6.0m.

The 2010 comparatives for the Group and Bank reflect a reclassification of £43.7m to derivatives from other assets.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

18. Equity shares

	Group and Bank	
	2011	2010
Investment securities – unlisted	**5.7**	7.2
Included above are the following trade investments:		
Vocalink Limited – 4,416,165 ordinary shares of £1 each (2010: 4,416,165)	**5.6**	7.1

Equity shares are classified as available for sale.

19. Goodwill

	Group and Bank	
	2011	2010
Net book amount		
At the beginning of the year and end of the year	**0.6**	0.6

The Bank's goodwill was recognised in 2009 and relates to the transfer of engagements of Britannia Building Society.

In accordance with IAS 38, the goodwill has been assessed as having an indefinite useful life. The Group tests the asset for impairment by comparing its recoverable amount, determined in accordance with IAS 36, with its carrying amount. The key assumptions used in the calculation are:

- forecast Co-operative Bank operating profits, excluding fair value amortisations, into perpetuity;
- a tax rate of 26% for 2012, falling to and remaining at 25% per annum thereafter; and
- a discount rate of 11% applied to the net operating profit after tax cash flows.

The calculations have been flexed to assess the sensitivities to reasonable changes in the already conservative assumptions. This sensitivity analysis did not indicate any likely impairment of the goodwill.

20. Intangible fixed assets

	Group 2011			Group 2010		
	Internally generated intangible assets	**Other intangible assets**	**Total**	Internally generated intangible assets	Other intangible assets	Total
Cost						
At the beginning of the year	**13.9**	**46.0**	**59.9**	18.9	46.0	64.9
Additions	**2.0**	**–**	**2.0**	3.1	–	3.1
Disposals	**(2.4)**	**–**	**(2.4)**	(8.1)	–	(8.1)
At the end of the year	**13.5**	**46.0**	**59.5**	13.9	46.0	59.9
Accumulated amortisation						
At the beginning of the year	**8.5**	**6.3**	**14.8**	15.1	3.7	18.8
Charge for the year	**1.9**	**4.5**	**6.4**	1.5	2.6	4.1
Disposals	**(2.4)**	**–**	**(2.4)**	(8.1)	–	(8.1)
At the end of the year	**8.0**	**10.8**	**18.8**	8.5	6.3	14.8
Net book value						
At the end of the year	**5.5**	**35.2**	**40.7**	5.4	39.7	45.1
At the beginning of the year	5.4	39.7	45.1	3.8	42.3	46.1

20. Intangible fixed assets continued

	Bank 2011			Bank 2010		
	Internally generated intangible assets	**Other intangible assets**	**Total**	Internally generated intangible assets	Other intangible assets	Total
Cost						
At the beginning of the year	**13.1**	**46.0**	**59.1**	17.3	46.0	63.3
Additions	**1.4**	**–**	**1.4**	2.7	–	2.7
Disposals	**(2.4)**	**–**	**(2.4)**	(6.9)	–	(6.9)
At the end of the year	**12.1**	**46.0**	**58.1**	13.1	46.0	59.1
Accumulated amortisation						
At the beginning of the year	**9.0**	**6.3**	**15.3**	14.7	3.7	18.4
Charge for the year	**1.4**	**4.5**	**5.9**	1.2	2.6	3.8
Disposals	**(2.4)**	**–**	**(2.4)**	(6.9)	–	(6.9)
At the end of the year	**8.0**	**10.8**	**18.8**	9.0	6.3	15.3
Net book value						
At the end of the year	**4.1**	**35.2**	**39.3**	4.1	39.7	43.8
At the beginning of the year	4.1	39.7	43.8	2.6	42.3	44.9

Internally generated intangible assets consist of software development costs.

Other intangible assets consist of a core deposit intangible of £44.0m and a brand intangible of £2.0m. The brand intangible has an indefinite useful life and is not amortised but is subject to an annual impairment review, using the same assumptions as those used for goodwill (note 19). On the basis of this review the brand is considered to be unimpaired.

21. Investment properties

	Group	
	2011	2010
Fair value		
At the beginning of the year	**162.3**	137.7
Additions – acquisitions	**9.2**	21.6
Additions – subsequent expenditure	**2.1**	3.6
Disposals	**(0.8)**	(0.5)
Changes in fair value (note 7)	**(0.1)**	(0.1)
At the end of the year	**172.7**	162.3

All investment properties are held to generate rental income until such time that the Group considers it appropriate to realise its investment. Investment properties are carried at fair value.

The range of yields applied to the net annual rental income to determine the fair value of property is 3% to 8%.

The Group lets investment properties on Assured Shorthold Tenancy agreements, most of which are for contract periods of no more than 12 months. The future minimum lease receipts under non-cancellable operating leases are £3.0m (2010: £2.4m). The Group has not recognised any contingent rent in the year (2010: £nil). None of the lease agreements are individually significant.

Included in Group other operating income for the year is £7.9m (2010: £6.5m) of rental income relating to investment properties (note 7).

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

22. Property, plant and equipment

2011 Group	Land and buildings	Leasehold improvements	Computers and other equipment	Total
Cost				
At the beginning of the year	**55.7**	**24.9**	**125.1**	**205.7**
Additions	**–**	**0.1**	**1.4**	**1.5**
Disposals	**–**	**–**	**(11.2)**	**(11.2)**
At the end of the year	**55.7**	**25.0**	**115.3**	**196.0**
Accumulated depreciation				
At the beginning of the year	**5.4**	**8.0**	**93.8**	**107.2**
Charge for the year	**1.2**	**5.4**	**13.0**	**19.6**
Disposals	**–**	**–**	**(10.9)**	**(10.9)**
At the end of the year	**6.6**	**13.4**	**95.9**	**115.9**
Net book value				
At the end of the year	**49.1**	**11.6**	**19.4**	**80.1**
At the beginning of the year	50.3	16.9	31.3	98.5

2010 Group	Land and buildings	Leasehold improvements	Computers and other equipment	Total
Cost				
At the beginning of the year	55.7	24.9	134.6	215.2
Additions	–	–	2.6	2.6
Disposals	–	–	(12.1)	(12.1)
At the end of the year	55.7	24.9	125.1	205.7
Accumulated depreciation				
At the beginning of the year	4.1	2.8	86.8	93.7
Charge for the year	1.3	5.2	18.3	24.8
Disposals	–	–	(11.3)	(11.3)
At the end of the year	5.4	8.0	93.8	107.2
Net book value				
At the end of the year	50.3	16.9	31.3	98.5
At the beginning of the year	51.6	22.1	47.8	121.5

22. Property, plant and equipment continued

2011 Bank	**Land and buildings**	**Leasehold improvements**	**Computers and other equipment**	**Total**
Cost				
At the beginning of the year	**34.8**	**24.8**	**121.0**	**180.6**
Additions	**–**	**0.1**	**0.9**	**1.0**
Disposals	**–**	**–**	**(10.8)**	**(10.8)**
At the end of the year	**34.8**	**24.9**	**111.1**	**170.8**
Accumulated depreciation				
At the beginning of the year	**2.2**	**7.9**	**91.4**	**101.5**
Charge for the year	**0.8**	**5.4**	**12.2**	**18.4**
Disposals	**–**	**–**	**(10.6)**	**(10.6)**
At the end of the year	**3.0**	**13.3**	**93.0**	**109.3**
Net book value				
At the end of the year	**31.8**	**11.6**	**18.1**	**61.5**
At the beginning of the year	32.6	16.9	29.6	79.1

2010 Bank	Land and buildings	Leasehold improvements	Computers and other equipment	Total
Cost				
At the beginning of the year	34.8	24.8	130.9	190.5
Additions	–	–	1.6	1.6
Disposals	–	–	(11.5)	(11.5)
At the end of the year	34.8	24.8	121.0	180.6
Accumulated depreciation				
At the beginning of the year	1.4	2.8	84.7	88.9
Charge for the year	0.8	5.1	17.4	23.3
Disposals	–	–	(10.7)	(10.7)
At the end of the year	2.2	7.9	91.4	101.5
Net book value				
At the end of the year	32.6	16.9	29.6	79.1
At the beginning of the year	33.4	22.0	46.2	101.6

	Group		**Bank**	
	2011	2010	**2011**	2010
The net book value of land and buildings comprises:				
Freehold	**48.6**	49.7	**31.3**	32.0
Leasehold	**0.5**	0.6	**0.5**	0.6
	49.1	50.3	**31.8**	32.6

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

23. Other assets

	Group		Bank	
	2011	2010	**2011**	2010
Amounts recoverable within one year:				
Trade debtors	**23.2**	1.4	**23.2**	1.3
Current tax assets	**13.6**	–	**48.2**	–
Other assets	**9.8**	7.4	**6.1**	6.5
	46.6	8.8	**77.5**	7.8

The 2010 comparatives for the Group and Bank reflect a reclassification of £43.7m to derivatives from other assets.

24. Prepayments and accrued income

	Group		Bank	
	2011	2010	**2011**	2010
Amounts recoverable within one year:				
Other	**18.7**	16.2	**17.7**	14.5

25. Deposits by banks

	Group		Bank	
	2011	2010	**2011**	2010
Items in course of collection	**48.7**	45.3	**48.7**	45.3
Deposits from other banks	**3,254.0**	2,893.3	**3,191.1**	2,825.5
	3,302.7	2,938.6	**3,239.8**	2,870.8

Included within deposits from other banks are liabilities of £1,703.2m (2010: £1,349.1m) secured on investment securities with a carrying value of £2,114.4m (2010: £1,550.9m) which have been sold under sale and repurchase agreements (note 35).

26. Customer accounts

	Group		Bank	
	2011	2010	**2011**	2010
Retail	**26,429.2**	25,993.6	**25,631.2**	25,228.9
CABB	**7,648.4**	5,146.6	**6,684.1**	4,076.6
Other	**913.0**	1,179.8	**354.8**	606.5
	34,990.6	32,320.0	**32,670.1**	29,912.0

The Group has entered into interest rate swaps that protect it from changes in interest rates on the floating rate assets that are funded by its fixed rate customer accounts. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed rate customer accounts. Included within customer accounts are 'fair value hedged' fixed rate accounts with a total nominal value of £3.0m (2010: £84.7m) against which there are fair value adjustments for hedged risk of £(0.4)m (2010: £0.2m), giving a total carrying value of £2.6m (2010: £84.9m).

27. Customer accounts – capital bonds

	Group		Bank	
	2011	2010	**2011**	2010
Retail	**1,429.8**	1,794.7	**1,397.3**	1,744.0

The capital bonds are fixed term customer accounts with returns based on the movement in an index (eg FTSE 100) over the term of the bond.

The capital bonds have been designated on initial recognition at fair value through income and expense and are carried at fair value.

The fair values for the capital bonds are obtained on a monthly basis from the swap counterparties. These external valuations are reviewed independently using valuation software to ensure the fair values are priced on a consistent basis.

None of the change in the fair value of the capital bonds is attributable to changes in the liability's credit risk.

The maximum amount the Group would contractually be required to pay at maturity for all the capital bonds is £1,429.6m (2010: £1,756.0m).

The Group uses swaps to create economic hedges against all of its capital bonds. The gain on capital bonds in the income statement for the year is £24.8m (2010: £28.5m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the year is a gain of £0.6m (2010: loss of £0.3m).

28. Debt securities in issue

	Group		Bank	
	2011	2010	**2011**	2010
Certificates of deposit	**252.1**	638.8	**252.1**	638.8
Commercial paper	**–**	20.1	**–**	20.1
Fixed and floating rate notes	**3,912.7**	3,553.3	**1,178.9**	1,197.9
	4,164.8	4,212.2	**1,431.0**	1,856.8

The Group has entered into cross currency interest rate swaps that protect it from changes in exchange rates and interest rates on its debt securities in issue. Changes in the fair values of these swaps are largely offset by changes in the sterling equivalent carrying value of the debt securities in issue.

Debt securities in issue include fixed and floating rate notes, the majority of which are secured on portfolios of variable and fixed rate mortgages. The notes are redeemable in part from time to time, such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets. There is no requirement for the Group to make good any shortfall out of general funds. The maturity date of the notes matches the maturity date of the underlying assets.

29. Other borrowed funds

	Group and Bank	
	2011	2010
Step up callable subordinated notes 2019	**150.0**	150.0
60,000,000 9.25% non-cumulative irredeemable preference shares of £1 each	**60.0**	60.0
Floating rate subordinated notes 2016	**20.6**	104.1
5.625% fixed rate subordinated notes 2021	**150.0**	150.0
9.25% fixed rate subordinated notes 2021	**275.0**	–
Fixed rate subordinated notes 2024	**167.1**	144.0
Fixed rate subordinated notes 2033	**122.2**	99.1
Perpetual subordinated bonds	**282.9**	253.2
Issue costs, discounts and accrued interest	**31.0**	15.0
	1,258.8	975.4

Step up callable subordinated notes 2019

The notes were issued on 1 April 2004 at a discount of 0.946%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an interest rate of 5.875% per annum to (but excluding) 2 April 2014, and thereafter the interest rate will be determined by reference to the gross redemption yield on the five year benchmark gilt, and a margin of 2.25%. Interest is payable annually in arrears on 2 April.

The Bank may redeem all, but not less than all, of the notes at their principal amount on 2 April 2014.

60,000,000 9.25% non-cumulative irredeemable preference shares of £1 each

The preference shares carry the right to a fixed non-cumulative preferential dividend on the capital for the time being paid up, at the rate of 9.25% per annum exclusive of any associated tax credit. The dividends are payable on 31 May and 30 November each year and take priority over dividends to any other class of share in the capital of the Bank.

On a return of capital on winding up, the assets of the Bank shall be applied in repaying the preference share capital in priority to any payments to the holders of any other class of shares in the capital of the Bank. The amount receivable by the holders of the preference shares shall be the greater of the capital paid up or the average quoted price during the three months immediately preceding the date of the notice convening the meeting to consider the resolution to wind up.

The holders of the preference shares shall have the right to vote at a general meeting of the Bank only if and when, at the date of the notice convening the meeting, the dividend due to them has been in arrears for six months or more or if a resolution is to be proposed at the meeting abrogating or varying their rights or privileges or for the winding up of the Bank or other return of capital and then only on that resolution.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

29. Other borrowed funds continued

Floating rate subordinated notes 2016
The notes were issued on 18 May 2006 at a discount of 0.14%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes are denominated in euros and interest is calculated at three months EURIBOR plus a margin of 0.28%. From 18 May 2011 interest has been calculated at three months EURIBOR plus a margin of 0.78%. The first interest coupon was paid in August 2006.

The notes were hedged with a cross currency swap converting the exposure into sterling which paid a floating rate of three months LIBOR with a margin on interest coupon of 0.34125% and received a floating rate of three months EURIBOR plus a margin on interest coupon of 0.28%. The cross currency swap matured on 18 May 2011.

On 28 April 2011 the Bank redeemed €149.2m of the notes (representing 81% of the amount outstanding) leaving €34.9m outstanding. The Bank had the option to call the outstanding notes in whole but not in part on the interest payment date falling on or nearest to May 2011, and now at any interest payment date thereafter subject to prior consent of the Financial Services Authority.

5.625% fixed rate subordinated notes 2021
The notes were issued on 16 November 2006 at a discount of 0.189%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.625% up to and including the interest payment date on 16 November 2016, when the interest basis changes to floating rate. During the fixed rate period, interest is payable semi-annually in arrears on 16 May and 16 November.

From 17 November 2016, the notes carry a floating interest rate of three months LIBOR plus a margin of 1.75%. Interest is payable quarterly in arrears on 16 February, 16 May, 16 August and 16 November, commencing on the interest payment date falling in February 2017 up to and including the maturity date.

The Bank may redeem all, but not less than all, of the notes at the principal amount on 16 November 2016, and on any quarterly interest payment date thereafter.

9.25% fixed rate subordinated notes 2021
On 28 April 2011 the Bank issued £275.0m fixed rate subordinated notes due 2021, issued at par.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 9.25% up to (but excluding) 28 April 2021. Interest is payable annually in April.

There is no option to redeem the notes early.

Fixed rate subordinated notes 2024
The notes were issued on 17 March 2004 at a discount of 1.148%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.75% to 2 December 2019 (reset date). During this period the notes are hedged with interest rate swaps that convert the interest rate payable into floating rates at six months LIBOR plus a margin of 0.72%. The fixed receipt leg of the swap is received annually to match the payment to the noteholders. The floating payment leg of the swap is payable semi-annually in June and December. The interest rate swaps mature on 2 December 2019.

From the reset date the interest rate will be calculated based on the Five Year Benchmark Gilt rate plus a margin of 1.94%. The Five Year Benchmark Gilt rate being the Gross Redemption Yield determined by the UK government security having a maturity date falling on or nearest the fifth anniversary of the determination date (the determination date being two days prior to the reset date), converted to an annualised yield. The Gross Redemption Yield being calculated on the basis set out by the UK Debt Management Office in the publication 'Formulae for Calculating Gilt Prices from Yields'. From the reset date the interest will be paid annually in arrears until maturity or redemption.

The notes are callable in whole but not in part, at the principal amount, on 2 December 2019, subject to the prior consent of the Financial Services Authority.

Fixed rate subordinated notes 2033
The notes were issued on 28 March 2002 at a discount of 0.93%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.875% to maturity. Interest is payable semi-annually in March and September.

Of the notes, £100m are hedged with interest rate swaps that have a floating payment leg at six months LIBOR payable in March and September. The fixed interest rate receivable legs on the swaps are £25m at 5.405% and £75m at 5.225%. The semi-annual interest receivable leg on the swap is matched to the dates on the notes.

29. Other borrowed funds continued

Perpetual subordinated bonds

Perpetual subordinated bonds (PSBs) with a par value of £110m were issued in 1992 at a discount of 0%. PSBs with a par value of £200m were issued in 2005 at a discount of 0%.

Both the £110m and £200m PSBs are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of the bondholders will be subordinated in right of payment of all creditors (including subordinated creditors) of the Bank.

The PSBs with a par value of £110m carry an annual interest rate of 13%. Interest is payable semi-annually in January and July.

The PSBs with a par value of £200m carry an annual interest rate of 5.5555% up until the reset date. This coupon is payable semi-annually in June and December. From the reset date of 14 December 2015 the interest rate will be amended to the rate for three month deposits in sterling plus a margin of 2.05% per annum. The interest payments will then be made quarterly in arrears in March, June, September and December, with the interest resetting at each interest payment date.

During the period up until the reset date the PSBs are hedged with an interest rate swap that converts the interest rate payable into floating rates at six months LIBOR plus a margin of 1.175%. The semi-annual interest receivable and payable on the swap is aligned to the interest payment dates of the notes. The interest rate swap matures on 14 December 2015.

Given prior relevant supervisory consent, the Bank may elect to repay all, but not less than all, of these PSBs on 14 December 2015 or on any interest payment date thereafter at their principal amount.

30. Other liabilities

	Group		Bank	
	2011	2010	**2011**	2010
Amounts falling due within one year:				
ATM creditor	**122.4**	92.0	**122.4**	92.0
Other creditors	**46.5**	50.8	**42.2**	44.7
Amounts falling due after one year:				
Other creditors	**4.8**	4.0	**4.5**	3.8
	173.7	146.8	**169.1**	140.5

Other creditors of the Group and Bank include finance lease obligations as follows:

	Present value of lease payments		Future minimum lease payments	
	2011	2010	**2011**	2010
Due within one year	**–**	–	**–**	–
Due between one year and five years	**0.1**	0.1	**0.1**	0.1
Due after five years	**1.0**	1.3	**1.7**	1.7
	1.1	1.4	**1.8**	1.8

The future minimum lease payments have been discounted at LIBOR over the term of the lease to give the present value of these payments.

31. Accruals and deferred income

	Group		Bank	
	2011	2010	**2011**	2010
Amounts falling due within one year:				
Other	**34.6**	85.3	**27.9**	71.1
Amounts falling due after one year:				
Other	**5.3**	46.0	**5.2**	45.9
	39.9	131.3	**33.1**	117.0

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

32. Provisions for liabilities and charges

2011 Group	Property	FSCS levies	PPI	Other	Total
At the beginning of the year	**8.8**	**20.9**	**4.3**	**21.8**	**55.8**
Income statement movements:					
Provided in the year – operating expense	**0.4**	**14.5**	**–**	**0.1**	**15.0**
Provided in the year – net fee and commission income	**–**	**–**	**90.0**	**1.0**	**91.0**
Released in the year – operating expense	**(0.3)**	**–**	**–**	**(0.1)**	**(0.4)**
Released in the year – net fee and commission income	**–**	**–**	**–**	**(0.9)**	**(0.9)**
Utilised during the year	**(2.0)**	**(10.4)**	**(32.6)**	**(13.5)**	**(58.5)**
At the end of the year	**6.9**	**25.0**	**61.7**	**8.4**	**102.0**
Provisions were analysed as follows:					
Amounts falling due within one year	**3.0**	**10.9**	**51.3**	**8.4**	**73.6**
Amounts falling due after one year	**3.9**	**14.1**	**10.4**	**–**	**28.4**
	6.9	**25.0**	**61.7**	**8.4**	**102.0**

2010 Group	Property	FSCS levies	PPI	Other	Total
At the beginning of the year	7.1	20.6	–	25.1	52.8
Income statement movements:					
Provided in the year – operating expense	3.4	11.5	–	3.5	18.4
Provided in the year – net fee and commission income	–	–	4.3	8.8	13.1
Released in the year – operating expense	(0.3)	–	–	(12.3)	(12.6)
Released in the year – net fee and commission income	–	–	–	–	–
Utilised during the year	(1.4)	(11.2)	–	(3.3)	(15.9)
At the end of the year	8.8	20.9	4.3	21.8	55.8
Provisions were analysed as follows:					
Amounts falling due within one year	1.2	10.6	4.3	19.8	35.9
Amounts falling due after one year	7.6	10.3	–	2.0	19.9
	8.8	20.9	4.3	21.8	55.8

2011 Bank	Property	FSCS levies	PPI	Other	Total
At the beginning of the year	**7.4**	**20.3**	**4.3**	**7.3**	**39.3**
Income statement movements:					
Provided in the year – operating expense	**0.4**	**14.5**	**–**	**–**	**14.9**
Provided in the year – net fee and commission income	**–**	**–**	**90.0**	**–**	**90.0**
Released in the year – operating expense	**(0.2)**	**–**	**–**	**–**	**(0.2)**
Released in the year – net fee and commission income	**–**	**–**	**–**	**(0.1)**	**(0.1)**
Utilised during the year	**(0.8)**	**(9.9)**	**(32.6)**	**(7.2)**	**(50.5)**
At the end of the year	**6.8**	**24.9**	**61.7**	**–**	**93.4**
Provisions were analysed as follows:					
Amounts falling due within one year	**2.9**	**10.8**	**51.3**	**–**	**65.0**
Amounts falling due after one year	**3.9**	**14.1**	**10.4**	**–**	**28.4**
	6.8	**24.9**	**61.7**	**–**	**93.4**

32. Provisions for liabilities and charges continued

2010 Bank	Property	FSCS levies	PPI	Other	Total
At the beginning of the year	5.4	20.1	–	19.5	45.0
Income statement movements:					
Provided in the year – operating expense	3.2	11.0	–	–	14.2
Provided in the year – net fee and commission income	–	–	4.3	–	4.3
Released in the year – operating expense	(0.2)	–	–	(12.2)	(12.4)
Released in the year – net fee and commission income	–	–	–	–	–
Utilised during the year	(1.0)	(10.8)	–	–	(11.8)
At the end of the year	7.4	20.3	4.3	7.3	39.3
Provisions were analysed as follows:					
Amounts falling due within one year	1.0	9.7	4.3	7.3	22.3
Amounts falling due after one year	6.4	10.6	–	–	17.0
	7.4	20.3	4.3	7.3	39.3

Property

The Group has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases using a discount rate of 11%.

FSCS levies

In common with other FSA authorised financial institutions doing business in the UK, the Group contributes to the Financial Services Compensation Scheme (FSCS). The FSCS covers financial institutions authorised to do business in the UK. When an institution is unlikely, or likely to be unable, to pay claims against it, its customers may be able to claim compensation from the FSCS. The FSCS raises funds to meet the known compensation claims through levies on other FSA authorised institutions.

As a result of a number of institutions failing during 2008, the FSCS received funds from HM Treasury in order to meet its obligations to depositors. These borrowings are anticipated to be repaid wholly or substantially from the realisation of the assets of the failed institutions.

The FSCS raises annual levies from the banking industry in order to meet its management expenses and compensation costs. The annual levies are based upon each individual institution's proportion of the total market protected deposits at 31 December each year.

The Group has provided £25.0m (2010: £20.9m) for its share of the levies that will be raised by the FSCS, including the interest on the loan from the HM Treasury, in respect of the levy years ended 31 March 2012 and 31 March 2013.

At the date of these financial statements, it is not possible to estimate whether there will ultimately be additional levies on the industry, the level of the Group's market participation or other factors that may affect amounts or the timing of amounts that may ultimately become payable, nor the effect that such levies may have upon operating results in any particular year.

The Financial Services Commission in the Isle of Man operates a similar scheme. Britannia International Limited has provided £nil for the year ended 31 December 2011 in respect of this scheme (2010: £0.3m).

PPI

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

The FSA issued a policy statement in August 2010 which amended the 'Disputes Resolution: Complaints' section of the FSA Handbook, setting out new rules for handling complaints, including complaints of PPI mis-selling. The new rules were challenged by the BBA which launched a judicial review heard in January 2011. The results of the review were announced on 20 April 2011 and the High Court dismissed the BBA arguments. Consequently the Bank must comply with the policy statement which requires complainants to receive adequate redress and the Bank to complete a proactive review of all past business to identify mis-sold policies where no complaint has been made. An additional provision of £90.0m has been recognised in the year (note 5), in respect of the expected cost to the Bank of carrying out this work and paying compensation.

Other

The release of other provisions during 2010 relates to a disputed claim which was resolved during the year.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

33. Deferred tax
Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 25% (2010: 27%).

The movements on the deferred tax accounts are as follows:

	Group		Bank	
	2011	2010	**2011**	2010
Net deferred tax at the beginning of the year	**87.0**	86.1	**154.0**	210.3
Income statement charge	**(61.7)**	(2.5)	**(44.5)**	(57.8)
Prior year adjustments	**9.7**	2.1	**9.4**	0.2
Charged to equity:				
Unrealised appreciation on investments	**0.4**	–	**0.4**	–
Pensions and other post-retirement benefits	**(0.1)**	0.1	**(0.1)**	0.1
Cashflow hedges	**(8.9)**	1.2	**(8.9)**	1.2
Net deferred tax at the end of the year	**26.4**	87.0	**110.3**	154.0
Components of net deferred tax:				
Deferred tax asset	**137.5**	203.3	**110.3**	154.0
Deferred tax liability	**(111.1)**	(116.3)	**–**	–
	26.4	87.0	**110.3**	154.0
Net deferred tax comprises:				
Cashflow hedges	**(22.4)**	(13.4)	**(22.4)**	(13.4)
Unrealised appreciation on investments	**(0.7)**	(1.1)	**(0.7)**	(1.1)
Capital allowances on fixed assets	**28.5**	32.6	**29.4**	33.6
Capital allowances on assets leased to customers	**(2.7)**	(3.5)	**0.6**	0.2
Pensions and other post-retirement benefits	**0.9**	1.0	**0.9**	1.0
Fair value adjustments	**(3.4)**	34.5	**98.9**	129.0
Other temporary differences	**26.2**	36.9	**3.6**	4.7
	26.4	87.0	**110.3**	154.0

Other temporary differences for the Group of £26.2m (2010: £36.9m) include deferred tax assets/liabilities as a result of loss provisions on mortgage assets held by Special Purpose Entities (SPEs), taxation of SPEs under the securitisation regime and spreading of the tax effect of IFRS transitional adjustments.

The deferred tax charge in the income statement comprises the following temporary differences:

	Group		Bank	
	2011	2010	**2011**	2010
Capital allowances on fixed assets	**4.0**	4.2	**4.1**	4.3
Capital allowances on assets leased to customers	**(0.7)**	(0.5)	**(0.2)**	(0.2)
Fair value adjustments	**35.7**	(44.3)	**27.8**	33.4
Other temporary differences	**13.0**	41.0	**3.4**	20.1
	52.0	0.4	**35.1**	57.6

The Budget on 23 March 2011 announced that the UK corporation tax rate would reduce from 28% to 23% over a period of four years. The first reduction in the UK corporation tax rate from 28% to 26% was substantively enacted on 29 March 2011 and was effective from 1 April 2011. The budget on 21 March 2012 announced that the UK corporation tax rate would reduce by an additional one percent to 24% from April 2012 with further reductions to 23% in 2013 and 22% in 2014. These rate changes will reduce the Group's future current tax charge accordingly. The reduction in the UK corporation tax rate from 26% to 25% with effect from 1 April 2012 was substantively enacted on 5 July 2011. The tax disclosures for the period reflect deferred tax at the 25% substantively enacted rate at the balance sheet date. It has not yet been possible to quantify the full anticipated effect of the further rate reduction, although this will further reduce the Group's future tax charge and reduce the Group's deferred tax assets/liabilities.

The Group has traded profitably and expects that the deferred tax asset will be recoverable against future profits.

34. Pensions

Defined contribution basis

The Group participates in The Co-operative Group Pension (Average Career Earnings) Scheme (the PACE scheme). This scheme is a defined benefit scheme, the assets of which are held in a separate fund administered by trustees. As a group-wide pension scheme, the PACE scheme exposes the participating businesses to actuarial risks associated with the current and former employees of other Group companies, with the result that there is no consistent and reliable basis for allocating liabilities, assets and costs to individual companies participating in the scheme. Therefore, pension costs in respect of the scheme are accounted for on a defined contribution basis and recognised as an expense in the income statement as incurred, based on a fixed percentage as agreed with the trustees.

Key assumptions of the Group pension scheme

The key aspects of the PACE scheme are as follows:

	2011	2010
The principal assumptions used to determine the liabilities of the PACE scheme are:		
Discount rate	**4.60%**	5.20%
Rate of increase in salaries	**4.80%**	5.20%
Future pension increases where capped at 5.0% per annum	**3.30%**	3.70%
Future pension increases where capped at 2.5% per annum	**2.50%**	2.50%
Assumptions used to determine net pension cost for the PACE scheme are:		
Discount rate	**5.20%**	5.60%
Expected long term return on scheme assets	**6.20%**	6.50%
Rate of increase in salaries	**5.20%**	5.30%

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the PACE scheme at the 2011 year end is:

	Male	**Female**
Life expectancy:		
Member currently aged 65 (current life expectancy)	**21.9**	**23.4**
Member currently aged 45 (life expectancy at age 65)	**23.3**	**25.0**

The amounts recognised in the balance sheet of The Co-operative Group are as follows:

	2011	2010
Present value of funded obligations	**(6,242.6)**	(5,794.2)
Present value of unfunded obligations	**(4.4)**	(4.1)
Fair value of plan assets	**6,610.5**	6,071.3
	363.5	273.0

The weighted average asset allocations at the year end were as follows:

	2011	2010
Equities	**29%**	31%
Liability driven investments	**51%**	54%
Alternative growth	**14%**	9%
Property	**5%**	4%
Cash	**1%**	2%

To develop the expected long term rate of return on assets assumption, The Co-operative Group considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long term rate of return on assets assumption for the portfolio. This resulted in the selection of the 6.2% assumption for the year ended 31 December 2011 (2010: 6.5%).

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

34. Pensions continued

Former Britannia Building Society pension scheme

Following the transfer of engagements of Britannia Building Society, the Britannia pension scheme transferred to the Co-operative Financial Services Management Services Limited (CFSMS). The pension cost shown in these accounts in respect of the Britannia defined benefit scheme for the period after 31 July 2009 is the actual contribution paid by the Bank.

The key aspects of the Britannia defined benefit scheme are as follows:

	2011	2010
The principal assumptions used to determine the liabilities of the Britannia defined benefit scheme are:		
Discount rate	**4.60%**	5.20%
Rate of increase in salaries	**4.80%**	5.20%
Future pension increases where capped at 5.0% per annum	**3.30%**	3.70%
Future pension increases where capped at 2.5% per annum	**2.50%**	2.50%
Assumptions used to determine net pension cost for the Britannia defined benefit scheme are:		
Discount rate	**5.20%**	5.60%
Expected long term return on scheme assets	**6.00%**	6.20%
Rate of increase in salaries	**5.20%**	5.30%

The average life expectancy (in years) for mortality tables used to determine defined benefit scheme liabilities for the former Britannia Building Society scheme at the 2011 year end is:

	Male	**Female**
Life expectancy:		
Member currently aged 65 (current life expectancy)	**23.5**	**25.8**
Member currently aged 40 (life expectancy at age 60)	**25.0**	**27.4**

The amounts recognised in the balance sheet of The Co-operative Group are as follows:

	2011	2010
Present value of funded obligations	**(608.4)**	(549.4)
Present value of unfunded obligations	**(2.9)**	(5.6)
Fair value of plan assets	**569.9**	509.2
	(41.4)	(45.8)

The weighted average asset allocations at the year end were as follows:

	2011	2010
Equities	**25%**	28%
Diversified growth	**15%**	17%
Liability driven investments	**57%**	54%
Property	**3%**	1%

To develop the expected long term rate of return on assets assumption, The Co-operative Group considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long term rate of return on assets assumption for the portfolio. This resulted in the selection of the 6.0% assumption for the year ended 31 December 2011 (2010: 6.2%).

34. Pensions continued

Bank (unfunded) pension scheme

The Bank also operates a small unfunded pension scheme.

	2011	2010	2009	2008	2007
Expected return on scheme assets	**N/A**	N/A	N/A	N/A	N/A
Rate of increase of pensions in payment	**3.3%**	3.7%	3.8%	3.3%	3.4%
Rate of increase in salaries	**4.8%**	5.2%	5.3%	4.8%	4.9%
Discount rate	**4.6%**	5.2%	5.6%	5.7%	5.7%

The values of the assets and liabilities of the unfunded pension scheme were:

	Group and Bank	
	2011	2010
Present value of unfunded obligations	**(3.9)**	(3.8)
Deficit in scheme	**(3.9)**	(3.8)
Related deferred tax asset	**0.9**	1.0
Net pension liability	**(3.0)**	(2.8)
Analysis of amount charged to income statement:		
Current service cost	**–**	–
Interest on pension scheme liabilities	**0.2**	0.2
	0.2	0.2

Changes in the present value of the scheme liabilities are as follows:

	Group and Bank	
	2011	2010
Opening defined benefit liabilities	**3.8**	3.5
Current service cost	**–**	–
Interest on liabilities	**0.2**	0.2
Actuarial losses	**–**	0.4
Benefits paid	**(0.1)**	(0.3)
Closing defined benefit liabilities	**3.9**	3.8

Amounts recognised in the statement of comprehensive income:

	Group and Bank	
	2011	2010
Actuarial losses on scheme liabilities during the year	**–**	(0.4)
Actuarial gains on scheme assets during the year	**–**	–
Total scheme losses during the year	**–**	(0.4)

The amounts for the current year are as follows:

	Group and Bank	
	2011	2010
Defined benefit obligation	**(3.9)**	(3.8)
Scheme assets	**–**	–
Deficit in scheme	**(3.9)**	(3.8)
Experience adjustment on scheme liabilities	**–**	–
Experience adjustment on scheme assets	**–**	–

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

35. Contingent liabilities and commitments
The tables below give, for the Group and the Bank, the contract amounts and risk weighted amounts of contingent liabilities and commitments. The contract principal amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The risk weighted amounts have been calculated in accordance with the FSA guidelines implementing the Capital Requirements Directive (CRD).

The contingent liabilities of the Group and the Bank as detailed below arise in the normal course of banking business and it is not practical to quantify their future financial effect.

	Contract amount 2011	**Risk weighted amount 2011**	Contract amount 2010	Risk weighted amount 2010
Group				
Contingent liabilities:				
Guarantees and irrevocable letters of credit	**167.6**	**131.8**	134.2	99.1
Bank				
Contingent liabilities:				
Guarantees and irrevocable letters of credit	**166.6**	**131.3**	132.8	98.4
Group				
Other commitments:				
Documentary credits and short term trade related transactions	**7.7**	**1.5**	2.8	0.5
Forward asset purchases and forward deposits placed	**44.9**	**0.9**	165.8	14.6
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[(i)]	**4,700.1**	**1,148.1**	4,590.9	1,089.3
	4,752.7	**1,150.5**	4,759.5	1,104.4
Bank				
Other commitments:				
Documentary credits and short term trade related transactions	**7.7**	**1.5**	2.8	0.5
Forward asset purchases and forward deposits placed	**44.9**	**0.9**	165.8	14.6
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[(i)]	**4,504.2**	**1,138.7**	4,450.9	1,081.5
	4,556.8	**1,141.1**	4,619.5	1,096.6

Notes
(i) Undrawn loan commitments include revocable commitments which are unused credit card limits of £2,181.6m (2010: £2,344.9m).

Assets pledged
Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Group's day to day operations. Mandatory reserve deposits are also held with the Bank of England in accordance with statutory requirements.

At 31 December 2011, the mandatory reserve deposits held with the Bank of England were £38.0m (2010: £36.1m) (note 13).

Within the Group and Bank, investment securities with a carrying value of £2,114.4m (2010: £1,550.9m) have been sold under sale and repurchase agreements. These assets have not been derecognised as the Group and Bank have retained substantially all the risks and rewards of ownership. Included within deposits by banks are the related liabilities of £1,703.2m (2010: £1,349.1m).

In addition, within the Bank, amounts owed by other Co-operative Group undertakings with a carrying value of £777.1m (2010: £988.6m) have been sold under sale and repurchase agreements. These assets have not been derecognised as the Bank has retained substantially all the risks and rewards of ownership. Included within deposits by banks are the related liabilities of £613.9m (2010: £778.6m).

The Group and Bank have loans and advances to banks of £255.7m (2010: £70.0m) under reverse sale and repurchase agreements and against which it holds gilts with a fair value of £267.8m (2010: £70.0m). These transactions are conducted under terms that are usual and customary to standard stock lending, securities borrowing and reverse purchase agreements. The Group is permitted to sell or repledge the assets received as collateral in the absence of their default. The Group is obliged to return equivalent securities. At 31 December 2011 the fair value of collateral repledged amounted to £267.8m (2010: £70.0m). The Group and Bank do not adjust for the fair value of securities received under reverse sale and repurchase agreements.

35. Contingent liabilities and commitments continued

Commitments under operating leases

The Group leases various properties and equipment under non-cancellable operating lease arrangements. The leases have various terms, ranging from six months to 999 years. None of these leases are individually material and none have any material clauses. The table below discloses the minimum operating lease payments the Group and the Bank will be required to make over the remaining lives of the leases.

	Land and buildings 2011	**Equipment 2011**	Land and buildings 2010	Equipment 2010
Group				
Falling due:				
Within one year	**26.1**	**0.3**	24.4	0.4
Between one and five years	**76.5**	**0.4**	78.6	0.4
In five years or more	**87.3**	**0.1**	103.5	–
	189.9	**0.8**	206.5	0.8
Bank				
Falling due:				
Within one year	**25.4**	**0.3**	24.0	0.4
Between one and five years	**78.7**	**0.4**	75.9	0.4
In five years or more	**73.7**	**0.1**	84.5	–
	177.8	**0.8**	184.4	0.8

The Group leases a number of branch and office premises under operating leases. The leases typically run for a period of up to 25 years, with an option to renew the lease after that period. Lease payments are generally reviewed every three to five years to reflect market rentals.

The total value of future minimum sub-lease payments expected to be received under non-cancellable sub-leases for the Group was £12.8m (2010: £13.4m) and for the Bank was £12.8m (2010: £12.2m).

Former Britannia Building Society pension scheme guarantee

Following the transfer of engagements of Britannia Building Society, the Britannia pension scheme transferred to CFSMS. Under the terms of this transfer the Bank entered into a deed of guarantee to provide assurance to the trustees of the pension scheme to support CFSMS in meeting its funding obligations to the scheme should CFSMS be unable to pay its obligations as they fall due.

Intra-group guarantee

The Bank has an indemnification agreement, accounted for as an intra-group guarantee under IFRS 4, with CFSMS in which the Bank has agreed to indemnify CFSMS against all and any liability, loss, damage, costs and expense arising from the agreement.

36. Investments in Group undertakings

Investments in equity shares and loans of subsidiary undertakings are financial assets.

	2011			2010		
	Ordinary shares	**Capital contributions**	**Total**	Ordinary shares	Capital contributions	Total
At the beginning of the year	**569.0**	**889.9**	**1,458.9**	576.4	996.0	1,572.4
Additions	**1.0**	**1,057.8**	**1,058.8**	11.5	386.0	397.5
Impairment of investment in Co-operative Bank Financial Advisers Limited	**–**	**–**	**–**	(18.9)	–	(18.9)
Repayments	**(0.3)**	**(944.0)**	**(944.3)**	–	(492.1)	(492.1)
At the end of the year	**569.7**	**1,003.7**	**1,573.4**	569.0	889.9	1,458.9

Subsidiary undertakings

The Bank has, except in the case of Unity Trust Bank plc, a direct interest in the ordinary share capital of the following principal subsidiary undertakings trading in the businesses indicated. All subsidiary undertakings are included in the consolidated Group results.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

36. Investments in Group undertakings continued
Principal subsidiary undertakings which are registered in England and operating in the UK:

		Group interest 2011	Group interest 2010
Unity Trust Bank plc (held through subsidiary undertaking)	Banking	**27%**	27%
Co-operative Commercial Limited	Investment company	**100%**	100%
First Roodhill Leasing Limited	Leasing	**100%**	100%
Second Roodhill Leasing Limited	Leasing	**100%**	100%
Third Roodhill Leasing Limited	Leasing	**100%**	100%
Fourth Roodhill Leasing Limited	Leasing	**100%**	100%
The Covered Bond LLP	Mortgage acquisition and guarantor of covered bonds	**100%**	100%
Britannia Treasury Services Limited	Holding company	**100%**	100%
Britannia Asset Management Limited	Holding company	**100%**	100%
Britannia Development and Management Company Limited	Property investment	**100%**	100%
Illius Properties Limited	Property investment	**100%**	100%
Moorland Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	**100%**	100%

The Covered Bond LLP was established as a result of a £1.0bn covered bond retained issuance by the Bank during 2008. Loans and advances to customers of £2.3bn were transferred to the LLP. The transfer was funded by a loan of £1.0bn and capital contribution of £1.3bn. This issuance was redeemed during the year.

Moorland Covered Bonds LLP was established as a result of a £1.4bn covered bond retained issuance. Loans and advances to customers of £1.9bn were transferred to Moorland Covered Bonds LLP. The transfer was funded by a loan of £1.4bn and capital contribution of £0.5bn. During October 2011 the £1.4bn loan was repaid. Following additional capital contribution repayment and on achieving Regulated Covered Bond status there was a public issuance of notes in November 2011 totalling £0.6bn. As a result of these changes at the year end the Bank held a loan of £0.6bn and a capital contribution of £1.0bn with Moorland Covered Bonds LLP.

The loans issued by the Bank are included within amounts owed by other Co-operative Group undertakings. The associated capital contribution invested by the Bank is included within investments in Group undertakings. The notes issued by the Bank in November 2011 are included within debt securities in issue.

The Covered Bond LLP and Moorland Covered Bonds LLP do not have ordinary share capital. The Bank's interest in The Covered Bond LLP and Moorland Covered Bonds LLP is in substance no different from a wholly owned subsidiary and consequently they are fully consolidated in the Group accounts.

The accounting policy for Special Purpose Entities (SPEs) is disclosed on page 39.

Unity Trust Bank plc is considered to be a subsidiary undertaking of The Co-operative Bank plc as The Co-operative Bank plc elects a majority of the directors and appoints the chair and managing director. This provides the power to control.

Investments in equity shares and loans with subsidiary undertakings are shown net of impairments.

Britannia Treasury Services Limited has the following principal wholly owned subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Mortgage Agency Services Number One Limited	Mortgage and syndicated lending
Mortgage Agency Services Number Two Limited	Mortgage lending
Mortgage Agency Services Number Four Limited	Mortgage lending
Mortgage Agency Services Number Five Limited	Mortgage lending
Mortgage Agency Services Number Six Limited	Mortgage lending
Western Mortgage Services Limited	Mortgage book administration
Platform Group Holdings Limited	Holding company

Platform Group Holdings Limited has the following principal wholly owned subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Platform Consumer Services Limited	Mortgage lending
Platform Funding Limited	Mortgage origination
Platform Home Loans Limited	Mortgage origination and servicing

Platform Consumer Services Limited is the only direct subsidiary of Platform Group Holdings Limited.

Registered in the Isle of Man and operating overseas:

Britannia International Limited	Deposit taking

36. Investments in Group undertakings continued
Registered in Scotland and operating in the UK:

Britannia Life Direct Limited	Direct sales of financial services

Securitisation vehicles

The results of the following principal securitisation vehicles are consolidated into the results of the Group under SIC 12 (Consolidation: Special Purpose Entities):

Leek Finance Number Seventeen plc	Securitisation company
Leek Finance Number Eighteen plc	Securitisation company
Leek Finance Number Nineteen plc	Securitisation company
Leek Finance Number Twenty plc	Securitisation company
Leek Finance Number Twenty One plc	Securitisation company
Leek Finance Number Twenty Two plc	Securitisation company
Meerbrook Finance Number One Limited	Securitisation company
Meerbrook Finance Number Two Limited	Securitisation company
Meerbrook Finance Number Three Limited	Securitisation company
Meerbrook Finance Number Four Limited	Securitisation company
Meerbrook Finance Number Six Limited	Securitisation company
Dovedale Finance Number One plc	Securitisation company
Silk Road Finance Number One plc	Securitisation company
Silk Road Finance Number Two plc	Securitisation company

All securitisation vehicles are registered in England and operate in the UK, with the exception of Dovedale Finance Number One plc, which is registered and operates in the Republic of Ireland.

All of the above companies are related parties to the Group. See note 37 for the related party disclosures.

Joint ventures

The Group's investment in joint ventures is £2.7m (2010: £2.5m).

The Bank owns 49% of the ordinary shares in Britannia Personal Lending Limited, a company registered in England and operating in the UK. The company trades in the business of unsecured personal lending.

The Group's interest in Britannia Personal Lending Limited is as follows:

	2011	2010
Current assets	**17.5**	21.7
Long term assets	**13.0**	22.6
	30.5	44.3
Current liabilities	**20.2**	27.3
Long term liabilities	**10.3**	17.0
	30.5	44.3
Income	**1.3**	2.5
Expenses	**(1.1)**	(1.5)
Profit before tax	**0.2**	1.0
Taxation	**–**	(0.3)
Profit after tax	**0.2**	0.7

Joint ventures are accounted for using the equity method.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

37. Related party transactions

Parent, subsidiary and ultimate controlling party

The Co-operative Banking Group Limited (previously the Co-operative Financial Services Limited) owns 100% of the issued ordinary share capital of the Bank and is the Bank's immediate holding company. The Co-operative Banking Group Limited is incorporated in England and is registered under the Industrial and Provident Societies Acts. The ultimate holding organisation is the Co-operative Group Limited, which is incorporated in England and registered under the Industrial and Provident Societies Acts. The financial statements of the immediate and ultimate holding organisations are available from New Century House, Manchester, M60 4ES.

Further details of subsidiary undertakings and joint ventures are disclosed in note 36.

A number of banking transactions are entered into, with related parties in the normal course of business on normal commercial terms. These include loans and deposits. Key management as defined by IAS 24 (Related Party Disclosures) are considered to be Board and executive members of the Group, and Board and executive members of the Group's immediate and ultimate holding organisations. The volume of related party transactions, outstanding balances at the year end, and related income and expense for the year are as follows:

Directors, key management personnel and close family members

	Group and Bank	
	2011	2010
Loans outstanding at the beginning of the year	**2.3**	3.1
Net movement	**(0.1)**	(0.8)
Loans outstanding at the end of the year	**2.2**	2.3
Deposits and investments at the beginning of the year	**2.0**	2.0
Net movement	**(0.1)**	–
Deposits and investments at the end of the year	**1.9**	2.0

Directors' loans

	Mortgages 2011	**Personal loans 2011**	**Credit cards 2011**	Mortgages 2010	Personal loans 2010	Credit cards 2010
Number of directors with loan type	**6**	**1**	**9**	8	–	11
Total value of directors' loans	**1.8**	**–**	**–**	2.2	–	–

The Bank undertook the following transactions with Group companies during the year:

	Interest paid to Bank	**Interest received from Bank**	**Staff recharges paid to Bank**	**Rent received from Bank**	**Administration recharge paid to Bank**
2011					
First Roodhill Leasing Limited	**–**	**0.2**	**–**	**–**	**–**
Second Roodhill Leasing Limited	**0.2**	**–**	**–**	**–**	**–**
Third Roodhill Leasing Limited	**0.3**	**–**	**–**	**–**	**–**
The Covered Bond LLP	**9.1**	**9.3**	**–**	**–**	**–**
Britannia Treasury Services Limited	**0.2**	**–**	**–**	**–**	**–**
Britannia Development and Management Company Limited	**–**	**–**	**–**	**0.6**	**–**
Britannia Asset Management Limited	**–**	**0.3**	**–**	**–**	**–**
Mortgage Agency Services Number One Limited	**17.6**	**–**	**–**	**–**	**–**
Mortgage Agency Services Number Two Limited	**0.4**	**–**	**–**	**–**	**–**
Mortgage Agency Services Number Four Limited	**1.3**	**–**	**0.1**	**–**	**–**
Mortgage Agency Services Number Five Limited	**2.9**	**–**	**0.4**	**–**	**–**
Mortgage Agency Services Number Six Limited	**0.3**	**–**	**–**	**–**	**–**
Platform Group Holdings Limited	**39.0**	**–**	**8.6**	**–**	**–**
Britannia International Limited	**–**	**40.5**	**–**	**–**	**–**
Britannia Life Direct Limited	**–**	**0.8**	**–**	**–**	**–**
Illius Properties Limited	**4.0**	**–**	**0.3**	**–**	**–**
Moorland Covered Bonds LLP	**18.5**	**42.5**	**–**	**–**	**–**
Other	**–**	**0.7**	**–**	**–**	**–**

37. Related party transactions continued

	Interest paid to Bank	Interest received from Bank	Staff recharges paid to Bank	Rent received from Bank	Administration recharge paid to Bank
2010					
First Roodhill Leasing Limited	–	0.1	–	–	–
Second Roodhill Leasing Limited	0.2	–	–	–	–
Third Roodhill Leasing Limited	0.3	–	–	–	–
Fourth Roodhill Leasing Limited	0.1	–	–	–	–
The Covered Bond LLP	11.9	12.0	–	–	–
Britannia Treasury Services Limited	0.3	–	–	–	–
Britannia Development and Management Company Limited	–	–	–	0.6	–
Britannia Asset Management Limited	–	0.3	–	–	–
Mortgage Agency Services Number One Limited	17.8	–	0.1	–	–
Mortgage Agency Services Number Two Limited	0.4	–	–	–	–
Mortgage Agency Services Number Four Limited	1.3	–	0.1	–	–
Mortgage Agency Services Number Five Limited	3.0	–	1.1	–	–
Mortgage Agency Services Number Six Limited	0.1	–	–	–	–
Platform Group Holdings Limited	44.2	–	–	–	–
Britannia International Limited	–	39.5	–	–	–
Britannia Life Direct Limited	–	0.7	–	–	–
Illius Properties Limited	3.5	–	1.0	–	–
Moorland Covered Bonds LLP	17.0	53.7	–	–	–
Other	–	0.5	–	–	7.6

Interest accrues on outstanding balances at a transfer price rate agreed between the Bank and its subsidiaries.

	Interest and fees received from other Co-operative Group undertakings 2011	**Interest and fees paid to other Co-operative Group undertakings 2011**	Interest and fees received from other Co-operative Group undertakings 2010	Interest and fees paid to other Co-operative Group undertakings 2010
Parent undertakings	**4.6**	**1.0**	5.7	0.5
Fellow subsidiary undertakings	**1.1**	**–**	2.1	–
	5.7	**1.0**	7.8	0.5

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

37. Related party transactions continued
At the year end the following unsecured balances were outstanding:

	Loans owed to Bank 2011	**Loans owed by Bank 2011**	Loans owed to Bank 2010	Loans owed by Bank 2010
Co-operative Commercial Limited	**0.5**	**–**	1.0	–
First Roodhill Leasing Limited	**–**	**3.8**	–	3.1
Second Roodhill Leasing Limited	**2.8**	**–**	3.5	–
Third Roodhill Leasing Limited	**3.7**	**–**	5.4	–
Fourth Roodhill Leasing Limited	**–**	**0.7**	0.7	–
The Covered Bond LLP	**–**	**–**	1,000.0	1,432.6
Unity Trust Bank plc	**–**	**102.8**	–	78.1
Britannia Treasury Services Limited	**8.4**	**–**	34.4	–
Britannia Development and Management Company Limited	**–**	**2.8**	–	2.3
Britannia Asset Management Limited	**–**	**40.1**	–	39.9
Mortgage Agency Services Number One Limited	**1,919.1**	**–**	2,169.3	–
Mortgage Agency Services Number Two Limited	**46.8**	**–**	55.9	–
Mortgage Agency Services Number Four Limited	**152.1**	**–**	165.7	–
Mortgage Agency Services Number Five Limited	**319.4**	**–**	365.6	–
Mortgage Agency Services Number Six Limited	**29.9**	**–**	33.4	–
Platform Group Holdings Limited	**3,297.4**	**–**	2,929.6	–
Britannia International Limited	**–**	**1,848.2**	–	1,931.3
Britannia Life Direct Limited	**–**	**101.6**	–	95.5
Western Mortgage Services Limited	**–**	**0.4**	0.7	–
Illius Properties Limited	**155.3**	**–**	144.1	–
Moorland Covered Bonds LLP	**616.8**	**1,562.1**	1,422.5	1,827.8
Other	**5.8**	**11.8**	5.6	12.5

Group	**Loans owed by other Co-operative Group undertakings 2011**	**Loans owed to other Co-operative Group undertakings 2011**	Loans owed by other Co-operative Group undertakings 2010	Loans owed to other Co-operative Group undertakings 2010
Parent undertakings	**1.6**	**74.0**	–	110.5
Fellow subsidiary undertakings	**177.6**	**58.3**	0.6	78.0
	179.2	**132.3**	0.6	188.5

Bank	**Loans owed by other Co-operative Group undertakings 2011**	**Loans owed to other Co-operative Group undertakings 2011**	Loans owed by other Co-operative Group undertakings 2010	Loans owed to other Co-operative Group undertakings 2010
Parent undertakings	**1.6**	**74.0**	–	110.5
Fellow subsidiary undertakings	**180.5**	**58.3**	0.6	78.0
	182.1	**132.3**	0.6	188.5

There are no formal repayment terms with subsidiary companies.

Recharges from CFSMS
During the year, operating costs of £488.6m (2010: £433.5m) incurred on its behalf were charged at cost to the Bank by CFSMS, a fellow subsidiary of the Co-operative Banking Group Limited. At 31 December 2011, the Bank was owed £180.5m by CFSMS. At 31 December 2010, the Bank owed £4.4m to CFSMS.

37. Related party transactions continued

Transactions with SPEs

The Bank undertook the following transactions with SPEs during the year:

	Interest paid to Bank 2011	**Interest received from Bank 2011**	Interest paid to Bank 2010	Interest received from Bank 2010
Leek Finance Number Seventeen plc	**3.7**	**2.3**	1.3	–
Leek Finance Number Eighteen plc	**4.7**	**3.1**	1.2	–
Leek Finance Number Nineteen plc	**4.8**	**3.0**	1.1	–
Leek Finance Number Twenty plc	**27.5**	**–**	26.4	–
Leek Finance Number Twenty One plc	**18.3**	**–**	17.7	–
Leek Finance Number Twenty Two plc	**7.7**	**–**	7.4	–
Meerbrook Finance Number One Limited	**0.2**	**–**	0.6	–
Meerbrook Finance Number Three Limited	**0.3**	**–**	0.3	–
Meerbrook Finance Number Four Limited	**8.1**	**0.7**	6.9	0.5
Meerbrook Finance Number Six Limited	**0.2**	**–**	0.1	–
Silk Road Finance Number One plc	**26.4**	**–**	24.4	–
Silk Road Finance Number Two plc	**1.2**	**–**	–	–
Other	**–**	**–**	1.1	–

	Fees paid to Bank 2011	**Fees received from Bank 2011**	Fees paid to Bank 2010	Fees received from Bank 2010
Silk Road Finance Number One plc	**2.0**	**–**	2.0	–
Silk Road Finance Number Two plc	**0.4**	**–**	–	–
Other	**–**	**–**	–	2.2

At the year end the following balances were outstanding with SPEs:

	Loans owed to Bank 2011	**Loans owed by Bank 2011**	Loans owed to Bank 2010	Loans owed by Bank 2010
Leek Finance Number Seventeen plc	**186.8**	**164.2**	22.3	2.1
Leek Finance Number Eighteen plc	**243.8**	**206.1**	13.4	0.3
Leek Finance Number Nineteen plc	**235.6**	**203.1**	35.0	0.3
Leek Finance Number Twenty plc	**1,667.4**	**2.5**	1,757.1	2.5
Leek Finance Number Twenty One plc	**1,118.9**	**0.9**	1,200.0	2.6
Leek Finance Number Twenty Two plc	**464.8**	**1.0**	487.1	1.6
Meerbrook Finance Number One Limited	**14.0**	**0.9**	41.5	27.8
Meerbrook Finance Number Two Limited	**–**	**0.1**	–	0.1
Meerbrook Finance Number Three Limited	**10.1**	**2.5**	10.1	2.8
Meerbrook Finance Number Four Limited	**682.2**	**109.6**	727.1	109.1
Meerbrook Finance Number Six Limited	**15.8**	**3.6**	15.8	4.5
Silk Road Finance Number One plc	**1,382.6**	**2,128.1**	1,586.4	2,574.4
Silk Road Finance Number Two plc	**199.1**	**828.3**	–	–
Dovedale Finance Number One plc	**–**	**0.5**	–	0.4
Other	**–**	**3.2**	–	1.0

In addition to the above the Bank holds floating rate notes in Leek Finance Number Seventeen plc of £18.5m (2010: £12.7m), in Leek Finance Number Eighteen plc of £23.3m (2010: £18.2m) and in Leek Finance Number Nineteen plc of £28.7m (2010: £21.7m) included within investment securities – available for sale.

The loans owed to the SPEs comprise cash balances deposited with the Bank.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

37. Related party transactions continued
Key management compensation

	Group and Bank	
	2011	2010
Salaries and short term benefits	**4.6**	5.4
Termination benefits	**2.5**	–
	7.1	5.4

Directors' remuneration
A list of the members of the Board of directors is shown on page 10. The total remuneration of directors was £3.7m (2010: £4.5m).

Further details of directors' remuneration are provided in the remuneration report on pages 19 to 28.

38. Share capital

	Group and Bank			
	No. of shares (millions) 2011	**Share capital 2011**	No. of shares (millions) 2010	Share capital 2010
Authorised capital (ordinary shares of 5p each)				
At the beginning of the year	**8,200**	**410.0**	4,600	230.0
Increase in the year	**–**	**–**	3,600	180.0
At the end of the year	**8,200**	**410.0**	8,200	410.0
Allotted, called up and fully paid (ordinary shares of 5p each)				
At the beginning of the year	**8,200**	**410.0**	4,600	230.0
Issued in the year	**–**	**–**	3,600	180.0
At the end of the year	**8,200**	**410.0**	8,200	410.0
Share premium account at the beginning and the end of the year		**8.8**		8.8

On 15 December 2010, the Bank issued 3,600,000,000 ordinary shares of 5p each at a cost of £180.0m. These were issued to its immediate parent company, the Co-operative Banking Group Limited.

The shareholders have one vote for every share held.

39. Fair values of financial assets and liabilities

The tables below analyse the balance sheet carrying values of financial assets and liabilities by classification.

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Cashflow hedges	Total
2011							
Group							
Assets							
Cash and balances at central banks	–	–	**6,696.6**	–	–	–	**6,696.6**
Loans and advances to banks	–	–	**2,006.5**	–	–	–	**2,006.5**
Loans and advances to customers	–	**114.1**	**34,018.2**	–	–	–	**34,132.3**
Investment securities	–	**343.1**	**804.9**	**3,423.0**	–	–	**4,571.0**
Derivative financial instruments	**163.7**	**593.6**	–	–	–	**218.5**	**975.8**
Equity shares	–	–	–	**5.7**	–	–	**5.7**
Amounts owed by other Co-operative Group undertakings	–	–	**179.2**	–	–	–	**179.2**
Total financial assets	**163.7**	**1,050.8**	**43,705.4**	**3,428.7**	–	**218.5**	**48,567.1**
Non-financial assets							**388.5**
Total assets							**48,955.6**
Liabilities							
Deposits by banks	–	–	–	–	**3,302.7**	–	**3,302.7**
Customer accounts	–	–	–	–	**34,990.6**	–	**34,990.6**
Customer accounts – capital bonds	–	**1,429.8**	–	–	–	–	**1,429.8**
Debt securities in issue	–	–	–	–	**4,164.8**	–	**4,164.8**
Derivative financial instruments	**143.5**	**838.2**	–	–	–	**106.2**	**1,087.9**
Other borrowed funds	–	–	–	–	**1,258.8**	–	**1,258.8**
Amounts owed to other Co-operative Group undertakings	–	–	–	–	**132.3**	–	**132.3**
Total financial liabilities	**143.5**	**2,268.0**	–	–	**43,849.2**	**106.2**	**46,366.9**
Non-financial liabilities							**315.6**
Total liabilities							**46,682.5**
Capital and reserves							**2,273.1**
Total liabilities and equity							**48,955.6**

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Cashflow hedges	Total
2010							
Group							
Assets							
Cash and balances at central banks	–	–	1,735.6	–	–	–	1,735.6
Loans and advances to banks	–	–	2,394.1	–	–	–	2,394.1
Loans and advances to customers	–	74.1	35,070.0	–	–	–	35,144.1
Investment securities	–	28.7	1,917.3	2,957.1	–	–	4,903.1
Derivative financial instruments	67.0	689.8	–	–	–	218.8	975.6
Equity shares	–	–	–	7.2	–	–	7.2
Amounts owed by other Co-operative Group undertakings	–	–	0.6	–	–	–	0.6
Total financial assets	67.0	792.6	41,117.6	2,964.3	–	218.8	45,160.3
Non-financial assets							421.0
Total assets							45,581.3
Liabilities							
Deposits by banks	–	–	–	–	2,938.6	–	2,938.6
Customer accounts	–	–	–	–	32,320.0	–	32,320.0
Customer accounts – capital bonds	–	1,794.7	–	–	–	–	1,794.7
Debt securities in issue	–	–	–	–	4,212.2	–	4,212.2
Derivative financial instruments	52.9	487.6	–	–	–	161.9	702.4
Other borrowed funds	–	–	–	–	975.4	–	975.4
Amounts owed to other Co-operative Group undertakings	–	–	–	–	188.5	–	188.5
Total financial liabilities	52.9	2,282.3	–	–	40,634.7	161.9	43,131.8
Non-financial liabilities							376.4
Total liabilities							43,508.2
Capital and reserves							2,073.1
Total liabilities and equity							45,581.3

39. Fair values of financial assets and liabilities continued

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Cashflow hedges	Total
2011							
Bank							
Assets							
Cash and balances at central banks	–	–	**6,696.6**	–	–	–	**6,696.6**
Loans and advances to banks	–	–	**1,300.1**	–	–	–	**1,300.1**
Loans and advances to customers	–	**114.1**	**22,986.7**	–	–	–	**23,100.8**
Investment securities	–	**343.1**	**866.1**	**3,107.4**	–	–	**4,316.6**
Derivative financial instruments	**166.4**	**319.5**	–	–	–	**218.5**	**704.4**
Equity shares	–	–	–	**5.7**	–	–	**5.7**
Amounts owed by other Co-operative Group undertakings	–	–	**12,961.2**	–	–	–	**12,961.2**
Total financial assets	**166.4**	**776.7**	**44,810.7**	**3,113.1**	–	**218.5**	**49,085.4**
Non-financial assets							**1,880.3**
Total assets							**50,965.7**
Liabilities							
Deposits by banks	–	–	–	–	**3,239.8**	–	**3,239.8**
Customer accounts	–	–	–	–	**32,670.1**	–	**32,670.1**
Customer accounts – capital bonds	–	**1,397.3**	–	–	–	–	**1,397.3**
Debt securities in issue	–	–	–	–	**1,431.0**	–	**1,431.0**
Derivative financial instruments	**146.0**	**799.3**	–	–	–	**106.2**	**1,051.5**
Other borrowed funds	–	–	–	–	**1,258.8**	–	**1,258.8**
Amounts owed to other Co-operative Group undertakings	–	**4,525.7**	–	–	**2,935.5**	–	**7,461.2**
Total financial liabilities	**146.0**	**6,722.3**	–	–	**41,535.2**	**106.2**	**48,509.7**
Non-financial liabilities							**295.6**
Total liabilities							**48,805.3**
Capital and reserves							**2,160.4**
Total liabilities and equity							**50,965.7**

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Cashflow hedges	Total
2010							
Bank							
Assets							
Cash and balances at central banks	–	–	1,735.6	–	–	–	1,735.6
Loans and advances to banks	–	–	1,728.6	–	–	–	1,728.6
Loans and advances to customers	–	74.1	23,935.4	–	–	–	24,009.5
Investment securities	–	28.7	1,986.8	2,621.4	–	–	4,636.9
Derivative financial instruments	70.4	415.5	–	–	–	218.8	704.7
Equity shares	–	–	–	7.2	–	–	7.2
Amounts owed by other Co-operative Group undertakings	–	–	14,233.7	–	–	–	14,233.7
Total financial assets	70.4	518.3	43,620.1	2,628.6	–	218.8	47,056.2
Non-financial assets							1,758.7
Total assets							48,814.9
Liabilities							
Deposits by banks	–	–	–	–	2,870.8	–	2,870.8
Customer accounts	–	–	–	–	29,912.0	–	29,912.0
Customer accounts – capital bonds	–	1,744.0	–	–	–	–	1,744.0
Debt securities in issue	–	–	–	–	1,856.8	–	1,856.8
Derivative financial instruments	56.3	479.2	–	–	–	161.9	697.4
Other borrowed funds	–	–	–	–	975.4	–	975.4
Amounts owed to other Co-operative Group undertakings	–	5,848.7	–	–	2,492.2	–	8,340.9
Total financial liabilities	56.3	8,071.9	–	–	38,107.2	161.9	46,397.3
Non-financial liabilities							314.1
Total liabilities							46,711.4
Capital and reserves							2,103.5
Total liabilities and equity							48,814.9

a. Use of financial instruments
The use of financial instruments is essential to the Bank's business activities, and financial instruments constitute a significant proportion of the Bank's assets and liabilities. The main financial instruments used by the Group, and the purposes for which they are held, are outlined below.

Loans and advances to customers and customer accounts
The provision of banking facilities to customers is the prime activity of the Bank, and loans and advances to customers and customer accounts are major constituents of the balance sheet. Loans and advances to customers include retail mortgages, corporate loans, credit cards, unsecured retail lending and overdrafts. Customer accounts include retail and corporate current and savings accounts. The Bank has detailed policies and procedures to manage risks. Retail mortgage lending and much of the lending to corporate and business banking customers is secured.

Loans and advances to banks and investment securities
Loans and advances to banks and investment securities underpin the Bank's liquidity requirements and generate incremental net interest and trading income.

Deposits by banks and debt securities in issue
The Bank issues medium term notes within an established euro medium term note programme and also issues certificates of deposit and commercial paper as part of its normal treasury activities. These sources of funds alongside wholesale market loans are invested in marketable, investment grade debt securities, short term wholesale market placements and used to fund customer loans.

Other borrowed funds
The Bank has a policy of maintaining prudent capital ratios and utilises a broad spread of capital funds. In addition to ordinary share capital and retained earnings, when appropriate, the Bank issues preference shares and perpetual and fixed term subordinated notes.

39. Fair values of financial assets and liabilities continued

Derivatives

A derivative is a financial instrument that derives its value from an underlying rate or price such as interest rates, exchange rates and other market prices. Derivatives are an efficient means of managing market risk and limiting counterparty exposure. The Bank uses them mainly for hedging purposes and to meet the needs of customers.

The most frequently used derivative contracts are interest rate swaps, exchange traded futures and options, caps and floors, forward rate agreements, currency swaps and forward currency transactions. Terms and conditions are determined by using standard industry documentation. Derivatives are subject to the same market and credit risk control procedures as are applied to other wholesale market instruments and are aggregated with other exposures to monitor total counterparty exposure which is managed within approved limits for each counterparty.

Foreign exchange

The Bank undertakes foreign exchange dealing to facilitate customer requirements and to generate incremental income from short term trading in the major currencies. Structured risk and trading related risk are managed formally within position limits approved by the Board.

b. Valuation of financial instruments carried at fair value

The following tables analyse financial assets and liabilities carried at fair value by the three level fair value hierarchy as defined within IFRS 7 (Financial Instruments: Disclosure):

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

	Fair value at end of the reporting period using:			
	Level 1	**Level 2**	**Level 3**	**Total**
2011				
Group				
Non-derivative financial assets				
Designated at fair value				
Loans and advances to customers	**–**	**101.7**	**12.4**	**114.1**
Investment securities	**343.1**	**–**	**–**	**343.1**
Available for sale financial assets				
Investment securities	**1,836.9**	**1,586.1**	**–**	**3,423.0**
Equity shares	**–**	**–**	**5.7**	**5.7**
Derivative financial instruments	**–**	**950.4**	**25.4**	**975.8**
Total assets carried at fair value	**2,180.0**	**2,638.2**	**43.5**	**4,861.7**
Non-derivative financial liabilities				
Designated at fair value				
Customer accounts – capital bonds	**–**	**1,429.8**	**–**	**1,429.8**
Derivative financial instruments	**–**	**1,074.6**	**13.3**	**1,087.9**
Total liabilities carried at fair value	**–**	**2,504.4**	**13.3**	**2,517.7**

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
2010				
Group				
Non-derivative financial assets				
Designated at fair value				
Loans and advances to customers	–	62.3	11.8	74.1
Investment securities	–	28.7	–	28.7
Available for sale financial assets				
Investment securities	902.9	2,054.2	–	2,957.1
Equity shares	–	–	7.2	7.2
Derivative financial instruments	–	958.1	17.5	975.6
Total assets carried at fair value	902.9	3,103.3	36.5	4,042.7
Non-derivative financial liabilities				
Designated at fair value				
Customer accounts – capital bonds	–	1,794.7	–	1,794.7
Derivative financial instruments	–	675.2	27.2	702.4
Total liabilities carried at fair value	–	2,469.9	27.2	2,497.1

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

	Fair value at end of the reporting period using:			
	Level 1	**Level 2**	**Level 3**	**Total**
2011				
Bank				
Non-derivative financial assets				
Designated at fair value				
Loans and advances to customers	**–**	**101.7**	**12.4**	**114.1**
Investment securities	**343.1**	**–**	**–**	**343.1**
Available for sale financial assets				
Investment securities	**1,836.9**	**1,270.5**	**–**	**3,107.4**
Equity shares	**–**	**–**	**5.7**	**5.7**
Derivative financial instruments	**–**	**694.9**	**9.5**	**704.4**
Total assets carried at fair value	**2,180.0**	**2,067.1**	**27.6**	**4,274.7**
Non-derivative financial liabilities				
Designated at fair value				
Customer accounts – capital bonds	**–**	**1,397.3**	**–**	**1,397.3**
Amounts owed to other Co-operative Group undertakings	**–**	**–**	**4,525.7**	**4,525.7**
Derivative financial instruments	**–**	**1,041.6**	**9.9**	**1,051.5**
Total liabilities carried at fair value	**–**	**2,438.9**	**4,535.6**	**6,974.5**

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
2010				
Bank				
Non-derivative financial assets				
Designated at fair value				
Loans and advances to customers	–	62.3	11.8	74.1
Investment securities	–	28.7	–	28.7
Available for sale financial assets				
Investment securities	902.9	1,718.5	–	2,621.4
Equity shares	–	–	7.2	7.2
Derivative financial instruments	–	684.6	20.1	704.7
Total assets carried at fair value	902.9	2,494.1	39.1	3,436.1
Non-derivative financial liabilities				
Designated at fair value				
Customer accounts – capital bonds	–	1,744.0	–	1,744.0
Amounts owed to other Co-operative Group undertakings	–	–	5,848.7	5,848.7
Derivative financial instruments	–	679.9	17.5	697.4
Total liabilities carried at fair value	–	2,423.9	5,866.2	8,290.1

Certain derivative financial instruments in Group and Bank have been reclassified between level 2 and level 3 in 2010 following a reassessment of the inputs used in the valuation models.

The carrying values of financial instruments measured at fair value are determined in compliance with the accounting policies on pages 37 to 45 and according to the following hierarchy:

Level 1 – Quoted market prices in active markets
Financial instruments with quoted prices for identical instruments in active markets. The best evidence of fair value is a quoted market price in an actively traded market.

Level 2 – Valuation techniques using observable inputs
Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

The valuation techniques used to value these instruments employ only observable market data and relate to the following assets and liabilities:

39. Fair values of financial assets and liabilities continued

Loans and advances to customers

Loans and advances to customers include corporate loans of £101.7m (2010: £62.3m) which are fair valued through income or expense using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

Investment securities – available for sale

Fair value is based on available market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

Derivative financial instruments

OTC (ie non-exchange traded) derivatives are valued using valuation models which are based on observable market data. Valuation models calculate the present value of expected future cash flows, based upon 'no arbitrage' principles. The Bank enters into vanilla foreign exchange and interest rate swap derivatives, for which modelling techniques are standard across the industry. Examples of inputs that are generally observable include foreign exchange spot and forward rates, and benchmark interest rate curves.

During 2011 the Group moved to using Overnight Indexed Swap (OIS) rates to value cash collateralised swaps, resulting in a one off charge to the income statement of £6m.

Customer accounts – capital bonds

The estimated fair value of customer accounts – capital bonds is based on independent third party valuations using forecast future movements in the appropriate indices.

Level 3 – Valuation techniques using unobservable inputs

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

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

Loans and advances to customers

Loans and advances to customers include 25 year fixed rate mortgages of £12.4m (2010: £11.8m) which are fair valued through income or expense using unobservable inputs. These mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has decreased the valuation by £0.5m in 2011 (2010: £0.1m). A reasonable change in the assumptions would not result in any material change in the valuation.

Equity shares

Equity shares primarily relate to investments held in Vocalink Limited which are unquoted shares. The valuation of these shares is based on the Group's percentage shareholding and the net asset value of the company according to its most recently published financial statements.

Amounts owed to other Co-operative Group undertakings

Deposits from customers includes deposits by Moorland Covered Bond LLP (the LLP), Silk Road Finance Number One plc (Silk Rd 1) and Silk Road Finance Number Two plc (Silk Rd 2) subsidiaries relating to the legal transfer of loans and advances on issue of the Bank's covered bonds and securitisations. The deposits are fair valued to eliminate an accounting mismatch of the swap derivative as discussed below.

Revaluation of the £4.5bn (2010: £5.9bn) mortgage pool from carrying to fair value is based on assumed timing of future mortgage capital and revenue receipts, discounted to present value using a credit adjusted discount rate.

The amortisation profile is as per the swap's valuation methodology, assuming some annual prepayment, but is extended beyond any bond maturity, until all the mortgages themselves mature, which is circa 25 years. Similarly, the revenue receipts are calculated as per the swap valuation methodology, but extended until all the mortgages mature. For fixed rate mortgages, revenue receipts are based on fixed customer rates within the assumed amortisation profile. For tracker, SVR and discount products, revenue receipts are assumed to be based on forward LIBOR rates plus the product margins. Fixed and tracker mortgages are assumed to revert to SVR at the end of any offer period.

Derivative financial instruments

Derivative financial instruments including internal interest rate swaps have been entered into between the Bank and the LLP, the Bank and Silk Rd 1 and the Bank and Silk Rd 2.

The purpose of the swap is to convert the fixed and base rate linked revenue receipts of the pool of mortgage assets to the same LIBOR linked basis as the intercompany loan. Under this swap arrangement the LLP or Silk Rd 1 or Silk Rd 2 pays to the swap counterparty the monthly mortgage revenue receipts of the pool of assets and receives from the swap counterparty LIBOR plus a contractual spread on the same notional balance; the spread being sufficient to cover the intercompany loan and any expenses.

The swap is valued based on an assumed amortisation profile of the pool of assets to the bond maturity date (assuming some annual prepayment), an assumed profile of customer receipts over this period, and LIBOR prediction using forward rates. Swap cash flows are discounted to present value using mid-yield curve zero coupon rates, ie no adjustment is made for credit losses, nor for transaction or any other costs.

The fair value of the swap is based on a valuation model that reflects the mortgage cash flows over a three year period using a discount rate based on LIBOR spreads. This derivative eliminates on consolidation.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued
Movements in fair values of instruments with significant unobservable inputs (level 3) were:

	Fair value at the beginning of the year	Purchases	Sales	Income or expense including impairment	Fair value at the end of the year
2011					
Group					
Loans and advances to customers	**11.8**	**–**	**–**	**0.6**	**12.4**
Derivative assets	**17.5**	**–**	**–**	**7.9**	**25.4**
Equity shares	**7.2**	**–**	**–**	**(1.5)**	**5.7**
Derivative liabilities	**(27.2)**	**–**	**–**	**13.9**	**(13.3)**
	9.3	**–**	**–**	**20.9**	**30.2**
2010					
Group					
Loans and advances to customers	11.8	–	–	–	11.8
Derivative assets	–	–	–	17.5	17.5
Equity shares	7.2	–	–	–	7.2
Derivative liabilities	–	–	–	(27.2)	(27.2)
	19.0	–	–	(9.7)	9.3

	Fair value at the beginning of the year	Purchases	Sales	Income or expense including impairment	Fair value at the end of the year
2011					
Bank					
Loans and advances to customers	**11.8**	**–**	**–**	**0.6**	**12.4**
Derivative assets	**20.1**	**–**	**–**	**(10.6)**	**9.5**
Equity shares	**7.2**	**–**	**–**	**(1.5)**	**5.7**
Derivative liabilities	**(17.5)**	**–**	**–**	**7.6**	**(9.9)**
Amounts owed to other Co-operative Group undertakings	**(5,848.7)**	**(833.1)**	**2,145.3**	**10.8**	**(4,525.7)**
	(5,827.1)	**(833.1)**	**2,145.3**	**6.9**	**(4,508.0)**
2010					
Bank					
Loans and advances to customers	11.8	–	–	–	11.8
Derivative assets	39.2	–	–	(19.1)	20.1
Equity shares	7.2	–	–	–	7.2
Derivative liabilities	–	–	–	(17.5)	(17.5)
Amounts owed to other Co-operative Group undertakings	(3,397.6)	(3,076.2)	625.1	–	(5,848.7)
	(3,339.4)	(3,076.2)	625.1	(36.6)	(5,827.1)

39. Fair values of financial assets and liabilities continued

c. Fair values of financial instruments not carried at fair value

The carrying values of financial instruments measured at amortised cost are determined in compliance with the accounting policies on pages 37 to 45.

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

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

unless there is no significant difference between carrying and fair values.

	Group		Bank	
	Carrying value	**Fair value**	**Carrying value**	**Fair value**
2011				
Financial assets				
Loans and receivables				
Loans and advances to banks	**2,006.5**	**2,004.2**	**1,300.1**	**1,297.8**
Loans and advances to customers	**34,018.2**	**34,236.4**	**22,986.7**	**22,988.4**
Investment securities	**804.9**	**798.5**	**866.1**	**859.7**
Financial liabilities				
Financial liabilities at amortised cost				
Deposits by banks	**3,302.7**	**3,305.1**	**3,239.8**	**3,242.2**
Customer accounts	**34,990.6**	**35,138.9**	**32,670.1**	**32,812.2**
Debt securities in issue	**4,164.8**	**4,008.1**	**1,431.0**	**1,434.5**
Other borrowed funds	**1,258.8**	**1,092.6**	**1,258.8**	**1,092.6**

	Group		Bank	
	Carrying value	Fair value	Carrying value	Fair value
2010				
Financial assets				
Loans and receivables				
Loans and advances to banks	2,394.1	2,391.8	1,728.6	1,726.3
Loans and advances to customers	35,070.0	35,696.9	23,935.4	24,436.0
Investment securities	1,917.3	2,036.4	1,986.8	2,119.6
Financial liabilities				
Financial liabilities at amortised cost				
Deposits by banks	2,938.6	2,971.1	2,870.8	2,903.3
Customer accounts	32,320.0	32,400.8	29,912.0	29,985.7
Debt securities in issue	4,212.2	4,831.7	1,856.8	1,898.6
Other borrowed funds	975.4	1,107.4	975.4	1,107.4

Key considerations in the calculation of fair values for loans and receivables and financial liabilities at amortised cost are as follows:

Loans and advances to banks/deposits by banks

Loans and advances to banks include interbank placements and items in the course of collection.

The fair value of floating rate placements and overnight deposits is their carrying amount. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity. A credit loss adjustment has been applied based on expected loss amounts derived from the Bank's regulatory capital calculations.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

Loans and advances to customers
Fixed rate loans and advances to customers are revalued to fair value based on future interest cash flows (at funding rates) and principal cash flows discounted using the zero coupon rate. Forecast principal repayments are based on redemption at the earlier of maturity or repricing date with some overlay for historical behavioural experience where relevant. The eventual timing of future cash flows may be different from the forecast due to unpredictable customer behaviour. It is assumed there is no fair value adjustment required in respect of interest rate movement on variable rate assets. A credit loss adjustment has been applied based on expected loss amounts derived from the Bank's regulatory capital calculations.

Investment securities
Fair value is based on available market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

Customer accounts
The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

Debt securities in issue and other borrowed funds
The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cashflow model is used based on a current yield curve appropriate for the remaining term to maturity.

Responsibility statement

For the year ended 31 December 2011

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the directors' report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By Order of the Board
Barry Tootell, Acting Chief Executive

28 March 2012

Notice of Annual General Meeting 2012

NOTICE IS HEREBY GIVEN that the Annual General Meeting of The Co-operative Bank plc will be held on the 24th Floor, CIS Building, Miller Street, Manchester, M60 0AL at 10am on Wednesday, 16 May 2012 for the following purposes:

Ordinary Business

1. To receive the notice convening the meeting.
2. To receive the annual reports and adopt the financial statements for the year ended 31 December 2011, together with the auditor's report.
3. To approve the remuneration report for the year ended 31 December 2011.
4. To accept the following recommendations of the Board in respect of the non-cumulative irredeemable preference shares:
   (i) that the payment of the dividend of 4.625p per £1 share on 30 November 2011 be confirmed.
   (ii) that a dividend of 4.625p per £1 share be declared and paid on 31 May 2012 to the registered holders as at 3 May 2012 providing a dividend rate of 9.25 per cent per annum and making a total distribution of £5,550,000.
5. To re-elect the following directors who retire by rotation, in accordance with the provisions of Articles 105 and 105A:
   (i) Paul Flowers, non-executive director (Chair)
   (ii) Peter Marks, non-executive director
   (iii) Paul Hewitt, non-executive director
6. To re-appoint the following directors who were appointed to the Board since the last Annual General Meeting of the Company:
   (i) Anne Gunther, non-executive director
   (ii) Merlyn Lowther, non-executive director
7. To re-appoint KPMG Audit Plc as auditor of the Company, to hold office from the conclusion of this meeting until the conclusion of the next Annual General Meeting at which accounts are laid before the Company, at a remuneration to be fixed by the directors.

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Reg. No. 990937 (England)
Tel: 0161 832 3456
Fax: 0161 829 4475
Tel: 0870 702 0003

Registrar
Computershare Investor Services PLC
PO Box 82
The Pavilions
Bridgwater Road
Bristol BS99 7NH

By Order of the Board
Moira Lees, Secretary

28 March 2012

A member entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote on his/her behalf. A proxy need not also be a member. Further information on preference shareholders' voting rights is given below.

Members should note that to attend the meeting their shareholding must be registered on the register of the Company not later than 9am on 14 May 2012. This applies to shares held in uncertified forms in CREST and to shares held in certified form.

Notes:

1. Director Information
The biographies of the directors up for re-election and re-appointment at the Annual General Meeting can be found on page 10 of the financial statements.

2. Preference Shareholders – Extract from Articles of Association 4 (B)(c)
Voting and General Meetings
(i) The holders of the preference shares shall be entitled to receive notice of and attend (either in person or by proxy) all General Meetings of the Company. The holders of the preference shares shall have a right to speak and vote at a General Meeting of the Company only if and when, at the date of the notice convening such meeting, the fixed preferential dividend payable to them respectively has been in arrears for six months or more after any date fixed for payment thereof, or if a resolution is to be proposed at such meeting abrogating or varying any of the respective rights or privileges attaching to their shareholding or for the winding-up of the Company or other return of capital and then on such resolution only.

(ii) Whenever the holders of the preference shares are entitled to vote at a General Meeting of the Company upon any resolution proposed at such meeting, on a show of hands every holder who (being an individual) is present in person or (being a corporation) is present by a representative or by proxy shall have one vote and, on a poll, shall have one vote in respect of each preference share registered in the name of such holder.

Glossary

For the year ended 31 December 2011

The following glossary defines terminology used within the Group's Financial Statements to assist the reader and to facilitate comparison with publications by other financial institutions:

Terminology	Definition
Almost prime	Almost prime lending is lending to borrowers with very low levels of adverse credit history.
Arrears	Customers are said to be in arrears or non-performing when they are behind in fulfilling their obligations with the result that an outstanding loan is unpaid or overdue. Corporate customers may also be considered non-performing prior to being behind in fulfilling their obligations. This can happen when a significant restructuring exercise begins.
Asset & Liability Committees (ALCO)	These committees are management committees of the Board which are chaired by the Chief Financial Officer. They are primarily responsible for overseeing the management of interest rate, market, liquidity and funding risks and to advise on capital utilisation, in addition to the composition and sourcing of adequate capital.
Audit Committee (AC)	The committee which provides oversight in relation to financial reporting, internal control, regulatory compliance, external and internal audit across the Banking Group.
Automated Valuation Model (AVM)	A valuation model used specifically for low loan to value (LTV) remortgages. Performance of AVMs is monitored on a regular basis to ensure their ongoing accuracy.
Bank for International Settlements (BIS)	An international organisation which fosters international monetary and financial co-operation and serves as a bank for central banks. Based in Basel, Switzerland.
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 III	A strengthening of the requirements laid out in Basel II, to be phased into the Bank gradually between 2013 and 2019 ahead of full implementation by 2023.
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.
BIPRU	The prudential sourcebook for banks, building societies and investment firms which sets out the FSA's capital requirements.
Britannia membership reward (BMR)	This was designed to reward customers for the contribution they made to the continued success of Britannia's business. After an initial qualifying period, certain customers of Britannia were able to earn points each year. Each year, the Board decided the amount to be paid out as the reward pool, and distributed this to the customers in proportion to the number of points earned.
Business model and external risk	Risk arising from changes to the Bank's business and the environment in which it operates, specifically the risk of not being able to carry out the Bank's business plan and desired strategy.
Buy to let	A commercial practice of buying a property to let to tenants, rather than to live in.
Capital bonds	Fixed term customer accounts with returns based on the movement in an index (eg FTSE 100) over the term of the bond.
Capital ratio	Total of tier one capital plus tier two capital, all divided by risk weighted assets.
Capital Requirements Directive (CRD)	The common framework for the implementation of Basel II in the EU.
Carrying value	The value of an asset or liability as it appears in the balance sheet. For each asset or liability, the value is based on either of the amortised cost or fair value principles.
Certificates of deposit (CDs)	Debt issued by banks, savings and loan associations to individual investors with terms ranging from a few months to several years. Longer term CDs tend to bear a higher interest rate. At the expiration of the term, investors may (subject to penalties) withdraw both the principal and the accrued interest.
Charged off	When all economical avenues to recover an unsecured debt have been exhausted, the Bank permanently closes the loan account, ie it is charged off. This final step sits at the end of a time frame within which the Bank attempts to manage the debt's recovery and differs from a 'write down' in terms of its fixed position in time (see 'Write down').
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').
Colleague engagement	An internal survey, measuring the level of the Bank's employees' engagement.
Collectively assessed for impairment	Impairment is measured collectively where a portfolio comprises assets with a homogenous risk and where appropriate statistical techniques are available.
Commercial Paper	An unsecured promissory note issued to finance short term credit needs. It specifies the face amount paid to investors on the maturity date.

Glossary continued
For the year ended 31 December 2011

Terminology	Definition
Contagion risk	An international financial market term which describes a corrupting or harmful influence, spreading effects of shocks from one counterparty to another.
Corporate and Business Banking (CABB)	The Group's operating segment which includes Corporate, Optimum and Platform. This includes lending to large corporate and commercial entities, acquired mortgage books and a specialist mortgage team dealing with intermediary lending.
Cost to income ratio	Operating expenses compared with operating income.
Council of Mortgage Lenders (CML)	A financial services industry body representing mortgage lenders in the United Kingdom.
Counterparty	In any financial contract, the person or institution entering the contract on the opposite side of the transaction is called a counterparty.
Covered bonds	Debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Bank issues covered bonds as part of its funding activities.
Credit Committee	A committee, chaired by the Banking Risk Officer, which has delegated authority for approving credit facilities within approved strategies and delegated authorities.
Credit conversion factors	The portion of an off balance sheet commitment drawn in the event of a future default. The conversion factor is expressed as a percentage. The conversion factor is used to calculate the exposure at default (EAD).
Credit default swap	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 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 its failure to perform as agreed.
Credit Risk Control Unit (CRCU)	This function provides an independent view of credit risk in order to support the business management functions' decision making. CRCU does not directly benefit from decisions to extend credit. The CRCU provides risk oversight by virtue of its independence from the business management functions. The CRCU function is in house and is not outsourced.
Customer advocacy	An external survey, measuring the level of the Bank's customers who would personally recommend the Bank to other potential new customers as their primary financial services provider.
Customer deposits	Money deposited by all individuals and companies that are not credit institutions. Such funds are recorded as liabilities in the Bank's balance sheet under customer accounts or financial liabilities designated at fair value.
Customer funding ratio	The ratio of customer loans funded by customer deposits. This is the reverse equation of the customer loan to deposit ratio (see 'Customer loan to deposit ratio').
Customer loan to deposit ratio	Customer loans divided by customer deposits. This is the reverse equation of the customer funding ratio (see 'Customer funding ratio').
Debt for equity swaps	The act whereby a creditor exchanges a loan asset for a stake in its relevant debtor company's equity share capital.
Delinquency	A customer in arrears is also said to be in a state of delinquency. When a customer is in arrears, his entire outstanding balance is said to be delinquent, meaning that delinquent balances are the total outstanding loans on which payments are overdue (see 'Arrears').
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.
Effective interest rate method (EIR)	The method used to measure the carrying value of certain financial assets or liabilities and to allocate associated interest income or expense over the relevant period.
Eurozone	The geographical area containing countries whose economies function using the European single currency.
Executive Team	The team which manages the business in line with the Board risk appetite statement. It also maintains oversight of risk management processes and management information.
Expected charge off rate	The expected level of a portfolio's loans that may be written off as bad debt.
Expected loss	A measure of anticipated loss for exposures captured under an internal ratings based credit risk approach. The expected loss amount is the exposure from a potential default of a counterparty or dilution over a one year period to the amount outstanding at default.
Exposure at default (EAD)	A Basel II parameter used in internal ratings based approaches to estimate the amount outstanding at the time of default.
Exposures Committee	The committee which monitors and controls the Banking Group's major credit exposures. Decision making responsibilities include the sanctioning of large counterparty transactions.
External audit	The independent review of the financial statements of the company, by an external firm.

Terminology	Definition
External credit rating	A financial indicator of risk, assigned by credit rating agencies, to potential investors in the Group.
Fair value adjustments	Fair value adjustments are the remaining balance sheet adjustments for the assets/liabilities acquired on the merger of the Bank and Britannia Building Society on 1 August 2009.
Fair value amortisation	The amortisation of the remaining interest risk related, fair value adjustments for the assets/liabilities acquired on the merger of the Bank and Britannia Building Society on 1 August 2009 (see 'Interest rate risk').
Financial instruments	Any document with monetary value. Examples include cash and cash equivalents, but also securities such as bonds and stocks which have value and may be traded in exchange for money.
Financial Services Authority (FSA)	An independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000, which regulates the financial services industry in the best interests of its stakeholders. It is a company limited by guarantee and financed by the financial services industry.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FSA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Floating rate notes (FRNs)	Investments with a variable interest rate. The adjustments to the interest rate are usually made every six months and are tied (or 'float') to a certain money market index.
Forbearance	The act of preventing a secured loan's counterparty from defaulting by relaxing and/or changing the borrower's repayment terms.
Foreclosure	The legal process by which a lender, eg the Bank, obtains a court order in order to terminate a borrower's equitable right of redemption. This legal action is required when a borrower has materially failed to comply with the agreed terms and conditions of the loan, eg by defaulting (see 'Forbearance').
Forward rate agreement	A legal contract, governing the terms and conditions of a forward or future, in which the buyer pays a fixed rate of interest to the seller in return for the seller's floating rate (see 'Forwards', 'Futures' and 'Swaps').
Forwards	Non-standardised contracts, traded over the counter, between two parties to buy or sell financial instruments at a specified future time at a price agreed today (see 'Over The Counter').
Futures	Standardised contracts, traded on an exchange, between two parties to buy or sell financial instruments at a specified future time at a price agreed today.
Gap	The Bank's net exposure to variable elements being managed within its market risk, eg interest rate movements (see 'Market risk').
Hedging	A technique used by the Bank to offset risks on one instrument by purchasing a second instrument that is expected to perform in the opposite way.
Her Majesty's Treasury (HMT)	Informally The Treasury, is the United Kingdom government department responsible for developing and executing the government's public finance policy and economic policy.
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.
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 FSA (see 'Liquidity risk').
Individual Liquidity Guidance (ILG)	A FSA 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.
Individually assessed for impairment	Impairment is measured individually for assets that are individually significant.
Institute of International Finance (IIF)	A global association of financial institutions which provides industry guidelines on areas such as liquidity management.
Interest rate risk	The variability in value borne by an interest bearing asset, such as a loan or a bond, due to variability of interest rates. In general, as rates rise, the price of a fixed rate bond will fall, and vice versa.
Internal audit	The examination of the company's records and reports by its employees. Internal audits are usually intended to prevent fraud and to ensure compliance with Board directives and management policies.
Internal Capital Adequacy Assessment Process (ICAAP)	The Bank's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events.
Internal rating grade (IRG)	The grading of credit risk resulting from the internal ratings based approach (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 FSA permission.
Investment grade	A debt security, treasury bill or similar instrument with a credit rating measured by external agencies of AAA to BBB.

Glossary continued
For the year ended 31 December 2011

Terminology	Definition
LIBOR (London Interbank Offered Rate)	The interest rate participating banks offer to other banks for loans on the London market.
Lifetime expected loss	The losses that the Bank expects to incur over the lifetime of portfolios of mortgage assets which were acquired on merger with Britannia Building Society. This is different from expected loss (see 'Expected loss') which is based on assets expected to default in the next 12 months.
Limited Liability Partnership (LLP)	An LLP provides each of its individual partners protection against personal liability for certain partnership liabilities.
Liquidity risk	The risk that the Bank's resources will prove inadequate to meet its commitments. It arises from the timing of cash flows generated from the Group's assets and liabilities (including derivatives).
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)).
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.
Low risk	Within neither past due nor impaired, low risk has been defined as exposures where the probability of deficit (PD) is 1% or below over a one year time horizon for exposures on an internal ratings based (IRB) approach under Basel II, and slotting category strong/good/satisfactory for specialised lending exposures under the slotting approach (see 'Slotting').
Lower tier two	Lower tier two capital comprises the Bank's long term subordinated debt.
Malus	A facility whereby the Remuneration Committee may reduce the amount of any deferred bonus payable in the event that any of the underpins to the incentive plans are not met or where business and/or individual performance otherwise requires.
Management expenses and compensation cost	The specific elements of both operating and financing cost which form the basis of the Financial Services Compensation Scheme (see 'Financial Services Compensation Scheme (FSCS)').
Mandatory reserve deposits	Mandatory reserve deposits are deposited with the Bank of England and are not available for use in the Group's day to day operations. They are non-interest bearing and are not included in cash and cash equivalents.
Market risk	The risk arising from the effect of changes in market prices of financial instruments, execution of customer and interbank business and proprietary trading. The majority of the Bank's market risk arises from changes in interest rates.
Medium term notes (MTN)	Flexible medium term corporate debt instruments, offered by the Bank to investors through a dealer. Investors can choose from differing maturities, ranging from nine months to 30 years.
Medium to high credit risk	Within neither past due nor impaired, medium to high risk has been defined as a probability of deficit (PD) of greater than 1% over a one year time horizon for exposure on internal ratings based (IRB) approach under Basel II, and slotting category weak for specialised lending exposures under the slotting approach (see 'Slotting').
Member	A person who has a share investment or a mortgage loan with the Bank.
Merger	Any combination of two or more business enterprises into a single enterprise. In the Group, this specifically refers to the merger of the Bank with Britannia Building Society on 1 August 2009 (see 'Transfer of engagements').
Mortgage backed securities	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 interest income	The difference between interest received on assets and interest paid on liabilities after taking into account the effect of derivatives.
Net present value (NPV)	The present value of the expected future cash in and out flows on an asset or liability.
Non-conforming	Loans originated by Platform prior to 2009 and those acquired by Britannia Treasury Services, with similar risk profiles to 'Almost prime' (see 'Almost prime').
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 Committee (ORC)	This committee reports into the Risk Management Group and is chaired by the Director of Specialist Risk Services. 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. This includes business continuity arrangements and insurance cover to protect the Banking Group's business. Capital requirements in relation to operational risk are monitored by the RC.

Terminology	Definition
Optimum	A sub-segment within Corporate and Business Banking which includes acquired mortgage books and a specialist mortgage team dealing with intermediary lending.
Options	Instruments which convey the rights, but not the obligations, to engage in future transactions.
Over The Counter (OTC)	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.
Overnight Indexed Swap (OIS)	A rate reflecting the overnight interest typically earned or paid on the Bank's collateralised swaps. The OIS rate is used for valuing the discounted cash flows of collateralised swaps.
Past due	When a counterparty has failed to make a payment when contractually due.
Payments Hub	The Bank's proposal, as part of its transformation programme, to centralise payment mechanisms into a single model in order to maximise internal process efficiencies.
Portfolio Credit Committee (PCC)	A designated committee, reporting to the Risk Committee, that is responsible for defining the Banking Group's credit risk appetite; providing oversight and timely action in relation to credit risk management; monitoring, challenging and approving changes to Basel rating systems; and reviewing lending and arrears policies.
Preference shares	Preferred shares of the Group that are paid to a fixed non-cumulative preferential dividend. The dividends take priority over dividends to any other class of share in the capital of the Group.
Prime	Prime mortgages are mainstream residential loans, which typically have a higher credit quality and fit standard underwriting processes. As such, they are likely to have a good credit history and pass a standard affordability assessment at the point of origination.
Probability of default (PD)	The likelihood that a loan will not be repaid and will fall into default. PD may be calculated for each customer who has a loan (normally applicable to wholesale customers) or for a portfolio of customers with similar attributes (normally applicable to retail customers). To calculate PD, the Bank assesses the credit quality of borrowers and other counterparties and assigns them an internal risk rating.
Project Unity	The process enabling The Co-operative Group's combined family of companies to become fully integrated, delivering synergies, putting the customer at the heart of all that it does.
Re-age/Re-ages	A process whereby unsecured delinquent debt is moved to a less delinquent time band, upon the settlement of a percentage of the existing debt (see 'Delinquency').
Renegotiated loans	A permanent change to the terms and conditions of the customer's mortgage contract.
Repo/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.
Retail segment	The segment that comprises customer focused products and services for individuals, sole traders and small partnerships. This includes mortgages, credit cards, consumer loans, current accounts and savings products.
Risk Committee (RC)	The committee responsible for the oversight, review and challenge of the adequacy of capital for all risks across the Banking Group.
Risk Management Group (RMG)	A designated committee, reporting to the Risk Committee, chaired by the Chief Risk Officer. Its purpose is to provide a mechanism to ensure that the Banking Group-wide risk management requirements, developments and processes are reviewed, challenged and approved (with escalation to RC where required) and embedded within and across the Banking Group. The committee also monitors all significant and emerging risks, and oversees the development and implementation of stress testing and risk appetite across the Banking Group.
Risk weighted amount	Risk weightings are established in accordance with Basel II as implemented by the FSA. Risk weighted amounts are the carrying value of the Bank's assets, adjusted by the risk weightings, to reflect the degrees of risk they represent.
Roll up mortgage	A mortgage, whose accrued interest is added to its principal amount and settled at the end of its repayment term.
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.
Securitisation	A process by which a portfolio of retail mortgages is used to back the issuance of new securities by an SPE. The Group has established securitisation structures as part of its funding and capital management activities (see 'Special purpose entities (SPEs)').
Significant items	Items which are material by both size and nature (ie outside of the normal operating activities of the Group) are treated as significant items and disclosed separately on the face of the income statement.

Glossary continued
For the year ended 31 December 2011

Terminology	Definition
Slotting	The regulatory defined approach used for rating the risk level of Corporate lending using a broad scope of financial, political and transactional factors. The regulatory slotting categories are listed as follows: – 'Unrated' businesses lack sufficient information upon which detailed credit analysis can be undertaken for which models have yet to be developed; – 'Strong' businesses have little competition, high demand, significant governmental support and enforceable collateral; – 'Good' businesses have limited competition, stable demand, good governmental support and enforceable collateral; – 'Satisfactory' businesses have a broad competition base with limited levels of demand, governmental support and collateral; – 'Weak' businesses operate at a disadvantage to competition, display a declining trend of demand, with no governmental support and no clear collateral; and – 'Default' businesses are considered unlikely to repay their credit obligations (see 'Impaired loans').
Sovereign exposure	The Bank's exposure to the total financial obligations incurred by all governmental bodies of any nation.
Special purpose entities (SPEs)	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	Lending in which 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.
Standard Variable Rate (SVR)	A variable and basic rate of interest charged on a mortgage. This may change in reaction to market conditions resulting in monthly repayments going up or down.
Subordinated debt/liabilities	Liabilities which, in the event of insolvency or liquidation of the Group, are subordinated to the claims of depositors and other creditors of the Group.
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.
Technical risk	The (non-operational) risk and exposure to material loss of The Co-operative Banking Group being unable to meet its capital/liquidity/profit targets in line with approved risk appetite.
Tenor	The length of time until a loan is due. For example, a loan is taken out with a two year tenor. After one year passes, the tenor of the loan is one year.
Term deposit	A deposit balance that cannot be withdrawn before a date specified at the time of deposit.
the Bank	The Co-operative Bank as a standalone entity.
the Banking Group	See 'The Co-operative Banking Group'.
the Board	The Board of Directors. They manage the Banking Group's business performance in line with its purpose, givens, vision and values.
The Co-operative Banking Group	An internal brand, which is a consolidation of the following entities: CFS Management Services Ltd, CFS Services Ltd, CIS General Insurance Ltd, Co-operative Insurance Society Ltd, Co-operative Asset Management Ltd and Co-operative Bank plc.
The Co-operative Group	The ultimate holding company.
the Group	The Co-operative Bank consolidated with its subsidiaries.
Tier one	A regulatory measure of financial (capital) strength. Tier one is divided into core tier one and other tier one capital. Core tier one capital comprises general reserves from retained profits. The book values of goodwill and intangible assets are deducted from core tier one 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 one capital.
Tier one ratio	Tier one capital divided by risk weighted assets.
Tier two	Tier two capital comprises the Bank's property valuation reserve, preference shares, 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 (see 'Upper tier two' and 'Lower tier two').
Transfer of engagements	On 1 August 2009, Britannia Building Society merged with The Co-operative Bank plc by a transfer of engagements between the building society and the bank under the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 (see 'Merger').
Transformation risk	The design, development and implementation risk associated with the Banking Group's significant change agenda that will transform the combined business into the 'compelling co-operative alternative'. This change is being managed in line with the Banking Group's risk appetite.

Terminology	Definition
Treasury segment	The treasury segment's responsibilities usually include capital management, risk management, strategic planning and investor relations.
Unencumbered	Those Bank assets which are not subject to any form of claim against them.
Unsecured lending	Lending for which there is no collateral for the loan.
Upper tier two	Upper tier two capital comprises the Group's preference shares, perpetual subordinated bonds and revaluation reserves.
Value at risk (VaR)	An estimate of the potential loss which might arise from market movements under normal market conditions, if the current positions were to be held unchanged for one business day, measured to a defined confidence level. The Bank uses a confidence level of 95%.
Watchlist	A list of counterparties, drawn up by the Bank once it has elected to closely monitor the performance of loans subject to significant credit risk.
Wholesale	Wholesale banking is the provision of loans to corporate customers and institutional customers and services to other banks and financial institutions.
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 debt's life (see 'Charge off').

Notes

Design by Radley Yeldar

Printed at APS Group, an ISO 14001 and
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Registered number: 990937
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PART (C)

AUDITED FINANCIAL STATEMENTS OF THE COMPANY FOR THE FINANCIAL YEAR ENDING 31 DECEMBER 2010

The Co-operative Bank plc

Building a better society

Financial Statements 2010

"Focused on future growth."

Part of The **co-operative** financial services

The **co-operative**
good with money

Contents

2 Chair's statement
3 Chief Executive's overview
5 Business and financial review
9 Sustainability report
11 The Board
13 Report of the Board of Directors
17 Corporate governance report
23 Remuneration report
29 Independent auditor's report
30 Consolidated income statement
31 Consolidated statement of comprehensive income
32 Consolidated balance sheet
33 Bank balance sheet
34 Consolidated statement of cash flows
35 Bank statement of cash flows
36 Consolidated and Bank statements of changes in equity
37 Basis of preparation and significant accounting policies
45 Risk management
78 Capital management
79 Critical judgments and estimates
82 Notes to the financial statements
124 Responsibility statement
125 Notice of Annual General Meeting 2011
126 Glossary

Chair's statement

This is my first report as Chair of The Co-operative Bank. I have been lucky enough to take the helm at one of the most exciting points in our history, one that will establish us in the world of financial services as a 'compelling, co-operative alternative'.

Many businesses talk about putting customers first and reducing their impact on the environment, but at The Co-operative Bank we have been 'walking the walk' since long before social responsibility was fashionable. As part of the UK's most diversified financial services mutual, we pride ourselves on being member owned, sharing the fruits of our business with our members and customers, rather than with external shareholders.

For many years some commentators have seen this as a limitation, given that it denies us one of the more common sources of generating capital; but we believe it allows us to focus more sharply on the interests of our members, our customers and the communities within which we operate. As the last of the demutualisers disappear into government or plc ownership, we are proud of the alternative we offer the increasingly beleaguered UK consumer.

That alternative is partly based on our well known ethical approach to our business. That ethical stance sees us continue to decline investment opportunities in businesses or governments that do not meet our customers' ethical expectations, but it also manifests itself in our positive engagement as investors ourselves, and as members of the wider co-operative movement.

That engagement encompasses support for the British credit union movement through pioneering initiatives such as the Credit Union Current Account and The Co-operative Enterprise Hub. It also manifests itself in support for local communities, with both financial support and over 47,000 hours of colleagues' own time invested in projects from conserving woodland to redecorating community centres. We are also actively inspiring young people to change their world, through schemes such as Fit4Finance, Number Partners and Enterprise4Education. This year saw the opening of the Co-operative Academy, while a planned Co-operative Apprenticeship Academy will deliver some 2,000 new apprenticeships by 2013. (You can learn more about these programmes in our Sustainability report on page 9.)

But the compelling, co-operative alternative is not just a matter of ethical leadership; it is firmly grounded in sound, commercial sense. In a mortgage market marked by retrenchment we have increased our lending portfolio, while focusing on lending to customers only what they can actually afford to repay. More generally, as a business moving from post merger stabilisation into ambitious transformation, we have taken great care to minimise the impact on our customers while maximising the benefits.

This year we were recognised by the Financial Times as the 'World's Most Sustainable Bank' ahead of an international field. The term 'sustainable' refers both to our determination to enrich rather than exploit our environment, and to the long term, commercial sustainability of our business model. Financial prudence and customer focus may sound like rather traditional ideas, but as the award demonstrates they are the hallmark of a business with its eye on the future.

Another hallmark of our forward looking approach is our increasingly close relationship with The Co-operative Group. The power of a shared brand has already enabled us to increase our profile with people who are not yet customers, and I note with pride that both The Co-operative Group and The Co-operative Bank featured in the top ten most influential brands in this year's survey of industry leaders and commentators. Not only had we risen to our highest ever position, but we were respectively the top placed retailer and financial services company in the survey.

Beyond the power of brand lies commercial opportunity, particularly the cross selling opportunities offered by the Group's diverse customer base. This year we have been working closely with the Co-operative Food business to pilot a number of in-store banking facilities. The pilot has provided some invaluable learning on what customers do and don't want, and we are planning to increase the number of in-store outlets in the coming year.

As active members of a unified, profitable 'superbrand' The Co-operative Bank can now look forward to even closer co-operation in the coming years, signalled by the appointment of our Chief Executive Neville Richardson, as one of two Deputy Group Chief Executives. Brought together already by our shared tradition and values, the next step in our evolution will be to focus on developing a truly joined up customer service proposition.

For the Bank in particular, this involves the replacement of our entire banking systems platform. We are the first UK bank to undertake such an ambitious programme, and we believe it will put us in an outstanding position to offer our customers the service they truly deserve, while attracting those who don't yet have a relationship with us through the advocacy of those who have.

As we look forward to the next chapter in our evolution I would like to express my thanks to the outgoing Chair, Bob Burlton. In his six year term Bob guided our business safely through both the credit crunch and our successful merger with Britannia Building Society. He can justly look back on his time as a period of successful change grounded in stability and a strong ethical compass.

I would also like to thank departing director John Reizenstein for shaping our corporate banking operations into a respected, competitive force.

Keith Alderson has joined the executive with responsibility for corporate and business banking. Keith has a wealth of corporate banking experience and has played a leading role in improving our corporate customer experience. I would like to congratulate him on a well deserved promotion.

At the end of my first few months in post, I feel a great sense of pride and excitement. Pride in the continued success and increasing recognition of The Co-operative Bank as a viable alternative to a discredited financial services model; and excitement at the journey ahead of us and the opportunities it offers. I would like to invite you to share that journey, whether as a member, an investor or a customer. As a group we have targeted a membership of 20 million by 2020; it is an ambitious figure but one that we believe we can achieve. As a new era dawns for the financial services market, we believe we offer something unique, democratic, forward thinking and on the verge of greatness. Come and join us, and be part of the *real* 'Big Society'.

Paul Flowers, Chair

Chief Executive's overview

Welcome to The Co-operative Bank's report and accounts for 2010. As I write, continued uncertainty hovers over the UK and wider economy, with the Government's austerity measures occupying the front pages and a 'double dip' recession still a possibility. Money remains in short supply, customer confidence is fragile, caution reigns and with the Bank of England base rate at an all time low, margins remain very tight.

Others (in Spain, Portugal and Ireland for instance) have been even less fortunate – and in a global market we share their pain. Economies that have been 'surfing the wave' of global expansion and cheap credit are now obliged to get themselves out of deep water. And as governments attempt to balance the books, the public inevitably gets the bill.

Customers are beset by financial woes for which by and large they bear little or no responsibility. Long held faith in the strength and trustworthiness of the banking sector has all but vanished, and as money becomes harder and more expensive to access, this distrust is fuelled by a real sense of anger and helplessness.

A compelling, co-operative alternative

In this climate, The Co-operative Bank is uniquely placed to deliver a compelling, co-operative alternative. Our business model is not driven by the needs of shareholders but by a long held belief in putting our customers' interests first. We have maintained a prudent approach, driven by our vision and values, trading within our means and focusing on sustainable customer service.

As a result we have not had to take government handouts to recapitalise or recover our commercial viability. Indeed, while many competitors retrench we have embarked on a pioneering transformation programme that will deliver an even better customer experience within the next three years. Moreover we are doing so without jeopardising either short term service levels or long term stability, which means that at no point will our customers be expected to underwrite our ambition at the expense of their financial security.

A year of stability and success

Our 2009 merger with Britannia Building Society launched us on a journey to become the UK's most admired financial services business. Eighteen months into that journey our financial results demonstrate the prudence that has made us an increasingly popular alternative to shareholder owned providers. In a year of low interest rates, cautious customer behaviour and tighter regulatory oversight we have maintained our profitability with an underlying operating result, excluding the cost of reinvesting in strategic change, of £170.5m (34.3% higher than in 2009).

Recognising the importance of overheads in the current financial climate, we have continued to manage our 'business as usual' operating cost closely, while the diversity of our business model enables us to offset limitations in one sector with opportunities in another.

The relationship of trust we enjoy with our customers has continued to yield dividends through excellent retention of funds (including a 97% retention of maturing cash ISA balances) while our willingness in a cautious mortgage market to lend to homebuyers within their means, has seen our mortgage book hold its value while those of many competitors are shrinking.

Our corporate sector continues to offer the same personal service to a wide range of business and corporate customers. In a difficult year for the industry, our operating result of £69.9m (an increase of £14.5m on 2009) reflects sustained demand, which has enabled our corporate banking team to be selective in its new business opportunities while significantly growing our term deposit base.

A key priority this year has been to grow our numbers of primary account holders – customers who are proud to say, "I bank with the Co-operative". Our focus on relationship banking is aimed at building a lasting, mutually rewarding relationship that will allow us to offer more and more customers both our own comprehensive range of products, and those of our parent company The Co-operative Financial Services (CFS). The high levels of service that underpin these products will help to strengthen the core relationship and make our customers powerful advocates for The Co-operative Bank in the wider community.

One key outcome of this strategic focus was a 79% increase in customers switching current accounts to us in 2010. This is testimony to the strength of our brand and reputation, particularly when one considers that the UK continues to have one of the lowest switching rates for primary bank accounts in the EU.

Current accounts play a key role in retail banking and yet are a major barrier to greater competition in the sector. We want to find a solution that makes switching a current account as easy as changing your utility provider or porting your mobile phone number. Our submission to the Treasury Select Committee on competition and choice in retail banking includes the recommendation that a dedicated working group be set up to consider how to make switching easier.

Meanwhile our balance sheet continues to reflect our underlying strength. We have maintained a robust capital position without resorting to the defensive recapitalisation seen elsewhere, itself the result of high risk strategies to which we did not expose ourselves. Our core tier 1 capitalisation reflects the requirements of our business model, but as a forward looking, competitive business we are actively exploring capitalisation options that will allow us to grow without impairing the mutual status that is so fundamental to our ethos.

Our liquidity remains stable – a fact highlighted by the strong customer funding profile underpinning our retail lending. We also benefit from a strong risk management strategy, with potential threats to the business understood and robust mitigants in place.

Our unique position as a prudent, trusted provider in a credibility challenged market has been underscored by a range of industry and customer voted accolades, and we were named the 'World's Most Sustainable Bank' by the Financial Times, ahead of an international field.

Chief Executive's overview continued

Transformation with the customer at its core
Sustainability is not merely a question of prudence or trust. To maintain and strengthen our place in the market we recognise that we must continue to offer our customers the best experience possible – we are aiming not just for satisfied customers but for customer advocates.

Last year the CFS Board agreed an investment of over £700m in the next three years to enable a business wide transformation into a truly compelling, co-operative alternative. A significant proportion of that investment is funding the replacement of The Co-operative Bank's core systems platform; we are the first UK bank to undertake such an ambitious project and we believe it will move us significantly closer to our vision of being the UK's most admired financial services provider.

Our corporate customers have already benefited from the launch of two new business banking platforms and over the next three years retail customers will also reap the benefits, as we develop a holistic view of customer holdings, faster and more efficient processing of customer transactions and the ability to bring new, customer focused products to market in days rather than months.

The journey continues
In 2009 with the creation of the UK's most diversified financial services mutual, The Co-operative Bank embarked on a new chapter in its history. Eighteen months on we have already laid the foundations with a unified leadership, organisational structure, vision and business strategy. Over the next year we will take further significant strides towards our vision of becoming the UK's most admired financial services business.

We have moved from stabilisation to transformation without disturbing our excellent customer relationships, and in many cases without customers noticing anything had changed (although we are confident they will as our transformation yields increasing customer benefits).

We have been able to achieve this, primarily through the dedication and engagement of colleagues throughout the business. 2010 has been a year of uncertainty in our markets and extensive change within the business itself; I would like to express my thanks to all my colleagues for remaining committed to the transformation process while refusing to compromise on our customer promise or our core values. This commitment, more than any other single factor, defines the 'compelling co-operative alternative'.

During 2011, in common with our colleagues within CFS, we intend to build on these firm foundations, with an ambitious strategy focusing on:

- active management of risk in accordance with our risk appetite, to deliver targeted rewards;
- implementation of a single employee terms and conditions package;
- embedding our target leadership model and culture across the business;
- support by all areas of the business for our game changing, banking transformation programme;
- consistent understanding of and delivery against our customer promise;
- maintenance of a dynamic balance between profit, capital and liquidity; and
- embedding a culture of cost control and efficiency.

Our target outcomes for 2012 reflect the same ambition grounded on firm foundations. Here is our vision of CFS in 2012:

We are clearly seen as the financial services arm of The Co-operative Group and customers repeatedly choose us for their primary financial services relationship and recommend us to others.

Our people are proud to work for us and advocate CFS as an employer and service provider, reflected in UK leading employee advocacy scores.

We operate within a clearly defined risk appetite. We are seen as a highly efficient business and we are recognised as a source of financial strength.

We stand at the threshold of a new era in financial services. We are uniquely placed to make it an 'era of co-operation'. The journey continues.

Neville Richardson, Chief Executive

Business and financial review

Overview

As the UK financial services market continues to suffer from the current, unprecedented, global economic challenges, The Co-operative Bank (the Bank), as part of The Co-operative Financial Services (CFS), has continued to offer a member owned, customer led and ethically guided alternative business model; one that has been endorsed this year, with the naming of the CFS as 'The World's Most Sustainable Bank'. As the award implies, CFS is forging a business model focused on long term, sustainable success. CFS was also named a 'recommended provider' by Which? Magazine and was the highest placed high street bank in the influential JD Power survey.

The Bank has maintained and enhanced its financial strength, while delivering benefits for customers and members. The operating result of £144.5m for 2010 was 25.4% higher than 2009. Excluding the costs of reinvesting in strategic change, the underlying operating result was up 34.3% to £170.5m. The excellent levels of customer funding in the Bank of 107% at December 2010, and the continued reduction in arrears (with a 22% reduction in late mortgage arrears during 2010) attest to our principle of being financially prudent and strong.

Meanwhile, the Bank's values based approach to all aspects of the business seeks to balance financial strength with the needs of our customers and our people. Our continuing focus on an easy, fair, personal and responsible service, during a time of deep uncertainty for many of our customers, remains a key distinguishing factor.

CFS customer advocacy figures remain 7.5 percentage points ahead of our competitors, while the business has also continued to deliver industry leading levels of employee engagement, with 89% of our people proud to work for us.

CFS saw a 79% increase in current account switchers in 2010. While this is testimony to the strength of, and trust in, our brand, the fact remains that the UK continues to have one of the lowest switching rates for primary bank accounts in the EU. Current accounts play a cornerstone role in retail banking and yet are a major barrier to greater competition in the sector. We want to find a solution that enables consumers to switch their current accounts and retain their current account number as easily as they can switch mobile phone providers whilst retaining their mobile phone number. In our submission to the Treasury Select Committee on competition and choice in retail banking, we recommended that a dedicated working group was set up to find a way to make switching easier. One issue it should consider is the introduction, longer term, of a portable bank account and sort code for personal customers.

By combining a unique business model, ongoing financial stability and strong customer advocacy, CFS and the Bank continue to offer the financial services customer a compelling, co-operative alternative.

Over the last 18 months, since the merger with Britannia Building Society, CFS has continued to make excellent progress, completing the integration of two complementary operations. The fundamental transformation of the combined business is now well underway, with its focus on delivering an enhanced customer experience. As the first release of our Banking Transformation Programme (the replacement of our core banking systems), Business Online Banking is now offered to our Small and Medium Enterprise customers and FD Online to our corporate customers. Both services offer enhanced functionality, improved security and have a more durable and responsive systems infrastructure. Co-operative current accounts are now available in all Britannia branches, and the core product range is aligned across Co-operative and Britannia channels.

The integration programme in relation to the merger with Britannia has built on the strengths of both heritage businesses and has so far delivered significant annual cost synergies within CFS of £48m, which predominantly relate to the Bank, and are ahead of expectations. Meanwhile, a comprehensive organisation design process has been completed, giving colleagues the focus, support structures and 'line of sight' to deliver the CFS customer promise.

Looking to the longer term, significant further investment is planned to extend the Banking Transformation Programme to all customers over the next three years. This will further transform the customer experience, through easier account opening processes, integrated product offerings and improved multi-channel capability. The business is also forging greater ties more widely across The Co-operative Group, which will enable the Bank to achieve its commitment to be part of the UK's most admired financial services business.

Business and financial review continued

Highlights

The Co-operative Bank operating result and profit before taxation	2010 £m	2009 £m	Change £m	Change %
Income	**821.8**	652.9	168.9	25.9
Operating costs – steady state	**(555.5)**	(413.8)	(141.7)	(34.2)
Operating costs – strategic initiatives	**(26.0)**	(11.8)	(14.2)	(120.3)
Impairment losses	**(95.8)**	(112.1)	16.3	14.5
Operating result	**144.5**	115.2	29.3	25.4
Significant items	**(55.5)**	(38.1)	(17.4)	(45.7)
Payment Protection Insurance (PPI) provision	**(4.3)**	–	(4.3)	–
Share of post tax profits/(losses) from joint ventures	**0.7**	(0.1)	0.8	800.0
Financial Services Compensation Scheme (FSCS) levies	**(11.5)**	(3.7)	(7.8)	(210.8)
Profit before taxation, distributions and fair value amortisation	**73.9**	73.3	0.6	0.8
Fair value amortisation	**(14.2)**	99.1	(113.3)	(114.3)
Profit before taxation and distributions	**59.7**	172.4	(112.7)	(65.4)
Membership dividend	**(10.8)**	(7.8)	(3.0)	(38.5)
Profit before taxation	**48.9**	164.6	(115.7)	(70.3)

Profit before taxation of £48.9m was lower than in 2009. This was predominantly due to amortisation of fair values created at the time of the merger; the apparent volatility of these initial adjustments is evident in the swing from a substantial benefit of £99.1m in 2009 to a charge of £14.2m in 2010. However, it should be noted that these adjustments are designed to unwind over future periods, are broadly profit neutral over time and have no cashflow impact.

Profit before taxation, distributions and fair value amortisation was 1% higher than 2009, at £73.9m. Higher significant items were incurred as a result of investment in the Banking Transformation Programme and a provision for pension mis-selling arising within the independent financial advisory business. In addition, the FSCS levy was £7.8m higher than 2009, and a £4.3m provision for Payment Protection Insurance (PPI) was incurred.

The operating result of £144.5m was 25.4% higher than 2009, reflecting both the increased scale of the combined business (with the result for 2009 including the Britannia business from August 2009) and notable organic growth in developing business areas. The operating profit reported within the consolidated income statement of £118.8m is stated after the deduction of the FSCS levy of £11.5m and the impact of fair value amortisation of £14.2m.

The operating result is stated after the significant costs of reinvesting in strategic change initiatives; these amounted to £26.0m in 2010 (2009: £11.8m). Excluding these change costs, the underlying operating result was up 34.3% to £170.5m, despite the challenges of the current economic environment and the ongoing weakness in the financial services sector in particular. On a like for like basis (including the pre-merger performance of Britannia for 2009), the underlying result excluding change costs was up by 10.8%.

Like for like income remained resilient (although down slightly in 2010 against 2009), a great achievement when taking into account the pressures on margin from low interest rates.

A policy of tight control and governance of the underlying cost base has continued in 2010 and is a key focus for the business going forward. Like for like costs fell by 2% in 2010, once the impact of inflation is excluded. Cost synergies of £41m, ahead of target, have helped to offset inflationary increases in costs.

Like for like impairment charges are significantly reduced from prior year levels, at 38.0% lower. This reflects a combination of improved arrears collection processes, the continued tightening of credit risk in the unsecured lending business and the cautious approach taken by both heritage businesses.

In 2010 a distribution of profit of £10.8m has been made to individual members of The Co-operative Group based on their account holdings with the Bank.

While total shareholder assets reduced slightly, from £46.1bn to £45.6bn, customer lending and deposits both grew, by 2.7% and 4.6% respectively.

Despite a difficult mortgage market, the Bank has increased its lending, with gross advances of £4.7bn, which illustrates the business's continued support to families and small businesses during these difficult times. The Bank is also sensitive to the depressed nature of the savings market and is doing what it can to balance savers' interests with those of borrowers.

While the credit risk on the residential mortgage portfolio is substantially mitigated by the fair value adjustments made at merger for any latent default risk in the Britannia assets, it is extremely pleasing to note the considerable reduction in arrears during 2010 (with a 22% reduction in late mortgage arrears during 2010), resulting from the tight credit control and focus on debt management.

The underlying strength of the business is evident in its stable capital and liquidity profile. The Bank core tier 1 ratio was 9.6% (2009: 8.7%), while the capital ratio was 14.0% (2009: 13.5%), and the tier 1 ratio, 9.9% (2009: 9.0%). These ratios reflect the strong capital base of the business, yet it is notable that the Bank has not taken, or needed, government capital support. This capital position has been more than sufficient to fund ambitious transformation projects while delivering outstanding service to our customers.

The Bank has maintained an excellent liquidity position, attracting and retaining high levels of customer funding. The customer funding ratio (excluding securitised assets) remains robust, at 107% (2009: 104%).

Our businesses

The Bank consists of two main segments – Retail, and Corporate and Markets (CAM).

The Co-operative Bank operating result	2010 £m	2009 £m	Change £m	Change %
Retail	**(3.2)**	(13.8)	10.6	76.8
CAM	**147.7**	123.7	24.0	19.4
Other	**–**	5.3	(5.3)	–
Operating result	**144.5**	115.2	29.3	25.4

The Retail business offers a range of financial products and services to individuals, households and small businesses throughout the UK, trading as The Co-operative Bank, Britannia and Smile.

Corporate and Markets (CAM) comprises a range of business to business services including corporate banking, treasury, intermediary mortgage lending and a number of fee for service businesses such as customer foreign exchange.

The other area of the Bank includes Unity Trust Bank, the result for which has decreased year on year.

Retail

Retail operating result	2010 £m	2009 £m	Change £m	Change %
Net interest income	**351.8**	262.2	89.6	34.2
Non-interest income	**149.7**	134.5	15.2	11.3
Net income	**501.5**	396.7	104.8	26.4
Operating costs – steady state	**(421.0)**	(318.6)	(102.4)	(32.1)
Operating costs – strategic initiatives	**(19.9)**	(9.2)	(10.7)	(116.3)
Impairment losses	**(63.8)**	(82.7)	18.9	22.9
Operating result	**(3.2)**	(13.8)	10.6	76.8

There was a significant improvement in the performance of the Retail Bank, reflecting stronger underlying profitability, despite the challenges of continuing low interest rates and uncertainty in the general economic environment. Underlying profitability, which excludes the cost of strategic change initiatives, was substantially improved at a profit of £16.7m (2009: loss of £4.6m). The strength of the CFS franchise, evidenced by continued growth in both current account balances and customer lending, combined with tight cost control and lower impairment charges have been at the heart of a strong 2010 performance. This places CFS in a great position for the future.

The improvement in profitability is complemented by high customer advocacy, 8.8% ahead of the 'top 5' in CFS's peer group.

The number of primary current accounts held by customers has increased by 17% in 2010; primary current accounts reflect those which a customer treats as their main bank account. In addition, the number of customers switching current account has increased by 79% during 2010.

Customer lending has increased, such that loans and advances now stand at £17.3bn (up 3.4%), reflecting the Bank's commitment to its retail customers, with gross advances of £3.1bn in 2010, at a time when many competitors were reducing their lending. The quality of the mortgage book remains high with a combined average loan to value of 41.8%. The growth in lending has been successfully self funded through the increase in customer deposits to £28.6bn and has contributed strongly to the Bank's overall customer funding ratio at 107%, reducing its dependency on funding from the wholesale markets.

Retail impairment of £63.8m was 22.9% better than 2009 reflecting a combination of improved arrears collection processes, strong quality of the mortgage book, declining credit card exposures and the continued tightening of credit risk scorecards in the unsecured lending business. These figures represent a considerable improvement given the current economic climate.

The strength of the retail customer proposition has again been recognised by a range of awards. CFS was named a 'recommended provider' by Which? Magazine, and won multiple categories at the Moneywise Customer Service awards. The Bank achieved the highest rating in the Forrester UK bank website benchmarking survey (beating NatWest, Santander, Barclays, Lloyds TSB and Halifax), and was the highest placed high street bank in the influential JD Power survey.

Business and financial review continued

Corporate and Markets (CAM)

CAM operating result	2010 £m	2009 £m	Change £m	Change %
Net interest income	**271.3**	199.4	71.9	36.1
Non-interest income	**38.2**	42.9	(4.7)	(11.0)
Net income	**309.5**	242.3	67.2	27.7
Operating costs – steady state	**(128.2)**	(87.7)	(40.5)	(46.2)
Operating costs – strategic initiatives	**(6.1)**	(2.6)	(3.5)	(134.6)
Impairment losses	**(27.5)**	(28.3)	0.8	2.8
Operating result	**147.7**	123.7	24.0	19.4

The CAM operating result for 2010 of £147.7m was 19.4% up on 2009.

Corporate banking

Corporate banking has delivered an operating result of £69.9m during 2010, an increase of £14.5m on 2009. This demonstrates a sustained performance in another difficult year for the industry, driven by measured growth on the corporate banking asset book through selected high quality new business, combined with significant liability growth through term deposits (54% growth in corporate deposits during 2010, evidencing the appeal of our proposition to the market). The increase in operating result is largely a result of a £13.0m increase in net interest income, due to the increased size of the newly combined business. Impairment losses have remained under control, falling from £32.3m to £30.4m.

Corporate will seek to drive further balance sheet growth through a dedicated customer deposits team and the roll out of a further two corporate banking centres during 2011, taking the total number to 22.

Platform

The Platform intermediary mortgage business, refocused on the prime mortgage market, has continued to grow its presence in this marketplace throughout 2010. The focus for Platform has been on good quality, prudent lending; advances of £0.6bn have been extended during 2010 with strong margins being achieved, and minimal arrears (0.71% of accounts in late arrears at the end of 2010).

Optimum

In 2010 the Optimum portfolio, a closed book of intermediary and acquired mortgage book assets, reduced in size, as planned, by 5% to £8.1bn, with the book performing strongly and in line with expectations.

Throughout the year, the business has delivered major improvements in the arrears management process with a focus on both existing arrears cases and pre-arrears cases. As a result, arrears in Optimum have improved steadily during the year. The merger related fair value provisions against the portfolio continue to provide a high degree of cover against credit losses.

Treasury

Treasury has delivered effectively on its core responsibilities of ensuring a strong and stable liquidity base, providing diverse sources of wholesale funding to the Bank, managing market risk within risk appetite and delivering a strong financial performance on the investment portfolio. The Treasury result was impacted by a challenging funding environment, with margins continuing to be under pressure during the year. Net interest income was negatively impacted due to increased investment in highly liquid, low risk assets in order to further strengthen our liquidity position as well as the reduction in higher risk, higher earning investment assets.

The Bank has been able to fund competitively in the wholesale markets, completing a £2.5bn prime mortgage securitisation transaction early in the year. This was followed towards the end of 2010 with an unsecured issuance of £400m, evidencing a considerable vote of confidence in the business from the market.

Summary and outlook

Notwithstanding the considerable challenges of the current economic environment and the integration of two businesses, the Bank has delivered a resilient performance for the year. Underlying profitability remains robust, supported by strong cost control and the complementary nature of the two heritage businesses. The Bank remains the compelling co-operative provider of a wide range of financial services, including our commitment to making switching current accounts an easier process, thanks to a strong balance sheet, responsible strategy and financial prudence, as evidenced by our strong capital and liquidity profile.

The excellent progress made in integrating the two businesses leaves the Bank, and its parent, CFS, well positioned to deliver market leading customer service. The benefits already provided to corporate customers through the Banking Transformation Programme will be extended to all customers over the next three years. We recognise the challenges ahead but are confident that our unique position within the industry, and the support of our people and customers, mean that we are favourably placed to achieve our vision.

Sustainability report

Sustainability is a key element of The Co-operative Financial Services' business strategy. The 'compelling co-operative alternative' means measuring our success, not just in financial terms but in how we impact on our community. It is one of the CFS 'givens' that we will champion co-operative values, principles and ethics. In furtherance of this we commit ourselves to taking personal and social responsibility. The following pages outline how we set out to honour these commitments.

2010 proved to be much more than a year of consolidation for The Co-operative Financial Services (CFS), following our merger with Britannia. With ethical and environmental considerations remaining key to our strategy, it was extremely pleasing to see our work recognised by the public and opinion leaders alike. From over 100 entrants in the global financial services industry, we became the Financial Times 'World's Most Sustainable Bank'. This award recognises our ethical and environmental leadership and the hard work of our colleagues. Together with our sector leading performance in the Sunday Times Best Green Companies List and our number one sector ranking amongst the general public for our social responsibility performance, the accolade attests to the absolute embeddedness of sustainability in our business.

We believe our future aspirations should surpass our previous accomplishments. That's why, in 2011, to consolidate its position as the most responsible UK business, The Co-operative has launched its boldest ethical campaign to date – Project Revolution – calling on millions of customers and members to help build a fairer world.

Strategy, materiality and governance

CFS' approach focuses on the issues of greatest relevance to our core business activities and stakeholders: the provision of ethical financial products and services; community investment and inclusion; and responsible environmental management.

As a co-operative business, our values and principles remain as relevant today as when they were conceived in the nineteenth century. Such values are reflected in The Co-operative's unique democratic structure, and in the ethical policies that underpin all banking and investments activity. This approach ensures that The Co-operative is held accountable via a Values and Principles Committee, drawn from the membership that own the business, and enables it to mobilise members and customers in innovative campaigning activity.

Leadership in social responsibility is taken into consideration in the remuneration of the CFS Executive Team, and performance is transparently reported in the award winning annual Sustainability Report of The Co-operative. 2011 sees a new milestone in our pursuit of sustainability, in the form of a three year Ethical Operating Plan, which sets ambitious new targets across our family of businesses.

Performance overview

Ethical finance

Our Co-operative Bank Ethical Policy acknowledges that the most significant sustainability impact we have is in who we lend money to – a principle that many of our competitors are slow to recognise. We have declined over £1bn of finance to businesses, in line with our customers' ethical concerns, whilst continuing to grow our commercial lending overall – its value is now 16 times that of 1992, when the policy was launched. We have extended our ethical screening approach to the £1bn of investments that underpin our insurance products, whilst continuing to ensure that we remain an active and responsible institutional investor. Our Ethical Engagement Policy, a world first, sets out a commitment to use our power as an institutional investor to push for improvements in the ethical and environmental performance of investee companies. In support of this policy, in 2010, we voted on over 4,000 UK shareholder resolutions, taking a stand against management in 10% of instances. This included challenging oil companies, such as BP and Shell, to be more transparent about tar sands developments, which risk dangerous levels of climate change and local ecological disaster.

Last year saw the launch of our Social Banking Unit, which ensures that businesses and organisations with a distinctly ethical or social purpose – such as charities or co-operatives – benefit from the services of a dedicated expert team. One early success story of this new service is the £1.2m loan provided for a wind turbine on the island of Tiree in the Inner Hebrides, where the majority of adults are Co-operative members. Moving forward, our commitment to fund energy efficiency and renewable solutions will increase to £1bn. During 2010, we also promoted awareness of ethical banking and investment amongst the general public, through our continued support for National Ethical Investment Week.

We continue to make finance accessible to all and not the few. Our provision of basic bank accounts is up nearly 30% from 2009, and we maintain our support to the pioneering bank accounts for prisoners project, through which over 5,000 prisoners have now been provided with an account – and, therein, a better opportunity to secure housing and employment; factors considered key to reducing reoffending.

Keeping communities thriving

In 2010, The Co-operative family of businesses invested £12.4m in the community. CFS colleagues contributed to the total of over 90,000 hours volunteered by Co-operative colleagues, taking part in community team challenges, which ranged from conserving woodland to redecorating community centres. Next year, we will encourage our colleagues, customers and members to help raise £5m for Mencap, our 2011 Charity of the Year, to enable their fantastic work improving the lives of young people with learning disabilities.

Our new Ethical Operating Plan has set an ambitious new target for our community investment – by 2013, 10% of The Co-operative's profits available for distribution will be invested in the community, with at least £5m being targeted at tackling poverty in the neighbourhoods around Co-operative branches and stores.

Sustainability report continued

Supporting co-operatives

We hold a strong belief in the principle of 'co-operation amongst co-operatives', and The Co-operative was proud to support the very first 'Co-operatives Fortnight' – a series of events aiming to raise the profile of co-operatives in the UK. We continue to be the largest provider of banking to the British Credit Union movement and support the Co-operative sector's further development through pioneering initiatives, such as the Credit Union Current Account.

The Co-operative Enterprise Hub, which is funded by The Co-operative, is committing some £7.5m over the next three years to provide the advice, training and finance needed to ensure that the sector continues to thrive. This further enhances CFS' support for renewable energy projects. For example, the Hub has provided funding to Energy4All Ltd, a development company born of the UK's first community owned wind farm, Baywind Energy Co-operative. Baywind was partly financed by The Co-operative Bank when it was established in 1996, and recent Hub funding has led to the creation of further co-operatives around the UK. The creation of an additional £20m International Co-operative Development Loan Fund promises to ensure that our investment in the co-operative sector can have similarly positive impacts in developing communities overseas.

Inspiring young people

The initiatives undertaken by The Co-operative with the aim of 'Inspiring Young People' are helping over 250,000 young people change their world. Our Skills4Schools programme, delivered by colleague volunteers, promotes three initiatives – Fit4Finance, Number Partners and Enterprise4Education – which aim to improve the financial literacy, numeracy and employability of schoolchildren. In 2010, 6,800 hours of Company time and expertise were invested in the programme. We are the main sponsor of The Co-operative Academy in Manchester, which was launched in 2010. Specialising in business and finance, this school benefits from our business expertise and receives funding for community work. Furthermore, work is currently underway on the creation of The Co-operative Apprenticeship Academy, which, by 2013, will have created 2,000 new apprenticeships.

Tackling global poverty

The Co-operative continues to strive for a fairer world, where basic human needs are met and rights are respected. At CFS, we have supported microfinance institutions in 27 countries across the globe, through a $50m fund to provide small loans to people in the world's poorest countries. To date, a staggering £6m has been raised by charity credit card customers for organisations that tackle global poverty or protect human rights, such as Oxfam or Amnesty International.

The Co-operative also continues to work directly with communities in the developing world – with significant water, sanitation and green energy solutions being funded and delivered in 2010. Our conviction that we can and should be doing more to tackle global poverty will see us launch, in 2011, a renewed third world debt campaign – 'Unfinished Business'.

Protecting the environment

CFS continues to offset all CO_2 emissions, together with an additional 10% to compensate for our carbon legacy. Most ambitiously, The Co-operative is now seeking to reduce, by 35%, operational greenhouse gas emissions across the family of businesses by 2017; a stretching target for a business that has already made considerable headway in addressing this impact.

Last year, CFS completed the roll out of our environmental management systems across the Britannia estate and were extremely proud to achieve recertification to the ISO14001 standard. We remain the only financial services organisation in the world to achieve this leading standard across all business activities and products.

Our pioneering 'Think' credit card not only rewards ethical consumerism, but has helped save over 2,000 acres of Indonesian rainforest through donations made by CFS on our customers' behalf. We've also worked to shape the wider debate on ecological sustainability. As part of our Toxic Fuels campaign, The Co-operative has called for a ban on UK shale gas developments until related human and environmental risks have been assessed.

The conviction that a profitable business must also be a principled one has remained integral to our business throughout a period of considerable change. 2011 promises to be another exciting year, as the launch of The Co-operative's new Ethical Operating Plan will not only bolster our own performance, but also challenge others in the UK financial services industry to raise their game in the pursuit of sustainable development.

The Board
The Co-operative Bank plc

Non-executive directors:

Paul Flowers (BA (Hons))
Age 60. Joined the Board in 2009 and appointed Chair in 2010. Deputy Chair of The Co-operative Group Limited. Superintendent Methodist Minister/ Bradford city councillor. Member of The Co-operative Group North Regional Board. Non-executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Rodney Baker-Bates (MA, FCA, AIMC, FCIB)
Age 66. Joined the Board in 2009 and appointed Deputy Chair in 2010. Directorships also held at Assura Group plc, AtlasFram Group Limited, Bedlam Asset Management plc, Dolphin Square Trust Limited, EG Solutions plc, G's Group Holding Limited and Stobart Group plc. Non-executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Duncan Bowdler (BSc (Hons) Biochemistry)
Age 52. Joined the Board in 2009. Trade liaison manager. Member of The Co-operative Group North West and North Midlands Regional Board. Non-executive director of The Co-operative Group Limited, Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

David Davies (BSc (Econ), FIA)
Age 63. Joined the Board in 2003, appointed Deputy Chair in 2010 and is the senior independent director. Chair of Sun Life Assurance Company of Canada (UK) and Nortel Networks Pension Scheme in the UK, and non-executive director of Interglobal Insurance Company Limited. Non-executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Peter Harvey (ACIB, Dip FS)
Age 55. Joined the Board in 2009. Consultant to Berwin Leighton Paisner LLP. Also non-executive director at Marshalls Holdings Limited and a member of the Supervisory Board and Audit Committee of Surrey Cricket Club Limited. Non-executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Paul Hewitt (MA, ACA, Dip German (Open))
Age 55. Joined the Board in 2003. Non-executive director of Kiln Group and Collins Stewart plc. Chair of Four Times Enterprises Limited, The Good Care Group Limited and R.J. Kiln & Co Limited. Industrial partner with Lyceum Capital, a mid market private equity firm and trustee of NEST (the National Employment Savings Trust). Non-executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Chris Jones (LLB)
Age 58. Joined the Board in 2009. Member of the Institute of Credit Management, the Law Society and a Fellow of the Royal Society of Arts and of the Association of Business Recovery Professionals. Runs Tourmalet Consulting, specialising in business turnaround. Non-executive director of Agenda Management Services Limited, Armitage Jones LLP, Montpelier Business Reorganisation Limited, Trango Ltd and The Business Desk. Non-executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited. Chair of Illius Properties Limited.

Stephen Kingsley (BSc (Hons), FCA)
Age 58. Joined the Board in 2009. Over 35 years' experience in financial services primarily auditing and consulting. Has held senior positions at Arthur Andersen and AON Corporation. Currently a senior Managing Director at FTI Consulting Limited, the global expert services firm. Non-executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Peter Marks
Age 61. Joined the Board in 2009. Chief Executive of The Co-operative Group Limited. Entire working life spent within the co-operative movement. Instrumental in bringing about a number of major co-operative mergers over the past decade. Non-executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Bob Newton (BSc, FIA, CDir)
Age 61. Joined the Board in 2007. Forty years' experience in the financial services industry; now has a portfolio of business and pro bono interests. Holds non-executive directorships with UIA (Insurance) Limited, and AI Claims Solutions plc. Non-executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited, CIS General Insurance Limited and Reclaim Fund Ltd.

Ben Reid (OBE, FCCA)
Age 56. Joined the Board in 2009. Chief Executive of The Midcounties Co-operative. Chair of Walsall Hospitals NHS Trust. Non-executive director of The Co-operative Group Limited, Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

The Board continued

Len Wardle (BA)
Age 66. Joined the Board in 2006. Chair of The Co-operative Group Limited and member of the South East Regional Board. Held management positions in local government and latterly was a Fellow at the University of Surrey in the School of Management. Director of Communicate Mutuality Limited. Non-executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Martyn Wates (ACA, ATII, BA (Hons))
Age 44. Joined the Board in 2007. Chief Executive, Specialist Businesses and Deputy Chief Executive of The Co-operative Group Limited. Has held various senior finance positions within the co-operative movement. Director of various internal subsidiaries and non-executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Steve Watts (MA (Cantab), MA (Econ), BA (Hons))
Age 59. Joined the Board in 2006. Member of the Central & Eastern Regional Board. Retired pricing, research, and information officer within the Directorate of Employment and Skills at Cambridge Regional College. Non-executive director of Unity Trust Bank plc. Deputy Chair of The Co-operative Group Limited, non-executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Piers Williamson (BA (Hons), ACIB, MCT)
Age 49. Joined the Board in 2005. Over 25 years' experience of the UK, US and European financial markets. Holds non-executive directorships with various Industrial and Provident Societies and funding vehicles associated with the Housing Finance Corporation, where he is Chief Executive, also a sustainable development commissioner for the Greater London Authority. Non-executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Executive directors:

Neville Richardson (BA (Hons), FCA)
Age 53. Joined the Board in 2009. Chief Executive. Deputy Chief Executive of The Co-operative Group Limited. Director of Communicate Mutuality Limited. Member of the Court of the University of Lancaster and of the Building Societies Association Council. Also Chief Executive of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Rod Bulmer (BA (Hons), MSc)
Age 41. Joined the Board in 2009. Managing Director, Retail. Joined Co-operative Financial Services in October 2007 and became Sales Director in July 2008. Executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Tim Franklin (ACIB)
Age 49. Joined the Board in 2009. Chief Operating Officer. Non-executive director of Reclaim Fund Ltd. Executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Phil Lee (BSc, CA)
Age 55. Joined the Board in 2009. Executive director, Integration and Change. Executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Barry Tootell (BA (Hons), FCA)
Age 49. Joined the Board in 2008. Chief Financial Officer. Qualified accountant with over 20 years of finance and control experience. Chair of CFS Management Services Limited. Executive director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Report of the Board of Directors

The directors submit their report, together with the audited financial statements, for the period to 31 December 2010. The full financial statements 2010 contain the corporate governance statement on pages 17 to 22 and the risk management section on pages 45 to 77, which are deemed to form part of the report of the Board of Directors. As set out more fully in the Basis of preparation and accounting policies, these financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. All financial information given in this report is taken solely from the statutory results prepared on this basis. Unaudited, like for like results which allow business segment comparison between 2010 and 2009 are given in the business and financial review on pages 5 to 8.

Principal activities

The Co-operative Bank plc (the Bank) and its subsidiary undertakings provide an extensive range of banking and financial services in the UK.

Business review

A review of the development and performance of the Bank and its operating subsidiaries during the financial year and any significant events since the year end are set out in the business and financial review on pages 5 to 8. The principal risks and uncertainties facing the Bank are set out in the risk management section on pages 45 to 77. Note 36 of the financial statements provides details of the Bank's principal subsidiaries and the nature of each organisation's business.

The Bank changed its accounting reference date in 2009 to 31 December. Where these financial statements refer to 'year ended 31 December 2010' this represents the 52 week period for 1 January 2010 to 31 December 2010. The 2009 comparatives are stated for the 51 week period from 11 January 2009 to 31 December 2009.

On 15 December 2010 the Bank allotted £180m of share capital to its parent company, Co-operative Financial Services Limited (CFS), to reinforce its capital strength.

Key performance indicators

The CFS Group has introduced a balanced scorecard that reflects its goals as a business over its three year corporate plan.

How do we measure our success?

The CFS business strategy measures success in four key areas: financial, customer, people and process. This 'balanced scorecard' approach is a key reflection of our co-operative difference. The balanced scorecard helps us ensure that, in all decisions we make as a business, we focus on the financial, customer, people and process implications of the decision. It also helps us to take a broad view of our progress towards our strategic vision.

How do we measure our success?

Financial

Financial measures focus on profitability and underlying financial strength:

- **Profit**
  This is our measure of operating profit for the business as a whole and includes operating profit (adjusted for significant items) before tax. The measure also incorporates a new business profit measure for our life business.
  CFS Shareholder profit before tax: £209.7m
  Progress: ●
- **Liquidity**
  Our liquidity measure sets a minimum liquidity limit for the year in line with the Financial Plan.
  Minimum liquidity level: 107%
  Progress: ●
- **Surplus capital**
  Similarly our surplus capital measure sets a minimum amount of capital for each year, below which the business should not operate. This minimum is set in line with the Financial Plan with due regard for our regulatory requirements.
  Amount of surplus capital: On target
  Progress: ●

Customer

Customer measures address the key relationships through which we sustain and grow our business:

- **Customer advocacy**
  We use an external survey to monitor advocacy of customers across the Retail businesses relative to appropriate peers. This gives us our customer advocacy measure.
  Customer advocacy: +7.5%
  Progress: ●
- **Primary current account customers**
  Primary current account customers are defined as those who:
  – hold one of our standard current accounts.
  – credit their account with at least £800 per month.
  Primary account customers: 552,000
  Progress: ●
- **Products held per primary current account customer**
  This measure monitors how well we are meeting the needs of our relationship customers (as defined above) by calculating the average number of active products they hold with us.
  Products per primary account holder: 2.59
  Progress: ●

To be the UK's most admired Financial Services Business

People

People measures reflect the importance of internal, as well as customer advocacy:

- **Colleague engagement**
  Our colleague engagement assessment is derived from our twice yearly internal colleague survey.
  Colleague engagement: 78.5%
  Progress: ●

Process

Process measures focus on the efficiency of our business in delivering services to our customers:

- **Cost**
  This measure focuses on our cost base. The target for this measure reflects the current combined business position and the outputs from the Financial Plan over a three year period.
  CFS efficiency ratio: 38.2%
  Progress: ●
- **Compliance with risk appetite**
  We track this measure using key risk criteria across the business. Success means no material breaches against any of these criteria.
  Compliance with risk appetite: 100%
  Progress: ●

● On target
○ Good progress
○ Below target

Report of the Board of Directors continued

Financial measures specific to the Bank are discussed in the business and financial review, on pages 5 to 8.

Results and dividends

Profit before taxation and significant items was £108.7m. Profit attributable to the ordinary shareholders amounted to £36.4m (2009: £110.3m). No dividends were paid during 2010. The directors recommend that no final dividend is paid in respect of 2010.

Changes to the Board

The names of the present members of the Board and their biographies and details of length of service are set out on pages 11 and 12.

The directors of the Bank during the financial year are listed below. They were appointed for the full period unless otherwise indicated:

Non-executive directors:
Paul Flowers (Chair)
Rodney Baker-Bates
Duncan Bowdler
Bob Burlton (resigned 15 April 2010)
David Davies
Peter Harvey
Paul Hewitt
Chris Jones
Stephen Kingsley
Peter Marks
Bob Newton
Ben Reid
Len Wardle
Martyn Wates
Steve Watts
Piers Williamson

Executive directors:
Neville Richardson (Chief Executive)
Rod Bulmer
Tim Franklin
Phil Lee
John Reizenstein (resigned 7 December 2010)
Barry Tootell

Reappointment of directors

Under the Articles of Association, one third of the Board are required to retire by rotation at the conclusion of the Annual General Meeting (AGM). In accordance with the Articles of Association, therefore, Len Wardle, Martyn Wates and Steve Watts retire by rotation and all offer themselves for re-election at the 2011 AGM. No directors have been appointed since the conclusion of the last AGM on 12 May 2010 which would make them eligible for re-appointment at the 2011 AGM. The notice of the AGM can be found on page 125. All directors up for re-election continue to demonstrate commitment to their roles (see schedule of attendance on page 20).

On 15 April 2010, Bob Burlton, Chair, retired from the Bank Board, and Paul Flowers was appointed Chair in his place. Paul Flowers has served on the Board since 2009 and on the Board of The Co-operative Group since 2008. Rodney Baker-Bates and David Davies were appointed Deputy Chairs on 21 April 2010. Rodney Baker-Bates had previously served on the Board of Britannia Building Society since 2006. David Davies joined the Board in 2003 and was appointed senior independent director in 2005. John Reizenstein, Managing Director Corporate and Markets, left the Bank Board on 7 December 2010.

Directors' and officers' liability insurance and indemnity

The Bank maintains appropriate directors' and officers' liability insurance cover, through the ultimate parent organisation, in respect of legal action against its directors and officers. This constitutes a 'qualifying third party indemnity provision' for the purposes of the Companies Act 2006 and applied to all of the Bank's directors serving during the financial year. The insurance cover was reviewed and renewed in 2010. A 'qualifying pension scheme indemnity provision' was also in place for one or more of the directors who served during the financial year.

Directors and their interests

No director had a material interest at any time during the year in any contract of significance, other than a service contract, with the Bank or any of its subsidiary undertakings.

No director had a beneficial interest in any shares in the Bank or in The Co-operative Group Limited, which is the ultimate holding organisation, or in any other entity controlled by The Co-operative Group Limited.

Going concern

The financial statements are prepared on a going concern basis as the directors are satisfied that the Group and parent company have the resources to continue in business for the foreseeable future. In making this assessment, the directors have considered a wide range of information relating to present and future conditions including future projections of profitability, cash flows and capital resources. Further information relevant to the assessment is provided within the basis of preparation of the financial statements on page 38.

Corporate governance

The Bank is committed to high standards of corporate governance. The Bank believes it has, with the exception of the level of independent Board representation, fully complied throughout the year with the principles and provisions of the Combined Code on Corporate Governance appropriate to the structure of the Bank and its parent organisation, Co-operative Financial Services Limited (CFS) and The Co-operative Group Limited (The Co-operative Group). Further information is provided within the corporate governance report on pages 17 to 22.

Information and communication

Communication takes place with all key stakeholders through a variety of media including the sustainability report produced by The Co-operative Group. Employees receive and provide information on strategy and objectives through their reporting lines and a formal performance measurement process. Newsletters, bulletins and electronic media communicate other information.

Employees

The Bank and its subsidiary undertakings employed 8,583 persons at 31 December 2010 (2009: 8,705). The weekly average number of people was 8,746 (2009: 5,993) and their aggregate remuneration, before significant items, for the year was £221.1m (2009: £151.0m). The Bank, as part of CFS operates learning and development initiatives across the organisation as part of a continuous improvement programme, supporting its approach to performance management, personal development, talent and succession planning.

CFS, in Bank orientated activities, continues to consult and communicate with colleagues on customer, organisation and business performance issues, using colleague publications, surveys, conferences, videos and both informal and formal consultations with Unite and other unions, which continue to be fully involved where organisational change and other issues affect colleagues.

Diversity
The Bank, as part of CFS, welcomes diversity and actively promotes a policy and practice of equality of opportunity in employment for all colleagues, regardless of age, disability, ethnicity, gender, religion or belief, or sexual orientation.

The Bank, as part of CFS, is a member of the following diversity advisory bodies:

- Employers Forum on Disability
- Employers Forum on Age
- Race for Opportunity
- Opportunity Now
- Stonewall

Employees with disabilities
CFS is a holder of the 'Positive about Disabled People' symbol, a recognition given by Jobcentre Plus to employers who have agreed to meet five commitments regarding the recruitment, employment, retention and career development of disabled people. CFS has policies and processes in place to support disabled colleagues in the workplace.

Further guidance and information for colleagues on disability issues is available through human resources and on the colleagues' intranet. CFS recognises its responsibility for making reasonable adjustments for new colleagues with disabilities and for those individuals who develop disabilities whilst in employment.

Employees' wellbeing
The Bank, as part of CFS, recognises that health and wellbeing at work play a vital part in delivering its core values. Wellbeing services include an occupational health scheme, physiotherapy services and seasonal wellbeing initiatives such as discounted allergy testing and flu jabs.

In addition to this, colleagues and their immediate families have access to an external employee assistance programme, providing free expert advice on a wide range of medical, legal and family issues.

Corporate responsibility
The Bank's corporate responsibility activities are outlined on pages 17 to 22. In addition, The Co-operative Group Sustainability Report, which will be published in the first half of 2011, describes how The Co-operative Group Limited, CFS, the Bank, Co-operative Insurance Society Limited and CIS General Insurance Limited manage their social, ethical and environmental impacts.

Political and charitable donations
During the year, CFS Management Services Limited, a fellow subsidiary of CFS, made donations (which exclude affinity card payments) of £0.4m to charitable organisations on behalf of the Bank (2009: £0.4m). A further £0.5m of donations were made directly by the Bank with £0.4m allocated through the Britannia Foundation. Additional costs associated with the Bank's community involvement are provided within The Co-operative Group Sustainability Report. It is the Bank's policy that no donations are made for political purposes.

Outlets
At 31 December 2010 the Bank had 370 outlets (2009: 368 outlets).

Market value of land and buildings
Freehold and leasehold land and buildings held by the Bank are held on the balance sheet at historic cost and have not been revalued. Based on valuations carried out by The Co-operative Group's internal property valuers, their market value at the balance sheet date is £75.2m which is £8.0m higher than carrying value.

Supplier payment policy and practice
With the exception of the Britannia business area detailed below, the Bank does not pay suppliers directly as all supplies and services are sourced through CFS Management Services Limited, a fellow subsidiary of CFS. A management charge is payable to cover the cost of these services.

Suppliers are paid directly by the former Britannia business where the policy is to agree the terms of payment at the start of trading with the supplier, ensure that suppliers are aware of the terms of payment and pay in accordance with its contractual and other obligations. Creditor days at 31 December were 16 (2009: 11 days).

Report of the Board of Directors continued

Post balance sheet events
The directors consider that there has been no event since the year end that has had a significant effect on the Bank's position or that of any of its connected undertakings.

Significant contracts
The Bank maintains a number of significant contracts with IT providers, cash handling entities and mailing service companies as well as with a CFS Group company, CFS Management Services Limited which provides facilities and services for all CFS Group companies.

Financial statements
So far as the directors are aware, there is no relevant audit information of which the Bank's auditors are unaware, and the directors have taken all steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Bank's auditors are aware of that information.

Statement of directors' responsibilities in respect of the report of the Board of Directors and the financial statements
The directors are responsible for preparing the financial statements and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare Group and parent company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of their profit or loss for that period. In preparing each of the Group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a remuneration report, a directors' report and a corporate governance report that comply with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Auditors
In accordance with Section 489 of the Companies Act 2006, resolutions for the appointment and remuneration of the auditors are proposed at the next AGM and set out on page 125. Further detail in relation to the appointment of the auditors is set out on page 22.

By Order of the Board
Moira Lees, Secretary

29 March 2011

Corporate governance report

UK Combined Code on Corporate Governance

For the period ended 31 December 2010, The Co-operative Bank plc (the Bank) believes it has, with the exception of the level of independent representation on the Board and CFS Audit and Regulatory Compliance Committee (which is commented upon later), fully complied with the principles and provisions of the Combined Code on Corporate Governance (the Code) appropriate to the structure of the Bank and its parent organisation, Co-operative Financial Services Limited (CFS) and The Co-operative Group Limited (The Co-operative Group).

The Bank will, for the period ended 31 December 2011, report against the new UK Corporate Governance Code. A gap analysis has been completed and work is underway to ensure compliance with the UK Corporate Governance Code.

Board composition and independence

The Board currently comprises 15 non-executive directors and five executive directors.

The Code requires at least half of the Board, excluding the Chair, to be independent non-executive directors. In accordance with the Code, it is for the Board to consider whether a director is independent in character and judgment and whether there are any relationships or circumstances which are likely to affect, or could appear to affect, the director's judgment. The size and composition of the Board is currently under review and increasing the proportion of independent directors on the Board will be considered as part of this review.

The Board has concluded that, looking across the wider Co-operative Group, the individual members elected by and from The Co-operative Group's seven regions to stand as directors (unless employees within the last five years) should be defined as independent, while those appointed directors representing independent society members of The Co-operative Group could not be so categorised in the co-operative context. This is because the latter represent significant shareholders with material business relationships.

Included within the Board members are seven independent professional non-executive directors, Rodney Baker-Bates, David Davies, Peter Harvey, Chris Jones, Bob Newton, Stephen Kingsley and Piers Williamson. David Davies is the senior independent director. In addition, there are two independent non-executive directors elected by and from the members of The Co-operative Group that the Board have determined to be independent as described above. These are Len Wardle and Steve Watts.

Ben Reid represents independent society members of The Co-operative Group. Peter Marks and Martyn Wates hold executive appointments in The Co-operative Group (Peter Marks is the Chief Executive and Martyn Wates is a Deputy Chief Executive). Duncan Bowdler is an employee of The Co-operative Group. Paul Hewitt was, until 28 July 2007, Deputy Chief Executive of The Co-operative Group. These directors cannot therefore be considered to be independent.

The Board believes it has sufficient independent representation having nine independent non-executive directors (excluding the Chair). The Board believes that all the non-executives have considerable experience and make valuable contributions to the operation of the Bank.

The non-executive directors constructively challenge and help develop proposals on strategy and bring strong, independent judgment, knowledge and experience to the Board's deliberations. The non-executive directors are of sufficient calibre and number that their views carry significant weight in the Board's decision making.

The directors that serve on the CFS Board (the Bank's parent) also sit on the Bank Board to provide a common understanding of objectives. Appointments to the CFS Board are made by The Co-operative Group Board. Under the CFS rules, each non-executive director is appointed for a term of three years commencing on the day following the Annual General Meeting for the year in which the director is appointed.

All non-executive directors are eligible for re-appointment at the end of each term of office. The Co-operative Group Board, being party to agreements with the independent professional non-executive directors for services to CFS and its subsidiaries, including the Bank, may resolve to re-appoint at or before the date their contracts expire for a further three year term. It is the normal policy of the Board not to allow an independent professional non-executive director to serve for more than nine years in aggregate.

For the recruitment of non-executive directors, external recruitment consultants are retained.

Roles and responsibilities of the Bank Board

The directors are committed to leading and controlling the Bank effectively. The Board is responsible for the success of the Bank within a framework of controls, which enables risk to be assessed and managed. It is responsible for setting strategy, maintaining the policy and decision making framework in which this strategy is implemented, ensuring that the necessary financial and human resources are in place to meet strategic aims, monitoring performance against key financial and non-financial indicators, overseeing the system of risk management and for setting values and standards in governance matters.

The responsibility of the Board is to direct the business of the Bank and in particular to:

- ensure that the Bank's affairs are conducted and managed in accordance with its Articles of Association and the best interests of its stakeholders and in accordance with co-operative values and principles;
- agree objectives, policies and strategies, and monitor the performance of executive management;
- approve the annual budget and business plan;
- approve the reported financial statements and dividends;
- monitor, through various committees, the key significant risks facing the Bank;
- establish Board committees and agree their terms of reference; and
- approve the delegated financial authorities.

Corporate governance report continued

The Board manages these matters at its regular Board and strategy meetings and details of attendance at Board meetings are noted on page 20. The Board meets on a monthly basis and it met 12 times in 2010. There were also two strategy meetings, attended by senior executives, devoted to consideration of performance and longer term planning. The Board is scheduled to meet for 11 Board meetings and to hold two strategy meetings in 2011.

Board procedures
Board and committee papers are distributed at least one week in advance of meetings. This provides the opportunity for directors to prepare fully for meetings. The minutes of all meetings are circulated to all directors. As well as circulating papers as hard copies, the Board has access to its own secure website where papers are available together with additional supporting material (and which acts as a library of papers for directors).

There is regular communication between the directors, the Chair, the Deputy Chairs and the Secretary between meetings.

When a director is unable to attend Board or committee meetings, issues can be raised with the Chair or the Deputy Chairs. Written questions for management on papers are encouraged from directors between meetings. A rolling schedule of matters arising from Board and committee meetings is followed through.

The roles of the Chair, Deputy Chairs and Chief Executive
The division of responsibilities between the Chair of the Board and the Chief Executive is clearly defined and has been approved by the Board.

The Bank Chair is a non-executive director. He leads the Board in the determination of its strategy and in the achievement of its objectives. The Chair is responsible for organising the business of the Board, ensuring its effectiveness and setting its agenda. He has no involvement in the running of the day to day business of the Bank. The Chair facilitates the effective contribution of directors and constructive relations between the executive and non-executive directors, and ensures directors receive accurate, timely and clear information and ensures that there is effective communication with members. During 2010 the Chair undertook one to one discussions with all directors regarding the performance of the Board. On 21 April 2010 two Deputy Chairs were appointed to support the Chair.

Details of the Chair's and Deputy Chairs' professional commitments are included in the biographies on page 11. The Board is satisfied that these responsibilities do not interfere with the performance of the Chair or Deputy Chairs' duties for the Bank.

The Chief Executive, appointed by The Co-operative Group Board, has direct charge of the Bank on a day to day basis and is accountable to the Board for the financial and operational performance of the Bank.

Board committees
With the agreement of the Financial Services Authority (FSA), the Board has delegated certain responsibilities to the following committees, all of which have written terms of reference covering the authority delegated to it by the Board. Each of these committees has a role in ensuring the effectiveness of the Bank and its subsidiaries. A provision of the Code is that the terms of reference for the Remuneration and Appointments Committee and the Audit and Regulatory Compliance Committee are available on the Bank's website, and the Bank complies with this.

Remuneration and Appointments Committee
The CFS Remuneration and Appointments Committee meets as a joint committee for CFS, Co-operative Insurance Society Limited (CIS), CIS General Insurance Limited (CISGIL) and the Bank. Information on the Remuneration and Appointments Committee is found on page 23.

CFS Audit and Regulatory Compliance Committee
The CFS Audit and Regulatory Compliance Committee meets as a joint committee for CFS, CIS, CISGIL and the Bank. The committee comprises five members and is chaired by Paul Hewitt. During the year the committee comprised:

Paul Hewitt (Chair)
Paul Flowers (resigned 12 May 2010)
Chris Jones
Bob Newton
Ben Reid
Martyn Wates

Paul Hewitt, Ben Reid and Martyn Wates bring recent and relevant financial experience and in addition Ben Reid is the Chair of The Co-operative Group's Audit and Risk Committee. Paul Flowers stood down from the committee following his appointment as Chair of the Board. Chris Jones and Bob Newton are considered to be independent members of the committee. The committee's terms of reference and constitution are currently under review. Please see page 20 for further detail.

The committee met four times during the financial year. The main responsibilities of the committee are to:

- review and discuss with management and auditors the preliminary results, interim information and annual financial statements of the Bank before submission to the Board;
- review, prior to its consideration by the Board, the external auditor's reports to the directors and management's response;
- receive reports on activities and note the minutes of the CFS Risk Management Committee;
- consider any necessary disclosure implications from the process that has been applied by the Board to deal with material internal control aspects of any significant problems disclosed in the financial statements;
- obtain assurance that the Bank is compliant with relevant regulation;
- review and discuss issues identified as a result of compliance work and how management is addressing these issues;
- monitor regulatory relationships, in particular, with the FSA;
- assess the qualification, expertise, resources, effectiveness and independence of the external auditors and approve the terms of engagement and remuneration paid to the external auditors in respect of the audit services provided;
- review co-ordination between the internal and external auditors and, where relevant, the risk management functions;
- review and discuss with the relevant business leaders any issues identified as a result of internal audit work and how management is addressing these issues as well as reviewing reports on management response to audit recommendations;
- monitor and assess the role and effectiveness of the internal audit function; and
- approve policies and review the adequacy of risk management activities in relation to operational risk.

CFS Risk Management Committee

The CFS Risk Management Committee meets as a joint committee for CFS, CIS, CISGIL and the Bank. The committee comprises six members and is chaired by Piers Williamson. During the year the committee comprised:

Piers Williamson (Chair)
David Davies
Mike Fairbairn (Director of Risk) (who is not a Board director)
Paul Flowers (resigned 7 July 2010)
Paul Hewitt
Stephen Kingsley
Barry Tootell

Paul Flowers stood down from the committee following his appointment as Chair of the Board although he may attend any committee meeting as an observer at his discretion. The committee's terms of reference and constitution are currently under review. Please see page 46 for further detail.

The committee met six times during the financial year. The main responsibilities of the committee are to:

- review and challenge the impact assessment of the strategic plan on the risk and capital profile of the Bank;
- review and challenge the risk appetite process with a focus on the overall organisational view of risk appetite;
- monitor compliance with Board approved risk appetite;
- approve mandates and portfolio limits in line with risk appetite, and monitor and review any breaches thereof;
- assess the robustness of Individual Capital Adequacy Assessment Processes (ICAAP);
- review and challenge the executive's recommendations on level of capital held in relation to how adequately it reflects the Bank's risk profile;
- review and challenge the adequacy of risk management activities across the Bank managed by the executive, including risk mitigation;
- review and challenge the adequacy of the risk management process and systems in operation;
- set standards for risk management processes and techniques, and benchmark against industry best practice on a regular basis; and
- monitor the credit risk performance of new and existing portfolios against limits, and ensure any appropriate risk mitigation action or review of risk policies or limits is taken.

CFS Exposures Committee

The CFS Exposures Committee meets as a joint committee for CFS, CIS, CISGIL and the Bank. The committee comprises five members and is chaired by Peter Harvey. During the year the committee comprised:

Peter Harvey (Chair)
Kevin Blake (Business Leader, Banking Risk) (who is not a Board director)
Bob Burlton (resigned 15 April 2010)
Neville Richardson
Steve Watts
Piers Williamson

The Bank Chair may attend any committee meeting as an observer at his discretion.

The committee met 11 times during the financial year. The main responsibilities of the committee are to:

- approve all Bank advances in excess of the delegated lending authority of the Chief Executive;
- review all decisions taken within the delegated authority of the Chief Executive or any individual executive by way of Noting Returns;
- review and approve management actions on excess positions on lending exposures which exceed the Chief Executive's discretion;
- review and approve management actions on excess positions on investment exposures which exceed the Chief Executive's discretion;
- review and approve management actions on individual counterparty positions on the corporate banking credit risk watchlist, the Bank's market credit risk watchlist, and The Co-operative Asset Management credit risk watchlist;
- review and approve management actions on any other positions which the Credit Committee or the Business Leader, Actuarial Risk, determine should be brought to its attention; and
- review minutes of the Risk Management Committee and note any actions to be taken as relevant to the remit of the committee.

During the year the committee reviewed its own effectiveness.

Corporate governance report continued

CFS Banking Transformation Programme Sub-Committee

In addition to the main Board committees detailed above, the CFS Banking Transformation Programme Sub-Committee was constituted by the CFS Board at its meeting on 17 February 2010. The sub-committee's purpose is to provide oversight of CFS's Banking Transformation Programme in order to give assurance to the Board on the progress of the work in the programme. The work of the Banking Transformation Programme includes replacing the existing retail and corporate banking systems with new technology systems, redesigning processes and interaction with customers.

Attendance

The table below sets out the frequency of, and attendance at, the Board and Board committee meetings for the period under review by directors.

The number in brackets indicates the total number of meetings the director was eligible to attend during the year. In the case of a director being unable to attend a meeting, the Chair has received a satisfactory reason for their absence.

Provision of advice to directors

A number of external consultants provide professional advice to the Boards of the constituent parts of the wider Co-operative Group. There is an agreed procedure by which directors may take independent professional advice at the Bank's expense in furtherance of their duties.

Training and professional development

In 2010, a new Board Learning and Development Policy was introduced to support all non-executive directors.

Following meetings with non-executive directors to review individual and collective training and development, thematic learning and development sessions for the whole Board have taken place each month.

Specific training has been organised for Board committees including the CFS Remuneration and Appointments Committee, the CFS Audit and Regulatory Compliance Committee and the Risk Management Committee. In addition, one to one support has been provided to a number of directors.

The directors' website has been used as a resource bank to enable directors to access, revisit and review copies of presentations and materials from the development sessions.

At the end of 2010 individual learning and development records were issued to all non-executive directors summarising activity through the year and individual learning plans were being progressed with a view to constructing the framework for individual and collective learning and development going forwards.

Performance evaluation

The Code requires the Board to undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

During the year an external evaluation of the CFS Board, also sitting as the Bank Board, was completed in order to provide independent and informed advice on the effectiveness and impact of the Board and its committees. The review included observation of Board and committee meetings, review of constitutional documents and one to one confidential interviews with directors. The findings of the review were reported back to the Board at a strategy meeting in November 2010. A small number of recommendations were made and these are being implemented during 2011.

In addition to the Board review, an external review of the Bank risk management framework was conducted during 2010 which included a review of the responsibilities and terms of reference for the CFS Audit and Regulatory Compliance Committee and the CFS Risk Management Committee. The results of the review, which were reported to the Board, confirmed that the Bank risk management framework was coherent. The review made a number of recommendations in light of new regulations and evolving best practice and these are to be considered during 2011 alongside a detailed review of the terms of reference and composition of both the CFS Audit and Regulatory Compliance Committee and the CFS Risk Management Committee.

Due to the extent of the external reviews which took place in 2010, with the exception of CFS Exposures Committee, internal Board and committee evaluations were not required. The internal evaluation process will recommence in 2011.

Directors	Bank Board	CFS Remuneration and Appointments Committee	CFS Audit and Regulatory Compliance Committee	CFS Risk Management Committee	CFS Exposures Committee
Number of meetings held	**12**	**6**	**4**	**6**	**11**
Paul Flowers	11 (12)	5 (6)	1 (1)	1 (3)	
Rodney Baker-Bates	11 (12)	5 (6)			
Duncan Bowdler	11 (12)				
Rod Bulmer	11 (12)				
Bob Burlton	4 (4)	4 (4)			3 (4)
David Davies	10 (12)	6 (6)		6 (6)	
Tim Franklin	11 (12)				
Peter Harvey	11 (12)				11 (11)
Paul Hewitt	11 (12)		4 (4)	4 (6)	
Chris Jones	12 (12)		4 (4)		
Stephen Kingsley	12 (12)			6 (6)	
Phil Lee	12 (12)				
Peter Marks	10 (12)	5 (6)			
Bob Newton	12 (12)		4 (4)		
Ben Reid	9 (12)		3 (4)		
John Reizenstein	10 (11)				
Neville Richardson	12 (12)				11 (11)
Barry Tootell	12 (12)			6 (6)	
Len Wardle	12 (12)	5 (6)			
Martyn Wates	12 (12)		4 (4)		
Steve Watts	12 (12)				11 (11)
Piers Williamson	12 (12)			6 (6)	11 (11)

The Secretary to the Board

The Secretary is professionally qualified and is responsible for advising the Board through the Chair on all governance matters. The directors have access to the advice and services of the Secretary. The Articles of Association and the schedule of matters reserved to the Board for decision provide that the appointment and removal of the Secretary is a matter for the full Board.

The executive

It is the responsibility of the executive to implement the strategic objectives as agreed by the Board. The executive, under the leadership of the Chief Executive is responsible for the day to day management of the Bank.

Effective from 1 January 2011 the Chief Executive reports directly to the Chief Executive of The Co-operative Group in order for CFS and its subsidiaries, including the Bank, to become more closely integrated into The Co-operative Group.

Relations with members

The Bank has two equity shareholders. The majority of the shares are held by CFS, which is a wholly owned subsidiary of The Co-operative Group. The remainder of the shares are held directly by The Co-operative Group.

The Bank has approximately 2,500 preference shareholders. The preference shares are fixed-interest shares and are non-cumulative and irredeemable. The preference shareholders are entitled to attend the Annual General Meetings, but the shares only hold speaking or voting rights if and when the dividend has been in arrears for six months or more, or if a resolution is to be proposed at general meeting abrogating or varying any of their respective rights or privileges, or for the winding up of the Bank or other return of capital and then only on such resolution.

Risk management

The Board and executive management have the primary responsibility for identifying the key business risks facing the organisation. The CFS risk management framework, which is approved and reviewed by the Bank Board, outlines the approach taken to ensure a robust risk management process is in place throughout the organisation and is regularly reviewed. The framework includes an ongoing process for identifying, evaluating and managing significant risks and has been in place for the year under review and up to the date of the approval of the annual financial statements.

An independent review of the Bank risk management framework has recently been completed. The objective of the review was to consider whether the current framework is capable of enabling good risk governance and to make recommendations for improvement. The review considered the current framework to be suitable for an organisation of the Bank's size and complexity.

The Board accepts that there are risks which could impact on the achievement of the Bank's business objectives, but endeavours through positive risk management strategies as outlined in the risk management framework, to manage these in a manner that optimises returns within the confines of the business' risk appetite, whilst protecting members' interests and reserves.

For further information on the Bank's approach to risk management see pages 45 to 77.

Internal control

Internal controls are the activities undertaken by management, the Board and other parties to enhance risk management and increase the probability that established objectives and goals will be achieved. The Board has overall responsibility for the Bank's system of internal controls which aim to ensure effective and efficient operations, quality of internal and external reporting, safeguarding of the Bank's assets and compliance with laws and regulations. Whilst recognising that the system is designed to manage rather than eliminate risk of failure to achieve business objectives, it can only provide reasonable and not absolute assurance against material misstatement or loss.

Corporate governance report continued

The Bank's internal control framework is designed to create an attitude of taking acceptable business risk within clearly defined limits. The control environment includes:

- an organisational governance structure with clear lines of responsibility, delegation of authority and reporting requirements;
- checks and balances to ensure that business processes operate efficiently reducing the risk posed to the organisation whilst adhering to organisational values;
- comprehensive systems of financial reporting. The annual budget and long term plan of the Bank and of each division are reviewed and approved by the Board;
- a code of business conduct covering relations with customers, shareholders, colleagues, suppliers, community and competitors;
- a whistleblowing policy and procedure which provides for any employee to report, in confidence, suspected serious malpractice;
- internal audit, risk and compliance functions that review the system of internal control; and
- a control self assessment process designed to fully support the annual review of the effectiveness of the system of internal control and enable continual monitoring and improvement of the internal control environment.

External audit

One of the duties of the CFS Audit and Regulatory Compliance Committee is to make recommendations to The Co-operative Group Audit and Risk Committee in relation to the appointment of the external auditors. In 2003 The Co-operative Group Board approved the re-appointment of KPMG Audit plc as the external auditor following a competitive tender exercise. A repeat tender exercise is currently underway and it is intended that a resolution to appoint the external auditor be put to the next Annual General Meeting of The Co-operative Group on 21 May 2011. It is proposed that KPMG Audit plc remain as external auditors of the Bank until this date. A resolution to re-appoint KPMG Audit plc as external auditor at the Bank's next Annual General Meeting on 12 May 2011 is contained in the Notice of the Annual General Meeting on page 125.

The CFS Audit and Regulatory Compliance Committee has put in place safeguards to ensure that the independence of the audit is not compromised including a policy on the conduct of non-audit services from the external auditors. The external auditors are permitted to provide some non-audit services that are not, and are not perceived to be, in conflict with their independence. The Co-operative Group Audit and Risk Committee receives at each meeting a report providing details of assignments (and related financial fees) carried out by the external auditor of the Bank in addition to their statutory audit work. The pre-approval of the committee is required for services above certain thresholds determined by the committee.

In addition, the following assignments are prohibited from being performed by the external auditors:

- bookkeeping or other services related to the accounting records or financial statements;
- financial information systems design and implementation;
- actuarial services;
- internal audit outsourcing services;
- management functions or human resources; and
- any other services that the CFS Audit and Regulatory Compliance Committee may determine.

The performance of the external auditors is regularly monitored to ensure it meets the needs of the Bank and the results are reported to the committee.

Internal audit

The internal audit function is an independent function, which reports to the CFS Audit and Regulatory Compliance Committee. Its primary role is to provide assurance over the adequacy and effectiveness of the internal control framework including risk management practices.

Internal audit seeks to discharge the responsibilities set down in its charter by completing a risk based internal audit plan, reviewing the processes which ensure that the key business risks are effectively managed by key controls.

Internal audit also acts as a source of constructive advice and best practice, assisting senior management with its responsibility to improve the processes by which business risks are identified and managed.

Internal audit reports are submitted to, and significant issues discussed at, the CFS Audit and Regulatory Compliance Committee. Full details of the operation of this committee can be found on page 18.

By Order of the Board
Moira Lees, Secretary

29 March 2011

Remuneration report

The Co-operative Bank (the Bank) uses, as a guideline for its disclosure in relation to remuneration, the requirements applicable to Listed Companies, as set out in schedule 8 of the Large and Medium sized Companies and Groups (Accounts and Reports) Regulations 2008 (incorporated into the Companies Act 2006) and will be subject to an advisory vote of shareholders of the Company at its Annual General Meeting to be held on 12 May 2011.

This report provides details of the remuneration of both the executive directors and the non-executive directors. The details, also shown in the report of Co-operative Financial Services (CFS), do not represent additional payments.

The key issues this year are:

- extensive dialogue with the Financial Services Authority (FSA) in connection with our current and future remuneration practices. All remuneration arrangements and practices in place are compliant with the FSA Code of Practice;
- compliance with the new disclosure requirements of the FSA in respect of those colleagues who are designated as code staff but who are not executives. The relevant information in respect of those colleagues is to be found in section 9 of this report;
- the introduction of a new annual incentive plan with effect from 1 January 2010; and
- the introduction of a new long term incentive plan with effect from 1 January 2010.

These issues are covered in detail in the body of the report.

Introduction

The remuneration report is presented by the Board and contains the following information:

- a description of the role of the CFS Remuneration and Appointments Committee (the committee), in respect of the Bank;
- a summary of the Bank's remuneration policy, including a statement of policy on executive directors and non-executive directors; and
- details of the terms of the service contracts and the remuneration of the executive directors and non-executive directors for the 2010 financial year.

The CFS Remuneration and Appointments Committee meets as a combined committee for CFS and the Bank. Its role is described below.

Role of the Remuneration and Appointments Committee

The committee's terms of reference were last revised and approved by the CFS Board on 12 May 2010.

The committee's principal terms of reference are to:

- determine the policy on remuneration and other main terms and conditions of employment in respect of Bank executives;
- oversee contractual arrangements for the executives and approve the principal terms and conditions of employment of such executives;
- review remuneration using comparisons against the agreed market policy for the executive;
- make recommendations on executive appointments and the terms and conditions relating to these;
- review and agree the remuneration policy and outcomes in respect of all code staff;
- approve any relevant incentive schemes, ensure that they are in line with current market practice and the FSA Code of Practice, and authorise payments under any incentive schemes in line with their rules; and
- receive, review and decide on issues raised in relation to the Co-operative Group Pension (Average Career Earnings) Scheme and any other retirement benefit scheme within the Group and advise the Board on them as appropriate.

The Co-operative Group Remuneration and Appointments Committee oversees these arrangements in respect of the CFS Chief Executive.

The terms of reference for the committee are available on the CFS website.

Members of the committee during 2010 were Rodney Baker-Bates (Deputy Chair CFS) as Chair, together with Len Wardle (Group Chair), Peter Marks (Co-operative Group Chief Executive), Paul Flowers (Bank Chair) and David Davies (Deputy Chair, CFS). Bob Burlton sat on the committee until his retirement from the Board on 15 April 2010. The Board believes that all members of the committee are independent for the purpose of reviewing remuneration matters.

The CFS Chief Executive and the Director of Organisational Development also attended the meetings of the committee during the year except when their own remuneration was being discussed. The Chief Risk Officer provided an annual report to the committee and attended and provided advice on specific risk adjustments in relation to remuneration issues as required by the FSA. Other individuals were invited to attend for specific agenda items when necessary. The committee worked with the Co-operative Group Remuneration and Appointments Committee in ensuring consistency, where appropriate, across the wider Co-operative Group.

The committee members are all non-executive directors. They have no personal financial interests in the committee's decisions, and they have no involvement in the day to day management of the Bank.

The committee met six times in the year to 31 December 2010.

To ensure that it receives independent advice on remuneration matters, the committee retained Hewitt New Bridge Street (a trading name of Aon Hewitt Limited, part of the Aon Corporation) as its advisers during 2010 to provide advice solely on remuneration matters. Hewitt New Bridge Street has supplied survey data and advised on market trends and other general remuneration issues. Other than specialist advice in relation to remuneration matters, Hewitt New Bridge Street does not provide other services to CFS. Addleshaw Goddard was also retained to provide legal advice to the committee with respect to executives' service contracts.

Policy on directors' remuneration

Executive directors

In determining the remuneration policy for executive directors, the committee consider a number of factors including:

- the importance of attracting, retaining and motivating senior executives of the appropriate calibre to further the success of the Bank;
- the linking of reward to business and individual performance and the strengthening of co-operative values which include a strong belief in stewardship of all the Bank's resources and, therefore, ensures that executives are not rewarded for the assumption of undue risk;
- ensuring that the interests and pay practices of the executive directors are aligned across the Bank, taking into account also the pay levels and employment conditions of colleagues within the business;
- in conjunction with the Group Remuneration and Appointments Committee ensuring that pay practices are coherent with those in the Society as a whole; and
- ensuring appropriate compliance with the FSA Code of Practice.

Remuneration report continued

The current policy is to pay executive directors, who also sit on the CFS Board, basic salaries around the market median, when compared with other organisations of comparable size and complexity, and also organisations in the same business sector. The committee supports the principle of performance related pay and operates an annual incentive plan and a long term incentive plan which, together, mean that over 50% of the remuneration package is performance related. The committee does not consider it appropriate to follow the quantum available in some publicly traded companies. Accordingly, the amounts payable under these plans are lower than in comparable publicly traded companies. Together, the annual incentive plan and long term incentive plan represent total variable remuneration, with awards under the long term incentive plan comprising the deferred element of variable remuneration as required by the FSA.

The committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the Bank's business environment, and in comparative remuneration practice. Accordingly, the committee continuously keeps the Bank's remuneration policy under review.

Whilst the business climate in financial services remains challenging, the Bank has remained resilient through the period, having a robust model based on sound co-operative principles (which avoid undue risk taking or reliance on a single business stream). In particular, the absence of highly leveraged incentive plans (when compared with some practices in the quoted sector) has ensured that executives have not been encouraged to accept undue risk as a means of securing personal reward.

The committee notes that the remuneration practices already adopted at the Bank, in addition to being right for the business, have been endorsed by the FSA through its Code of Practice on remuneration policies. However, the committee continues to strive for further improvements in its executive remuneration arrangements as best practice evolves.

The main components of executive directors' remuneration are:

1. Basic salary

It is the committee's policy to ensure that the basic salary for each executive director is appropriate and competitive for the responsibilities involved. Basic salaries for executive directors are reviewed by the committee, normally annually, having regard to competitive market practice (in particular, salary levels for similar positions in comparable companies), and business and individual performance during the financial year. The normal month for salary review is January. Basic salary is the only element of remuneration that is pensionable. Salaries received by executive directors in respect of 2010 are set out in table 1.

2. Annual incentive plan

Each executive director is eligible to participate in an annual performance related incentive plan. The committee reviews and sets incentive targets and levels of eligibility annually.

The design and terms of the 2010 plan are as follows:

- target payment levels for all of the executive team are 35% of base salary with a maximum opportunity of 60%; and
- all measures used in the plan are derived from the corporate balanced scorecard.

Such an approach, in addition to being right for the business, represents best practice as set out in the FSA Code of Practice.

The measures and weightings in the balanced scorecard are as set out below:

- financial (30%): shareholder profit before tax;
- process (30%): cost v budget;
- customer (20%): customer advocacy; and
- people (20%): colleague engagement score.

In addition to achieving performance against the balanced scorecard measures and weightings, four further underpins must be achieved before any payment is made. These are as follows:

1. The budget profit must be achieved before any element becomes payable.
2. CFS must stay within its required liquidity range as agreed by the CFS Board.
3. CFS must stay within its required minimum capital level as agreed by the CFS Board.
4. There should be no material breaches of risk in accordance with the risk appetite as agreed by the CFS Board. The Chief Risk Officer is required to provide an annual report to the committee before bonus payments are signed off.

Additionally in accordance with the FSA Code of Practice, deferral provisions, clawback facility and malus adjustment (bonus reduction facility) are built into the plan.

3. Long term incentive plan

A new long term incentive plan (LTIP), compliant with the FSA Code of Practice and representing deferred remuneration, was introduced with effect from 1 January 2010. The plan is designed to focus and align the leadership team with the long term strategy of the business. The plan measures performance over a three year period. The first three year period is 2010 to 2012 with potential payment in 2013. It is intended that awards will be made annually thereafter.

The level of award under the LTIP is 75% of base salary for executives and 100% of base salary for the Chief Executive. These awards represent the maximum amount payable in respect of each three year performance period. The actual amount of award vesting is subject to the achievement of the performance measures.

The performance measures are based on the performance of the business over a three year period as set out in the balanced scorecard, the measures being designed to ensure delivery of CFS's strategic targets. The specific measures for 2010 to 2012 are shareholder profit, cost management, customer satisfaction, and colleague engagement. Additionally, the underpins applicable to the annual incentive plans also apply to the LTIP. Any breach thereof will result in the committee considering a reduction in any payment that may otherwise be calculated as due. These underpins are to provide appropriate risk adjustment and to be compliant with the FSA Code of Practice.

4. Service agreements

It is the Bank's policy for the notice period in executive directors' service contracts not to exceed one year. Executive directors have consistent contracts that are terminable by up to one year's notice by the organisation and six months' notice by the individual. In the event of termination, any payments due to an executive director would be based on this. The committee may make a discretionary award of bonus earned up to the date of termination of employment. Any such award would be subject to deferral in accordance with the FSA code of practice.

All the Bank executive directors had similar contracts during 2010. The dates of existing contracts or dates of appointment are shown in table 1.

In normal circumstances, it is the committee's policy to apply service contracts for any newly recruited executive directors in a similar form to the model that has been developed for existing executive directors.

5. Share options

As a co-operative, CFS does not operate a share or share option plan.

6. Non-executive directorships

The committee has determined that, subject to the committee's approval, executive directors may accept one non-executive directorship, or similar, with an external organisation believing that this represents an important opportunity for professional development. Any fees received from such a role will normally be paid to the Bank, CFS or The Co-operative Group.

At this time, with the exception of Neville Richardson who is a director of Communicate Mutuality Limited, none of the executives hold any non-executive directorships with companies outside of The Co-operative Group.

7. Pensions

The financial services businesses participate in the Co-operative Group Pension (Average Career Earnings) Scheme (the PACE Scheme). However, following the merger with Britannia Building Society on 1 August 2009, colleagues who at that date were members of the Britannia Pension Scheme (the Britannia Scheme) continue in membership of the Britannia Scheme. From 1 August 2009, for the interim, only the defined contribution section of the Britannia Scheme is available to new colleagues of the financial services businesses.

The PACE Scheme, which is a registered occupational pension scheme, provides defined benefit pensions based on 1/60th of average pensionable earnings, re-valued for inflation for each year of pensionable service from 6 April 2006 (the date the PACE Scheme was implemented). Benefits accrued as at 5 April 2006, in respect of membership of the scheme preceding the PACE Scheme, continue to be linked to final pensionable salary at a member's date of leaving or retirement, whichever is earlier. Pensions are also payable to dependants on death and a lump sum is payable if death occurs in service.

The Britannia Scheme, which is also a registered occupational pension scheme, provides benefits under two sections:

– a defined benefit (DB) section (closed to new colleagues), which provides pensions based on an accrual of 1/80th, 1/60th or up to 1/30th for executives, of final pensionable salary for each year of pensionable service; and

– a defined contribution (DC) section (open to new colleagues) with an employer contribution rate of 4%, 6% or 8% depending on the level of member contribution.

Under both sections pensions are also payable to dependants on death and a lump sum is payable if death occurs in service.

Members of the PACE Scheme currently contribute 6% of their pensionable salary whilst members of the Britannia Scheme contribute either 6% or 8% of their pensionable salary if they are in the DB section. The employer pays the balance of cost of providing DB benefits. Members of the Britannia Scheme DC section pay 2%, 3% or 4% of their pensionable salary. All members have the choice of making pension contributions by salary sacrifice.

Prior to the merger on 1 August 2009, Neville Richardson, Tim Franklin and Phil Lee had contractual arrangements under which they accrued pension benefits in an unfunded employer financed retirement scheme (EFRBS).

Remuneration report continued

These contractual arrangements were revised from 1 August 2009 and the rate of benefit aligned more closely to Group executive pension policy. The EFRBS is in place to provide pension benefits that exceed the lifetime allowance. Benefits up to the lifetime allowance will be provided from the Britannia Scheme. The revised pension arrangements are subject to further review in 2011.

Executives have the facility of opting out of future pension accrual under the relevant registered scheme when the value of their accrued pension benefits reaches the lifetime allowance under the tax rules in favour of a pension allowance of 16% of basic salary in lieu of pension provision. John Reizenstein had previously opted out of the PACE Scheme on this basis and is entitled to a deferred pension. He received a pension allowance of 16% of basic salary.

Supplementary life cover is provided to executives in order to provide total life cover of four times salary when aggregated with benefits from the PACE Scheme or Britannia Scheme, as appropriate.

Additional details are available in table 2.

Non-executive directors
All the non-executive directors are appointed, and their directors' fees are determined and paid, by The Co-operative Group.

The basic fee for a non-executive director elected to sit on The Co-operative Group Board who is also appointed to serve on the CFS Board and its principal subsidiaries (including the Bank) is £15,555 per annum, and these same non-executive directors receive additional fees for serving on the various CFS Board committees (which also have responsibility for Bank business). The Chair's fee is £107,848 per annum.

During the year under review, Hewitt New Bridge Street conducted a benchmarking exercise of fee levels for the independent professional non-executive directors serving on the CFS Board and its committees, and, as a result, recommendations from the CFS Remuneration and Appointments Committee were approved by the Board of The Co-operative Group in September 2010.

Following this benchmarking exercise the seven independent professional non-executive directors and the professional non-executive director receive a fee of £57,002 per annum. Directors serving on the various committees also receive additional fees, as do the Deputy Chairs, to reflect their additional responsibilities.

Fees are increased in line with RPI every year. The increase in fees in 2010 was 3.7%, effective from 1 June 2010.

The independent professional non-executive directors and the professional non-executive director are party to agreements with The Co-operative Group governing the terms on which their services are made available to the Bank. These service agreements all expire on 31 July 2012, with the exception of Bob Newton, Piers Williamson and Paul Hewitt whose service agreements expire on 31 July 2011.

The Co-operative Group Board may resolve to re-appoint any of the independent professional non-executive directors at or before the date their service agreements expire for a further three year term. It is the normal policy of the Board not to allow an independent professional non-executive director to serve for more than nine years in aggregate.

The non-executive directors' service agreements contain no specific provision for liquidated damages on early termination of an agreement.

None of the independent professional non-executive directors are directors of The Co-operative Group or members of any Co-operative Group pension scheme or incentive plan.

Details of the directors' year of appointment and fees are shown in table 3.

Code staff remuneration
Code staff is defined by the FSA as staff having a material impact on a firm's risk profile, including a person who performs a significant influence function for a firm, a senior manager and risk takers. The information provided within this section is supplementary to the qualitative and quantitative information provided herein with respect to the executive and non-executive directors, all of whom are code staff.

Remuneration policy and outcomes for code staff are determined by the committee. The design of the component parts of remuneration is as set out for the executives. However, the overall remuneration levels and incentive opportunities are lower than for executives. For all code staff, performance related pay is risk adjusted through the use of the underpins to the incentive plans together with the application of deferrals, clawback and malus adjustments in accordance with the FSA Code of Practice.

Details of the aggregate remuneration information required by the FSA are shown in table 4 and are in respect of all CFS code staff. The amounts shown in respect of executive and non-executive directors do not represent additional remuneration.

By Order of the Board
Rodney Baker-Bates, Chair
CFS Remuneration and Appointments Committee

29 March 2011

Table 1 – Emoluments of executive directors for the year ending 31 December 2010

	Date of service contract or appointment	Basic salary £000	Other supplements[1] £000	Performance related pay annual[2] £000	Benefits in kind £000	Total related to 2010 £000	Performance related pay medium/long term[3] £000	2010 Total emoluments £000	2009 Total emoluments[9] £000
Neville Richardson[4] [8]	1 August 2009	664	9	349	12	1,034	162	1,196	443
Rod Bulmer[7] [8]	1 June 2008	351	150	184	–	685	69	754	203
Tim Franklin[4] [8]	1 August 2009	385	18	203	1	607	94	701	262
Phil Lee[4] [8]	1 August 2009	385	9	203	9	606	94	700	262
John Reizenstein[5] [6]	6 January 2005	351	74	–	–	425	–	425	728
Barry Tootell[8]	4 April 2008	385	25	203	–	613	78	691	566
Total		2,521	285	1,142	22	3,970	497	4,467	2,464
Former directors who served the Bank in 2009									1,014
Compensation for loss of office[10]									1,750
									5,228

The table above represents total emoluments for executive directors in relation to their services for the CFS Group.

(1) Other supplements include car allowance, pension (in lieu), and medical insurance (in lieu). These elements are non-pensionable.
(2) Performance related pay (annual) refers to amounts earned in respect of 2010.
(3) Performance related pay (medium/long term) refers to compensatory amounts paid in respect of the lost opportunity as a result of the early vesting of the 2008–2010 plan.
(4) Benefits in kind for Neville Richardson and Phil Lee are in respect of company car and medical insurance and for Tim Franklin in respect of medical insurance only. These benefits were provided under the terms of their contract with Britannia.
(5) The other supplements figure for John Reizenstein includes a salary supplement in lieu of pension provision.
(6) John Reizenstein resigned as executive director on 7 December 2010.
(7) The other supplements figure for Rod Bulmer includes a compensatory payment in respect of a lost long term incentive opportunity arising from his previous employment.
(8) In accordance with the FSA Code of Practice, payment of 60% of 2010 variable pay is deferred over a three year period. Variable pay comprises annual bonus in respect of 2010 plan plus long term incentive awarded in 2011 in respect of the 2010 year.
(9) 2009 total emoluments were in respect of a part year only for Neville Richardson, Tim Franklin and Phil Lee.
(10) Compensation for loss of office in 2009 was in respect of David Anderson £1,022,000 and Dick Parkhouse £728,000.

Table 2 – Pension details of executive directors

	Years of service[1]	Total accrued pension at 31 December 2010[1] £000	Increase in accrued pension during the year £000	Increase in accrued pension during the year (net of inflation) £000	Transfer value of previous column at 31 December 2010 net of members' contributions[3] £000	Transfer value of total accrued pension at 31 December 2009[3] £000	Transfer value of total accrued pension at 31 December 2010[3] £000	Increase in transfer values net of members' contributions[3] £000
Neville Richardson	12	140	18	13	174	2,423	2,903	433
Rod Bulmer[2]	3	13	6	6	20	53	99	25
Tim Franklin	10	87	11	7	77	1,310	1,536	199
Phil Lee	8	78	11	8	125	1,409	1,717	280
John Reizenstein[4]	7	5	–	–	–	89	99	10
Barry Tootell[2]	2	17	7	6	37	97	166	45

(1) Years of service include, where appropriate, pre-merger service with Britannia. The total accrued pension is that which would be paid annually on retirement at normal retirement age based on service to 31 December 2010 and includes any transferred-in benefits as appropriate.
(2) Members have the option of paying additional voluntary contributions to their respective pension scheme. Neither these contributions nor the benefits arising from them are shown in the above table.
(3) All transfer values have been calculated in accordance with the current transfer value method and basis in force for the scheme applicable to the executive director. This is set by the Trustee(s), after taking actuarial advice, to be consistent with the requirements of legislation and the rules of the scheme.
(4) John Reizenstein opted out of joining the PACE Scheme on 6 April 2006 and became entitled to a deferred pension. He is paid a pension allowance of 16% of basic salary in lieu of pension provision. Deferred pensions are revalued under the PACE Scheme rules but no account has been taken of this in the above table. He resigned as an executive director on 7 December 2010. The details on the table are calculated at that date.

Remuneration report continued

Table 3 – Non-executive directors' remuneration

Non-executive directors	Date appointed	2010 fees £000[1]	2009 fees £000
Duncan Bowdler[5]	2009	16	8
Paul Flowers[3]	2009	83	11
Peter Marks[4]	2009	–	–
Ben Reid[5] [6]	2009	19	10
Len Wardle[5]	2006	16	13
Martyn Wates[4]	2007	–	–
Stephen Watts[5] [7]	2006	18	15
Bob Burlton[2]	2004	48	102
Independent professional non-executive directors (IPNEDs)			
Rodney Baker-Bates[8] [9]	2009	66	20
David Davies[8] [9]	2003	68	58
Peter Harvey[8] [10]	2009	57	24
Chris Jones[8] [14]	2009	72	28
Stephen Kingsley[8] [11]	2009	58	24
Bob Newton[8]	2007	56	53
Piers Williamson[8] [12]	2005	58	53
Professional non-executive director (PNED)			
Paul Hewitt[8] [13]	2003	66	62

(1) Fees for the year are based on 52 weeks compared to 51 weeks in 2009.
(2) Bob Burlton resigned with effect from 15 April 2010.
(3) Paul Flowers was appointed Chair with effect from 15 April 2010. His annual fee is £107,848.
(4) Peter Marks, Chief Executive of The Co-operative Group and Martyn Wates, Chief Executive of Food and Specialist Businesses are both employees and remunerated by The Co-operative Group and do not receive fees for serving on the CFS Board.
(5) The non-executive directors that also serve on the Group Board receive a fee of £15,555 per annum for serving on the CFS Board.
(6) Ben Reid, as a non-executive director who is a member of the CFS Audit and Regulatory Compliance Committee and who is not an IPNED, receives an additional £3,111 per annum.
(7) Stephen Watts, as a non-executive director who is a member of the CFS Exposures Committee and who is not an IPNED, receives an additional £2,074 per annum.
(8) Under their service contracts, the IPNEDs receive a fee of £57,002 per annum.
(9) The Deputy Chairs receive an additional fee of £15,000 per annum.
(10) The Chair of the CFS Exposures Committee receives an additional £5,000 per annum.
(11) The Chair of the CFS Banking Transformation Programme sub-committee receives an additional £7,000 per annum.
(12) The Chair of the CFS Risk Management Committee receives an additional £10,500 per annum.
(13) The Chair of the CFS Audit and Regulatory Compliance Committee receives an additional £10,500 per annum.
(14) The Chair of Illius Properties Limited receives a fee of £15,000 per annum.

Table 4 – Aggregate information in respect of code staff

Number of code staff	Total remuneration[1] £000	Total fixed remuneration[2] £000	Total variable remuneration[3] £000	Annual incentive plan[4] £000	Long term incentive plan[5] £000	Outstanding deferred remuneration[6] £000	Deferred reduced and paid £000	Sign on and severance payments £000	Severance payments made in year £000
Senior Management 25[7]	8,306	4,395	3,911	1,482	2,429	5	–	–	–
Other code staff 40	12,550	7,510	5,040	2,529	2,511	194	–	–	–

The table above represents the emoluments of code staff in relation to their services for the CFS Group.

(1) Total remuneration consists of base salary as at 31 December 2010, allowances, employer pension contributions and incentive payments relating to the 2010 financial year together with future earnings opportunity comprised in the 2011–13 long term incentive awards.
(2) Total fixed remuneration is base salary as at 31 December 2010 plus allowances and employer pension contributions.
(3) Total variable remuneration is the sum of the annual incentive plan payments in respect of the 2010 financial year and the awards made under the 2011–13 long term incentive plan. The awards under the 2011–13 long term plan are performance related and, to the extent achieved will be payable in 2014. All payments as and when due are made in cash.
(4) Payments made under the annual incentive plan are in respect of the 2010 financial year.
(5) Awards made under the 2011–13 long term incentive plan are all unvested and represent deferred remuneration in respect of the 2010 financial year, in accordance with the FSA code.
(6) The outstanding deferred remuneration is deferred cash where no long term incentive award is made or the award is insufficient to satisfy the deferral percentage required by the FSA.
(7) Senior management consists of executive directors, members of the executive committee and non-executive directors.

Independent auditor's report

We have audited the financial statements of The Co-operative Bank plc for the year ended 31 December 2010 set out on pages 30 to 75 and pages 78 to 123. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and reporting on corporate governance, on terms that have been agreed. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and reporting on corporate governance, those matters that we have agreed to state to them in our report, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the directors' responsibilities statement set out on page 16, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2010 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the information given in the corporate governance statement set out on pages 17 to 22 with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review the directors' statement, set out on page 15, in relation to going concern.

In addition to our audit of the financial statements, the directors have engaged us to review their corporate governance statement as if the company were required to comply with the Listing Rules and the Disclosure Rules and Transparency Rules of the Financial Services Authority in relation to those matters. Under the terms of our engagement, we are required to review the part of the corporate governance statement on pages 17 and 18 relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

Andrew Walker, Senior Statutory Auditor
for and on behalf of KPMG Audit Plc,
Statutory Auditor
Chartered Accountants
St James Square
Manchester
M2 6DS

29 March 2011

Consolidated income statement

For the year ended 31 December 2010

All amounts are stated in £m unless otherwise indicated

	Notes	Before significant items 2010	Significant items 2010	After significant items 2010	Before significant items 2009	Significant items 2009	After significant items 2009
Interest receivable and similar income	4	**1,713.3**	**–**	**1,713.3**	1,061.6	–	1,061.6
Interest expense and similar charges	4	**(1,104.9)**	**–**	**(1,104.9)**	(481.9)	–	(481.9)
Net interest income		**608.4**	**–**	**608.4**	579.7	–	579.7
Fee and commission income	5	**237.2**	**(13.1)**	**224.1**	210.8	–	210.8
Fee and commission expense	5	**(60.3)**	**–**	**(60.3)**	(47.2)	–	(47.2)
Net fee and commission income		**176.9**	**(13.1)**	**163.8**	163.6	–	163.6
Net trading income	6	**4.6**	**–**	**4.6**	5.2	–	5.2
Other operating income	7	**8.1**	**–**	**8.1**	6.9	–	6.9
Operating income		**798.0**	**(13.1)**	**784.9**	755.4	–	755.4
Operating expenses	8	**(571.9)**	**(46.7)**	**(618.6)**	(429.0)	(38.1)	(467.1)
Financial Services Compensation Scheme levies	32	**(11.5)**	**–**	**(11.5)**	(3.7)	–	(3.7)
Operating profit before impairment losses		**214.6**	**(59.8)**	**154.8**	322.7	(38.1)	284.6
Impairment losses on loans and advances	15	**(97.3)**	**–**	**(97.3)**	(116.1)	–	(116.1)
Impairment gains on investments	16	**1.5**	**–**	**1.5**	4.0	–	4.0
Operating profit		**118.8**	**(59.8)**	**59.0**	210.6	(38.1)	172.5
Share of post tax profits/(losses) from joint ventures	36	**0.7**	**–**	**0.7**	(0.1)	–	(0.1)
Profit before taxation and profit based payments		**119.5**	**(59.8)**	**59.7**	210.5	(38.1)	172.4
Profit based payments to members of The Co-operative Group		**(10.8)**	**–**	**(10.8)**	(7.8)	–	(7.8)
Profit before taxation		**108.7**	**(59.8)**	**48.9**	202.7	(38.1)	164.6
Income tax	10	**(29.8)**	**16.7**	**(13.1)**	(62.1)	10.7	(51.4)
Profit for the financial year		**78.9**	**(43.1)**	**35.8**	140.6	(27.4)	113.2
Attributable to:							
Equity shareholders	12	**79.5**	**(43.1)**	**36.4**	137.7	(27.4)	110.3
Minority interests		**(0.6)**	**–**	**(0.6)**	2.9	–	2.9
		78.9	**(43.1)**	**35.8**	140.6	(27.4)	113.2
Earnings per share (basic and diluted)	12	**1.67p**	**(0.90)p**	**0.77p**	3.60p	(0.72)p	2.88p

Results relating to the transfer of engagements of Britannia Building Society are included with effect from the date of completion on 31 July 2009.

The significant items in 2010 relate to a programme of investment and integration and to provisions made for customer redress (see note 8 and note 32).
The significant items in 2009 relate to a programme of investment and integration.

Consolidated statement of comprehensive income

For the year ended 31 December 2010

All amounts are stated in £m unless otherwise indicated

	Group	
	2010	2009
Profit for the year – equity shareholders	**36.4**	110.3
(Loss)/profit for the year – minority interests	**(0.6)**	2.9
Profit for the financial year	**35.8**	113.2
Other comprehensive expense:		
Changes in cashflow hedges		
Net changes in fair value recognised directly in equity	**(3.5)**	(29.5)
Income tax	**1.5**	8.2
Net losses transferred from equity to income or expense	**(0.1)**	–
Changes in available for sale assets		
Net changes in fair value recognised directly in equity	**(25.4)**	28.6
Income tax	**6.2**	(7.4)
Net losses transferred from equity to income or expense	**4.8**	–
Income tax	**(1.3)**	–
Revaluation of equity shares	**–**	(3.2)
Income tax	**–**	0.9
Transferred to other operating income on disposal of equity shares	**–**	(0.7)
Income tax	**–**	0.2
Defined benefit plan actuarial losses	**(0.3)**	(0.3)
Income tax	**0.1**	0.1
Other comprehensive expense for the financial year, net of income tax	**(18.0)**	(3.1)
Total comprehensive income for the financial year	**17.8**	110.1
Attributable to:		
Equity shareholders	**19.0**	108.5
Minority interests	**(1.2)**	1.6
Total comprehensive income for the financial year	**17.8**	110.1

The accounting policies and notes on pages 37 to 123 form part of these financial statements.

Consolidated balance sheet

At 31 December 2010

All amounts are stated in £m unless otherwise indicated

	Notes	2010	2009 restated
Assets			
Cash and balances at central banks	13	**1,735.6**	1,706.8
Loans and advances to banks	14	**2,394.1**	1,781.5
Loans and advances to customers	15	**34,977.3**	34,073.7
Fair value adjustments for hedged risk	15	**166.8**	66.1
Investment securities – loans and receivables	16	**1,917.3**	2,486.2
Investment securities – available for sale	16	**2,985.8**	4,457.3
Derivative financial instruments	17	**931.9**	1,023.0
Equity shares	18	**7.2**	7.2
Investments in joint ventures	36	**2.5**	1.8
Goodwill	19	**0.6**	0.6
Intangible fixed assets	20	**45.1**	46.1
Investment properties	21	**162.3**	137.7
Property, plant and equipment	22	**98.5**	121.5
Amounts owed by other Co-operative Group undertakings	37	**0.6**	91.0
Other assets	23	**52.5**	22.1
Prepayments and accrued income	24	**16.2**	30.1
Deferred tax assets	33	**87.0**	86.1
Total assets		**45,581.3**	46,138.8
Liabilities			
Deposits by banks	25	**2,938.6**	6,082.4
Customer accounts	26	**32,320.0**	30,828.2
Customer accounts – capital bonds	27	**1,794.7**	1,647.1
Debt securities in issue	28	**4,212.2**	3,334.3
Derivative financial instruments	17	**702.4**	591.3
Other borrowed funds	29	**975.4**	946.5
Amounts owed to other Co-operative Group undertakings	37	**188.5**	329.2
Other liabilities	30	**146.8**	221.9
Accruals and deferred income	31	**131.3**	158.0
Provisions for liabilities and charges	32	**55.8**	52.8
Current tax liabilities		**42.5**	71.0
Total liabilities		**43,508.2**	44,262.7
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	38	**410.0**	230.0
Share premium account	38	**8.8**	8.8
Retained earnings		**1,598.9**	1,562.8
Available for sale reserve		**(13.1)**	2.5
Cashflow hedging reserve		**36.9**	38.4
		2,041.5	1,842.5
Minority interests		**31.6**	33.6
Total equity		**2,073.1**	1,876.1
Total liabilities and equity		**45,581.3**	46,138.8

Approved by the Board on 29 March 2011 and signed on its behalf by:

Paul Flowers, Chair
Neville Richardson, Chief Executive
Moira Lees, Secretary

The accounting policies and notes on pages 37 to 123 form part of these financial statements.
Restated items are shown in notes 15, 32 and 33.

Bank balance sheet

At 31 December 2010

All amounts are stated in £m unless otherwise indicated

	Notes	2010	2009 restated
Assets			
Cash and balances at central banks	13	**1,735.6**	1,706.8
Loans and advances to banks	14	**1,728.6**	1,220.1
Loans and advances to customers	15	**23,844.9**	23,050.8
Fair value adjustments for hedged risk	15	**164.6**	60.6
Investment securities – loans and receivables	16	**1,986.8**	2,555.6
Investment securities – available for sale	16	**2,650.1**	4,060.6
Derivative financial instruments	17	**661.0**	660.8
Equity shares	18	**7.2**	7.2
Investments in Group undertakings	36	**1,458.9**	1,572.4
Goodwill	19	**0.6**	0.6
Intangible fixed assets	20	**43.8**	44.9
Property, plant and equipment	22	**79.1**	101.6
Amounts owed by other Co-operative Group undertakings		**14,233.7**	11,861.6
Other assets	23	**51.5**	45.8
Prepayments and accrued income	24	**14.5**	27.4
Deferred tax assets	33	**154.0**	210.3
Total assets		**48,814.9**	47,187.1
Liabilities			
Deposits by banks	25	**2,870.8**	5,613.0
Customer accounts	26	**29,912.0**	28,660.0
Customer accounts – capital bonds	27	**1,744.0**	1,581.7
Debt securities in issue	28	**1,856.8**	1,739.3
Derivative financial instruments	17	**697.4**	567.2
Other borrowed funds	29	**975.4**	946.5
Amounts owed to other Co-operative Group undertakings		**8,340.9**	5,765.0
Other liabilities	30	**140.5**	210.8
Accruals and deferred income	31	**117.0**	134.3
Provisions for liabilities and charges	32	**39.3**	45.0
Current tax liabilities		**17.3**	56.8
Total liabilities		**46,711.4**	45,319.6
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	38	**410.0**	230.0
Share premium account	38	**8.8**	8.8
Retained earnings		**1,661.4**	1,588.5
Available for sale reserve		**(13.1)**	2.5
Cashflow hedging reserve		**36.4**	37.7
Total equity		**2,103.5**	1,867.5
Total liabilities and equity		**48,814.9**	47,187.1

Approved by the Board on 29 March 2011 and signed on its behalf by:

Paul Flowers, Chair
Neville Richardson, Chief Executive
Moira Lees, Secretary

The accounting policies and notes on pages 37 to 123 form part of these financial statements.
Restated items are shown in notes 32 and 36.

Consolidated statement of cash flows

For the year ended 31 December 2010

All amounts are stated in £m unless otherwise indicated

	2010	2009
Cash flows from operating activities		
Profit before taxation	**48.9**	164.6
Adjustments for:		
Decrease in prepayments and accrued income	**16.0**	105.1
Decrease in accruals and deferred income	**(81.9)**	(67.2)
Interest payable in respect of subordinated liabilities	**45.5**	17.1
Effect of exchange rate movements	**(2.8)**	(96.0)
Effect of non-cash pension costs	**–**	0.2
Impairment losses on loans and advances	**97.3**	116.1
Movements on investment impairments	**(1.5)**	(4.0)
Depreciation and amortisation	**26.3**	22.4
Interest amortisation	**(6.3)**	(12.6)
Amortisation of investments	**(40.6)**	(0.8)
Loss on disposal of fixed assets	**0.8**	1.4
Unwind of fair value adjustments arising on transfer of engagements	**14.2**	(99.1)
Preference dividend	**5.6**	5.6
	121.5	152.8
Decrease in deposits by banks	**(3,143.8)**	(1,108.5)
Increase in customer accounts and capital bonds	**1,639.1**	872.0
Increase/(decrease) in debt securities in issue	**471.6**	(1,035.5)
Decrease/(increase) in loans and advances to banks	**401.5**	(1,037.5)
Increase in loans and advances to customers	**(850.6)**	(996.2)
Decrease in amounts owed by other Co-operative Group undertakings	**90.4**	46.9
(Decrease)/increase in amounts owed to other Co-operative Group undertakings	**(140.7)**	103.7
Net movement of other assets and other liabilities	**112.4**	82.1
Income tax paid	**(34.9)**	(23.4)
Net cash flows from operating activities	**(1,333.5)**	(2,943.6)
Cash flows from investing activities		
Cash and cash equivalents acquired on transfer of engagements	**–**	1,535.6
Purchase of tangible and intangible fixed assets	**(30.9)**	(15.1)
Proceeds from sale of investment properties	**0.5**	–
Purchase of investment securities	**(1,506.2)**	(1,814.8)
Proceeds from sale and maturity of investment securities	**3,757.2**	3,162.4
Net cash flows from investing activities	**2,220.6**	2,868.1
Cash flows from financing activities		
Interest paid on subordinated liabilities	**(44.8)**	(29.7)
Proceeds of issued shares	**180.0**	175.0
Preference share dividends paid	**(5.6)**	(5.6)
Dividends paid to minority shareholders in subsidiary undertaking	**(0.8)**	(0.9)
Net cash flows from financing activities	**128.8**	138.8
Increase in cash and cash equivalents	**1,015.9**	63.3
Cash and cash equivalents at the beginning of the financial year	**2,387.3**	2,324.0
Cash and cash equivalents at the end of the financial year	**3,403.2**	2,387.3
Cash and balances with central banks (note 13)	**1,699.5**	1,672.8
Loans and advances to banks (note 14)	**1,478.7**	462.5
Short term investments (note 16)	**225.0**	252.0
	3,403.2	2,387.3

The cash flows cannot be directly reconciled to the Group balance sheet movements as these movements include the non-cash unwinds of the fair value adjustments arising on the transfer of engagements of Britannia Building Society.

Bank statement of cash flows

For the year ended 31 December 2010

All amounts are stated in £m unless otherwise indicated

	2010	2009
Cash flows from operating activities		
Profit before taxation	**101.9**	201.8
Adjustments for:		
Decrease in prepayments and accrued income	**14.1**	119.4
Decrease in accruals and deferred income	**(67.2)**	(131.3)
Interest payable in respect of subordinated liabilities	**45.5**	17.1
Effect of exchange rate movements	**(2.8)**	(96.0)
Effect of non-cash pension costs	**–**	0.2
Impairment losses on loans and advances	**94.5**	114.9
Movements on investment impairments	**(1.5)**	(4.0)
Depreciation and amortisation	**26.5**	21.4
Interest amortisation	**(6.3)**	(12.6)
Amortisation of investments	**(82.6)**	(4.4)
Loss on disposal of fixed assets	**0.8**	1.5
Unwind of fair value adjustments arising on transfer of engagements	**(234.3)**	(99.1)
Dividends from subsidiary undertakings	**–**	0.2
Preference dividends	**5.6**	5.6
	(105.8)	134.7
Decrease in deposits by banks	**(2,742.2)**	(1,089.6)
Increase in customer accounts and capital bonds	**1,398.6**	486.7
Increase/(decrease) in debt securities in issue	**98.4**	(798.4)
Decrease/(increase) in loans and advances to banks	**517.1**	(499.8)
Increase in loans and advances to customers	**(812.3)**	(1,059.4)
(Increase)/decrease in amounts owed by other Co-operative Group undertakings	**(2,372.1)**	11.4
Increase in amounts owed to other Co-operative Group undertakings	**2,575.9**	38.2
Net movement of other assets and other liabilities	**151.0**	160.5
Income tax paid	**(10.6)**	(3.1)
Net cash flows from operating activities	**(1,302.0)**	(2,618.8)
Cash flows from investing activities		
Cash and cash equivalents acquired on transfer of engagements	**–**	889.6
Purchase of tangible and intangible fixed assets	**(4.3)**	(3.7)
Movements in investments in Group undertakings	**–**	310.4
Purchase of investment securities	**(126.2)**	(624.9)
Proceeds from sale and maturity of investment securities	**2,330.3**	1,947.5
Net cash flows from investing activities	**2,199.8**	2,518.9
Cash flows from financing activities		
Interest paid on subordinated liabilities	**(44.8)**	(29.7)
Proceeds of issued shares	**180.0**	175.0
Preference share dividends paid	**(5.6)**	(5.6)
Net cash flows from financing activities	**129.6**	139.7
Increase in cash and cash equivalents	**1,027.4**	39.8
Cash and cash equivalents at the beginning of the financial year	**2,363.6**	2,323.8
Cash and cash equivalents at the end of the financial year	**3,391.0**	2,363.6
Cash and balances with central banks (note 13)	**1,699.5**	1,672.8
Loans and advances to banks (note 14)	**1,466.5**	438.8
Short term investments (note 16)	**225.0**	252.0
	3,391.0	2,363.6

The cash flows cannot be directly reconciled to the Bank balance sheet movements as these movements include the non-cash unwinds of the fair value adjustments arising on the transfer of engagements of Britannia Building Society.

The accounting policies and notes on pages 37 to 123 form part of these financial statements.

Consolidated and Bank statements of changes in equity

For the year ended 31 December 2010

All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Company							
	Share capital	Share premium	Available for sale reserve	Cashflow hedging reserve	Retained earnings	Total	Minority interest	Total equity
Group								
2010								
Balance at the beginning of the year	**230.0**	**8.8**	**2.5**	**38.4**	**1,562.8**	**1,842.5**	**33.6**	**1,876.1**
Total comprehensive income for the financial year	**–**	**–**	**(15.6)**	**(1.5)**	**36.1**	**19.0**	**(1.2)**	**17.8**
Transactions with owners recorded directly in equity:								
Increase in share capital	**180.0**	**–**	**–**	**–**	**–**	**180.0**	**–**	**180.0**
Dividend	**–**	**–**	**–**	**–**	**–**	**–**	**(0.8)**	**(0.8)**
Balance at the end of the year	**410.0**	**8.8**	**(13.1)**	**36.9**	**1,598.9**	**2,041.5**	**31.6**	**2,073.1**
Group								
2009								
Balance at the beginning of the year	55.0	8.8	(16.6)	59.1	641.5	747.8	32.9	780.7
Amounts arising on transfer of engagements	–	–	–	–	811.2	811.2	–	811.2
Total comprehensive income for the financial year	–	–	19.1	(20.7)	110.1	108.5	1.6	110.1
Transactions with owners recorded directly in equity:								
Increase in share capital	175.0	–	–	–	–	175.0	–	175.0
Dividend	–	–	–	–	–	–	(0.9)	(0.9)
Balance at the end of the year	230.0	8.8	2.5	38.4	1,562.8	1,842.5	33.6	1,876.1

	Attributable to equity holders of the Company					
	Share capital	Share premium	Available for sale reserve	Cashflow hedging reserve	Retained earnings	Total equity
Bank						
2010						
Balance at the beginning of the year	**230.0**	**8.8**	**2.5**	**37.7**	**1,588.5**	**1,867.5**
Total comprehensive income for the financial year	**–**	**–**	**(15.6)**	**(1.3)**	**72.9**	**56.0**
Transactions with owners recorded directly in equity:						
Increase in share capital	**180.0**	**–**	**–**	**–**	**–**	**180.0**
Balance at the end of the year	**410.0**	**8.8**	**(13.1)**	**36.4**	**1,661.4**	**2,103.5**
Bank						
2009						
Balance at the beginning of the year	55.0	8.8	(16.8)	58.2	610.7	715.9
Amounts arising on transfer of engagements	–	–	–	–	811.2	811.2
Total comprehensive income for the financial year	–	–	19.3	(20.5)	166.6	165.4
Transactions with owners recorded directly in equity:						
Increase in share capital	175.0	–	–	–	–	175.0
Balance at the end of the year	230.0	8.8	2.5	37.7	1,588.5	1,867.5

The accounting policies and notes on pages 37 to 123 form part of these financial statements.

Basis of preparation and significant accounting policies
For the year ended 31 December 2010

The Co-operative Bank plc is registered in England and Wales under the Companies Act 2006.

Basis of preparation

Both the parent company financial statements and the Group financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and IFRS Interpretations Committee (IFRIC) guidance as adopted by the European Union (EU). On including the parent company financial statements here together with the Group financial statements, the Company is taking advantage of the exemption in s408 of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these approved financial statements. Information in respect of the Company alone is labelled throughout as 'Bank'.

The financial information has been prepared on the basis of recognition and measurement requirements of IFRS in issue that are endorsed by the EU and are effective for accounting periods beginning on or after 1 January 2010.

Standards and interpretations issued and effective

In preparing these consolidated financial statements, the Bank has adopted the following pronouncements during the year that are new or revised but have no material impact on the financial statements:

- Revised IFRS 3 Business Combinations (2008)

  This standard incorporates the following changes which will be applied prospectively:

  – The definition of a business has been broadened, which may result in more acquisitions being treated as business combinations.
  – Contingent consideration will be measured at fair value, with subsequent changes in fair value recognised in profit or loss.
  – Transaction costs, other than share and debt issue costs, will be expensed as incurred.
  – Any pre-existing interest in an acquiree will be measured at fair value, with the related gain or loss recognised in profit or loss.
  – Any non-controlling (minority) interest will be measured at either fair value, or at its proportionate interest in the identifiable assets and liabilities of an acquiree, on a transaction by transaction basis.

- Amended IAS 27 Consolidated and Separate Financial Statements (2008)

  This standard requires accounting for changes in ownership interests in a subsidiary that occur without loss of control, to be recognised as an equity transaction. When the Bank loses control of a subsidiary, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognised in profit or loss.

- Amended IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items (2008)

  The standard was amended to clarify how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations.

- IFRIC 17 Distributions of Non-cash Assets to Owners

  This interpretation was issued to address when an entity should recognise, measure and account for any differences arising on dividends payable from non-cash assets.

Standards and interpretations issued but not yet effective

- IFRS 9 Financial Instruments: Classification and Measurement

  This new standard's objective is to gradually phase out IAS 39 Financial Instruments: Recognition and Measurement. Phase one of this process specifically requires financial assets to be classified as at amortised cost or at fair value. Consequently, the available for sale (AFS) category currently used by the Bank will become void.

  Early adoption is permitted, once endorsed by the EU. The impact of IFRS 9 is likely to be material to the Bank once it becomes effective as of 1 January 2013.

- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments

  This interpretation addresses the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability. It does not address the accounting by the creditor.

  The impact of this interpretation is considered to be immaterial to the Bank.

- Revised IAS 24 *Related Party Disclosures*

  IAS 24 requires entities to disclose in their financial statements information about transactions with related parties. In broad terms, two parties are related to each other if one party controls, or significantly influences, the other party.

  The standard simplifies the disclosure requirements for government related entities and clarifies the definition of a related party. The revised standard is effective for annual periods beginning on or after 1 January 2011, with earlier application permitted.

  The impact of this revision is considered to be immaterial to the Bank.

  Other standards and interpretations have been issued but these are not considered to be relevant to the Bank's operations.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2010

Basis of preparation continued

Going concern
The Group's business activities together with its financial position, and the factors likely to affect its future development and performance are set out in the business and financial review on pages 5 to 8. In addition, the risk management section on pages 45 to 77 includes the Group's objectives, policies and processes for managing its liquidity risk, details of financial instruments and hedging activities, and its exposure to credit risk and liquidity risk. The capital management section provides information on the Bank's capital policies and capital resources.

In common with many financial institutions, the Group meets its day to day liquidity requirements through managing both its retail and wholesale funding sources, and is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business. The Group's forecasts and objectives, taking into account a number of potential changes in trading performance and funding retention, show that the Group should be able to operate at adequate levels of both liquidity and capital, for the foreseeable future. The Group has also considered a number of stress tests on capital and liquidity and these provide assurance that the Bank is sufficiently capitalised and adequately positioned in excess of liquidity stress tests.

Consequently, after making enquiries, the directors are satisfied that the Group has sufficient resources to continue in business for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements.

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

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of estimation, uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements are described within the risk management section on pages 45 to 77 and the critical judgments section on pages 79 to 81.

Prior year restatements
In accordance with IFRS 3, the Bank has 12 months from the date of the merger with Britannia in which to complete the initial accounting for the merger. The Bank has reassessed the carrying values of the Britannia assets and liabilities acquired and made the following adjustments:

The carrying value of loans and advances to customers has been increased following a review of the probabilities of default of assets that were neither past due nor impaired at the merger date. Based on further information that has become available, the Bank has reassessed the fair value of provisions for liabilities and charges.

The impact of this adjustment is not material to the overall level of adjustments to the carrying values of Britannia assets and liabilities that were made on merger and there is no change to the amount of goodwill arising.

Change in accounting reference date
Following the transfer of engagements of Britannia Building Society, the Bank changed its accounting reference date to 31 December. Where these financial statements refer to 'year ended 31 December 2009' this represents the 51 week period from 11 January to 31 December 2009.

Significant accounting policies
The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

(a) Business combinations
On 1 August 2009 The Co-operative Bank plc merged with Britannia Building Society, with Britannia transferring their engagements to the Company.

This business combination has been accounted for applying the requirements of IFRS 3: Business Combinations (2004).

The consideration transferred was valued by reference to the members' interests acquired. Financial assets and liabilities which, following the Group's accounting policies, would be carried at amortised cost, were brought on to the balance sheet at their fair value at acquisition and were subsequently carried at amortised cost using the effective interest rate method. The income statement includes the results of the engagements transferred from Britannia since the date of acquisition. Details of the combination are given in note 39.

(b) Basis of consolidation
Subsidiaries
Subsidiaries are entities controlled by the Bank. Control exists when the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The financial statements have been prepared using uniform accounting policies and are based on the same accounting period as the Bank.

Intra-group balances and transactions, and any unrealised gains and losses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

Special purpose entities
Special purpose entities (SPEs) are 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 a guarantor for the issue of covered bonds (refer to note 36 for further information).

An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Bank and the SPE's risks and rewards, the Bank concludes that it controls the SPE.

Significant accounting policies continued

The following circumstances may indicate a relationship in which, in substance, the Bank controls and consequently consolidates an SPE:

- the activities of the SPE are being conducted on behalf of the Bank according to its specific business needs so that the Bank obtains benefits from the SPE's operation.
- the Bank has the decision making powers to obtain the majority of the benefits of the activities of the SPE.
- the Bank has the rights to obtain the majority of the benefits of the SPE and therefore may be exposed to the risks incidental to the activities of the SPE.
- the Bank retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The assessment of whether the Bank has control over an SPE is carried out at inception. No further assessment of control is carried out unless changes in the structure or terms of the SPE or additional transactions between the Bank and the SPE occur.

Interests in joint ventures

The Bank's interests in joint ventures are accounted for using the equity method. The consolidated financial statements include the Bank's share of the income and expenses and equity movements of equity accounted investees, after adjustments to align the accounting policies with those of the Bank.

(c) Revenue recognition

Interest income and expense

Interest income and expense is recognised on an effective interest rate (EIR) basis, inclusive of directly attributable incremental transaction costs and fees including arrangement and broker fees, valuation and solicitor costs, discounts and premiums where appropriate and loan closure based transactions ie early redemption and late notice fees.

The EIR basis spreads the interest income and expense over the expected life of each instrument. The EIR is the rate that, at the inception of the instrument, exactly discounts expected future cash payments and receipts through the expected life of the instrument back to the initial carrying amount. When calculating the EIR, the Group estimates cash flows considering all contractual terms of the instrument (for example, prepayment options) but does not consider assets' future credit losses except for assets acquired at a deep discount.

For assets acquired at a value significantly below the carrying value in the acquiree's financial statements because they have incurred loss, expectations of future loss are higher than at origination, and interest spreads have widened because of deteriorating market conditions, the calculation of EIR is the same as shown above with the exception that the estimates of future cash flows include anticipated credit losses.

Fees and commissions

Fee and commission income is predominantly made up of arrangement and other fees relating to loans and advances to customers that are included in the effective interest calculation. Commitment fees received are deferred and included in the effective interest calculation upon completion or taken in full at the date the commitment period expires and completion does not occur.

Fees and commissions payable to introducers in respect of obtaining lending business, where these are direct and incremental costs related to the issue of a financial instrument, are included in interest income as part of the effective interest rate. Other fees are taken to the income statement.

All other fee and commission income that is not included in the effective interest calculation is recognised on an accruals basis as the service is provided.

(d) Significant items

Items which are material by both size and nature (ie outside of the normal operating activities of the Bank) are treated as significant items and disclosed separately on the face of the income statement.

The separate reporting of significant items helps provide an indication of the Bank's underlying business performance. Events which may give rise to the classification of items as significant include individually significant restructuring costs.

(e) Financial instruments (excluding derivatives)

Recognition

The Group initially recognises loans and advances, deposits, debt securities issued and other borrowed funds on the date at which they are originated.

Regular way purchases and sales of financial assets are recognised on the trade date at which the Group commits to purchase or sell the asset. All other financial assets and liabilities are initially recognised on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

Financial assets

The Bank classifies its financial assets (excluding derivatives) as either:

- Loans and receivables;
- Available for sale; or
- Financial assets at fair value through income statement.

i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and the Group does not intend to sell immediately or in the near term. These are initially measured at fair value plus transaction costs that are directly attributable to the financial asset. Subsequently, these are measured at amortised cost using the effective interest method. The amortised cost is the amount advanced less principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the amount advanced and the maturity amount less impairment provisions for incurred losses.

Loans and receivables mainly comprise loans and advances to banks and customers (except where the Group has elected to carry the loans and advances to customers at fair value through income or expense as described in accounting policy (e) iii) below) and assets reclassified from available for sale (see below).

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2010

Significant accounting policies continued

ii) Available for sale

Available for sale financial assets are debt securities that are not held for trading and are intended to be held for an indefinite period of time. These are measured at fair value based on current bid prices where quoted in an active market. Where the securities are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Movements in fair value are recorded in equity as they occur. On disposal, gains and losses recognised previously in equity are transferred to the income statement. In exceptional circumstances, for instance where the market in the securities has become inactive, the Group has reclassified such assets as loans and receivables.

Any transfer back from loans and receivables, upon reclassification, would be measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the securities are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques.

iii) Financial assets at fair value through income or expense

These are either:

- acquired or incurred principally for the purpose of selling or repurchasing in the near term;
- part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short term profit taking; or
- upon initial recognition designated at fair value through income or expense to eliminate or significantly reduce a measurement and recognition inconsistency or where management specifically manages an asset or liability on that basis ie capital bonds.

These are measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the securities are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Gains and losses arising from changes in the fair value are brought into the income statement within trading income as they arise.

iv) Impairment provision

At the balance sheet date, the Bank assesses its financial assets not at fair value through income or expense for objective evidence that an impairment loss has been incurred.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a loan or advance on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, or the disappearance of an active market for a security.

The Group considers evidence for impairment for loans and advances at both a specific asset and collective level. All individually significant loans and advances are assessed specifically for impairment. Loans and advances not individually significant are collectively assessed for impairment by grouping together loans and advances by similar risk characteristics.

In assessing collective impairment the Group uses statistical modelling of historical trends of probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

The amount of the loss is the difference between:

- the asset's carrying amount; and
- the present value of estimated future cash flows (discounted at the asset's original or variable effective interest rate for amortised cost assets and at the current market rate for available for sale assets).

Impairment of financial assets carried at amortised cost

The amount of the impairment loss on assets carried at amortised cost is recognised immediately through the income statement and a corresponding reduction in the value of the financial asset is recognised through the use of an allowance account.

A write off is made when all or part of a claim is deemed uncollectible or forgiven after all the possible collection procedures have been completed and the amount of loss has been determined. Write offs are charged against previously established provisions for impairment or directly to the income statement. Any additional recoveries from borrowers, counterparties or other third parties made in future periods are offset against the write off charge in the income statement once they are received.

Provisions are released at the point when it is deemed that following a subsequent event the risk of loss has reduced to the extent that a provision is no longer required.

Impairment of financial assets classified as available for sale

Available for sale assets are assessed at each balance sheet date to see whether there is objective evidence of impairment. In such cases, any impairment losses are recognised by transferring the cumulative loss that has been recognised directly in equity to income or expense.

When a subsequent event causes the amount of impaired loss on available for sale investment securities to decrease and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income statement. However any further recovery in fair value of an impaired available for sale equity security is recognised directly in equity.

Significant accounting policies continued

v) Derecognition of financial assets

Financial assets are derecognised when:

- the rights to receive cash flows from the asset have ceased; or
- the Bank has transferred substantially all the risks and rewards of ownership of the assets.

When available for sale financial assets are derecognised the cumulative gain or loss, including that previously recognised in reserves, is recognised in the income statement.

vi) Financial liabilities

Financial liabilities are contractual obligations to deliver cash or another financial asset. Financial liabilities are recognised initially at fair value, net of directly attributable transaction costs.

Financial liabilities, other than derivatives and capital bonds, are subsequently measured at amortised cost.

Certain non-derivative financial liabilities included within customer accounts (capital bonds) have been designated at fair value upon initial recognition in the balance sheet. Changes in fair value are recognised through the income statement. The capital bonds are economically matched using equity linked derivatives, which do not meet the requirements for hedge accounting. Recording changes in fair value of both the derivatives and the related liabilities through the income statement most closely reflects the economic reality of the transactions. In doing so this accounting treatment eliminates a measurement inconsistency that would otherwise arise from valuing the capital bonds at amortised cost and the derivatives at fair value.

A financial liability is derecognised when the obligation is discharged, cancelled or expires. Any difference between the carrying amount of a financial liability derecognised and the consideration paid is recognised through the income statement.

Borrowed funds

Borrowings are recognised initially at issue proceeds net of transaction costs incurred, equating to their fair value. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. The Bank's preference shares are classified as financial liabilities as they carry the right to a fixed non-cumulative preferential dividend (further information is provided in note 29) and are subsequently presented in other borrowed funds. The dividends on these preference shares are recognised in the income statement as interest expense on an amortised cost basis using the effective interest method.

Subscribed capital

Subscribed capital is carried at the nominal value plus any share premium and a fair value adjustment for hedged risk where items are designated as part of a fair value hedge relationship.

Interest payable on perpetual subordinated bonds recognised in the income statement using the EIR method.

(f) Offsetting

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(g) Sale and repurchase agreements

Securities sold subject to repurchase agreements (repos) are reclassified on the balance sheet as pledged assets when the transferee has the right by contract or custom to sell or repledge the assets. The liability to the transferee is also included on the balance sheet, in deposits from banks, other deposits or shares, as appropriate. The difference between sale and repurchase price is accrued over the life of the agreements using the EIR method.

Securities purchased under agreements to re-sell (reverse repos) are classified as loans and advances to banks on the balance sheet, as appropriate.

Securities lent to counterparties are retained on the balance sheet.

Securities borrowed are not recognised on the balance sheet, unless they are sold to third parties, in which case the purchase and sale are recorded. The obligation to return them is recorded at fair value as a trading liability.

(h) Derivative financial instruments and hedge accounting

Derivatives used for asset and liability management purposes

Derivatives are used to hedge interest and exchange rate exposures related to non-trading positions. Instruments used for hedging purposes include swaps, forward rate agreements, futures, options and combinations of these instruments. The Bank also uses equity derivatives to hedge the equity risks within its capital bonds.

Derivative financial instruments are stated at fair value based on quoted market prices in active markets, and where these are not available, using valuation techniques such as discounted cashflow models. Further information is provided on page 74. All derivatives are carried as assets when the fair value is positive and liabilities when the fair value is negative. The gain or loss on re-measurement to fair value is recognised immediately in the income statement except where derivatives qualify for cashflow hedge accounting.

On initial designation of derivatives and qualifying hedged items as a hedge, the Bank formally documents the relationship between the hedging instrument(s) and hedged item(s) including the risk management objective and strategy in undertaking the hedge transaction together with the method used to assess effectiveness of the hedging relationship.

The Bank makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, whether the hedging instruments are expected to be 'highly effective' on offsetting the changes in fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80%–125%.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2010

Significant accounting policies continued

Cashflow hedges
Where derivatives are designated as hedges of the exposure to variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the portion of the fair value gain or loss on the derivative that is determined to be an effective hedge is recognised directly in equity. The ineffective part of any gain or loss is recognised in the income statement immediately.

Cumulative amounts recognised through equity are recycled to the income statement in the period in which the underlying hedged item matures and its associated gain or loss affects the income statement. When a hedging relationship is designated, or the hedge becomes ineffective, hedge accounting is discontinued. The cumulative unrealised gain or loss remaining in equity continues to be held in equity, and is transferred to the income statement when the forecast transaction is recognised.

Where the gain or loss in equity relates to a forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss remaining in equity is amortised to the income statement over the remaining life of the asset or liability as part of the item's effective interest rate, or all transferred to the income statement when a forecast transaction is recognised.

Fair value hedges
Where a derivative is designated as the hedging instrument to hedge the change in fair value of a recognised asset or liability or a firm commitment that could affect income or expense, changes in the value of the derivative are recognised immediately in the income statement together with changes in the fair value of the hedged item that are attributable to the hedged risk.

Fair values are based on quoted market prices in active markets, and where these are not available, using valuation techniques such as discounted cashflow models.

If the derivative expires or is sold, terminated, or exercised, or no longer meets the criteria for fair value hedge accounting, or the designation is revoked, then hedge accounting is prospectively discontinued. Any adjustment up to that point, to a hedged item for which the effective interest method is used, is amortised to income or expense as part of the recalculated effective interest rate of the item over its remaining life.

Fair value hedge accounting for a portfolio hedge of interest rate risk
As part of its risk management process the Bank identifies portfolios whose interest rate risk it wishes to hedge. The portfolios may comprise only assets, only liabilities or both assets and liabilities. The Bank analyses each portfolio into repricing time periods based on expected repricing dates, by scheduling cash flows into the periods in which they are expected to occur. Using this analysis, the Bank decides the amount it wishes to hedge and designates as the hedged item an amount of assets or liabilities from each portfolio equal to this.

The Bank measures monthly the change in fair value of the portfolio relating to the risk that is being hedged. Provided that the hedge has been highly effective the Bank recognises the change in fair value of each hedged item in the income statement with the cumulative movement in its value being shown on the balance sheet as a separate item, fair value adjustment for hedged risk, either within assets or liabilities as appropriate. If the hedge no longer meets the criteria for hedge accounting, this amount is amortised to the income statement over the remaining average useful life of the hedge relationship.

The Bank measures the fair value of each hedging instrument monthly. The value is included in derivative financial instruments in either assets or liabilities as appropriate, with the change in value recorded in the income statement.

Any hedge ineffectiveness is recognised in the income statement as the difference between the change in fair value of the hedged item and the change in fair value of the hedging instrument.

Embedded derivatives
A derivative may be embedded in another instrument, known as the host contract. Where the economic characteristics and risks of an embedded derivative are not closely related to those of the host contract (and the host contract is not carried at fair value through income or expense), the embedded derivative is separated from the host and held on balance sheet at fair value.

Movements in fair value are posted to the income statement, whilst the host contract is accounted for according to the relevant accounting policy for that particular asset or liability.

Derivatives used for trading purposes
Derivatives entered into for trading purposes include swaps, forward rate agreements, futures, options and combinations of these instruments. Derivatives used for trading purposes are measured at fair value and any gains or losses are included in the income statement. The use of derivatives and their sale to customers as risk management products is an integral part of the Bank's trading activities.

Mortgage commitments
The Bank enters into derivative contracts to reduce the exposure to risk on mortgage commitments made (for example, where the Bank has made an irrevocable offer of a loan to a customer). Mortgage commitments are designated at fair value through income or expense, the corresponding derivative contracts are recorded at fair value and movements are recognised in the income statement.

Financial guarantee contracts
Other financial guarantees, in respect of intra group funding and the pension deficit in respect of the former Britannia Pension Scheme, between the Bank and its subsidiaries are treated as insurance contracts in accordance with IFRS 4. In accordance with the standard the recognised insurance liability is assessed based on the current estimate of forecast future cash flows. If this highlights that the liability is inadequate the liability is increased and the corresponding charge taken through income statement.

Significant accounting policies continued

(i) Property, plant and equipment

Items of property, plant and equipment are stated at cost less any accumulated depreciation and impairment losses. Depreciation is provided on a straight line basis at the following rates, which are estimated to write down the assets to realisable values at the end of their useful lives.

Freehold and long leasehold buildings	2% to 2.5% per annum
Short leasehold buildings	life of lease
Equipment	10% to 33.3% per annum
Vehicles	25% per annum

All items of property, plant and equipment are reviewed for indications of impairment on a regular basis and at each balance sheet date. Any impairment identified would be charged to the income statement.

(j) Intangible assets

Computer software

Computer software is stated at cost less cumulative amortisation and impairment. All costs directly attributable in the development of computer software for internal use are capitalised and classified as intangible assets where they are not an integral part of the related hardware and amortised over their useful life up to a maximum of seven years. For core systems, a review of the asset's useful life is carried out and a maximum useful life of up to ten years may be applied.

Goodwill

All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries, associates and joint ventures and represents the difference between the cost of the acquisition and the fair value of the identifiable assets, liabilities and contingent liabilities acquired.

If a business combination is achieved without transfer of consideration, the amount of goodwill is calculated by reference to the fair value of the Group's interest in the aquiree using a valuation technique. The technique involves assessing the future net profit of the acquiree and then discounting using a rate that reflects current market assessment of the time value of money and risks specific to the acquiree.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is not amortised but is tested for impairment on an annual basis. Where impairment is required the amount is recognised in the income statement and cannot be written back.

(k) Assets leased to customers

Finance leases

Income from assets leased to customers is credited to the income statement based on a pattern reflecting a constant periodic rate of return on the net investment in the lease.

(l) Assets leased from third parties

The Bank enters into leases for land and buildings and operating leases for vehicles.

Leases for land and buildings are split between leases for the land and leases for the buildings for accounting purposes only. The leases are separately assessed as to whether they are finance or operating leases.

Finance lease assets are initially recorded at the lower of fair value and the present value of the minimum lease payments, and subsequently in accordance with the relevant policy for the underlying asset. An equal liability is recorded in other liabilities. Interest is allocated to the lease payments so as to record a constant periodic rate of charge on the outstanding liability.

Operating lease payments are charged to the income statement on a straight line basis over the term of the lease and the asset is not recognised on the balance sheet.

The Bank policy is to provide for the minimum future lease payments on buildings that it does not currently use.

(m) Investment property

Property held for long term rental yields that is not occupied by the Bank or property held for capital appreciation is classified as investment property.

Investment property comprises freehold land and buildings. It is carried at fair value. Fair value is based on discounted expected future cashflows and is representative of current prices in an active market for similar properties in the same location and condition. No depreciation is provided on these properties. Any gain or loss arising from a change in fair value is recognised in the income statement.

If the Bank takes occupancy of an investment property it is reclassified as property, plant and equipment and its fair value at the date of reclassification becomes its cost for subsequent accounting purposes. Similarly, transfers to the investment property portfolio are made when occupancy by the Bank ceases and the property meets the criteria of an investment property under IAS 40. Prior to such a transfer the property is measured at fair value with any gain or loss recognised in the income statement.

(n) Cash and cash equivalents

Cash and cash equivalents comprises cash balances and balances with a maturity of three months or less from the acquisition date, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2010

Significant accounting policies continued

(o) Income tax

Tax on the income statement for the year comprises current and deferred tax, which is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in the statement of comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided for is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(p) Pension costs

Defined contribution basis

With effect from 6 April 2006, the Bank, along with other businesses within The Co-operative Group, has participated in the Co-operative Group Pension (Average Career Earnings) Scheme (the PACE scheme). This scheme is a defined benefit scheme, the assets of which are held in a separate fund administered by trustees. As a group wide pension scheme, the PACE scheme exposes the participating businesses to actuarial risks associated with the current and former employees of other group companies, with the result that there is no consistent and reliable basis for allocating liabilities, assets and costs to individual companies participating in the scheme. Therefore pension costs in respect of the scheme are accounted for on a defined contribution basis and recognised as an expense in the income statement as incurred.

Former Britannia Building Society pension scheme

Following the transfer of engagements of Britannia Building Society (note 39), the Britannia defined benefit pension scheme transferred to The Co-operative Financial Services Management Services Limited (CFSMS), a fellow subsidiary undertaking of Co-operative Financial Services Limited. As this pension fund is not maintained by the Bank, pension costs in respect of the scheme are accounted for on a defined contribution basis and recognised as an expense in the income statement as incurred.

(q) Foreign currency

The functional and presentational currency for the Bank is sterling. Transactions in foreign currencies are translated at the foreign exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to sterling at the foreign exchange rate ruling at that date. Foreign currency differences arising on retranslation are recognised in the income statement, except for foreign currency differences arising on retranslation of available for sale equity instruments or a qualifying cashflow hedge, which are recognised directly in the statement of comprehensive income. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair values are translated to sterling at the exchange rates prevailing at the dates the values were determined.

(r) Investments in group undertakings

Investments in subsidiaries are initially measured at fair value which equates to cost and subsequently valued at cost less impairment.

(s) Provisions for liabilities and charges

A provision is recognised in the balance sheet if the Bank has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(t) Profit based payments to members of The Co-operative Group

Members of The Co-operative Group receive a dividend based on their transactions with the Group and its subsidiaries including the Bank. The profit based payments to members of The Co-operative Group represent a recharge of the proportion of the dividend payable to the ultimate parent company, Co-operative Group Limited, where the underlying transaction is a Bank product. The recharge is recognised when the profit based payments are approved by The Co-operative Group Limited.

Risk management

For the year ended 31 December 2010

All amounts are stated in £m unless otherwise indicated

The CFS group of companies including The Co-operative Financial Services Limited, Co-operative Insurance Society Limited (Life & Savings business), CIS General Insurance Limited, and The Co-operative Bank plc have a common Board composition.

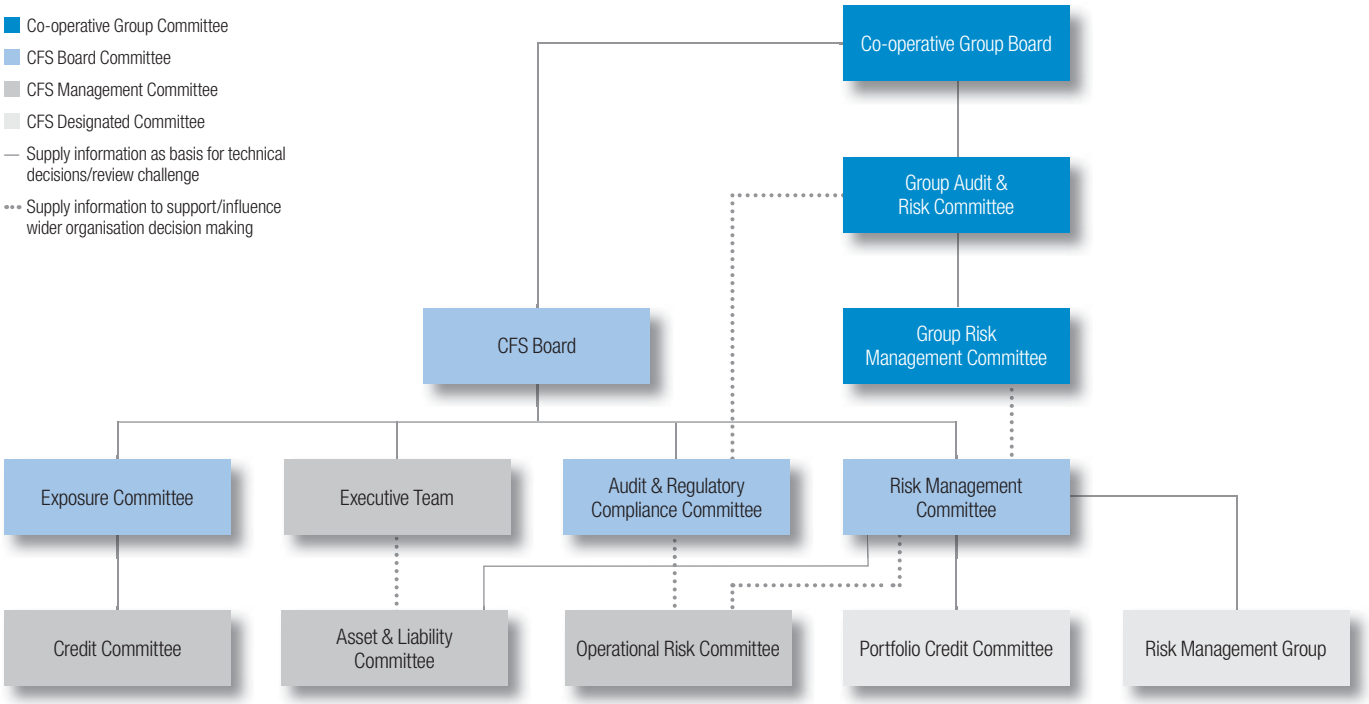
CFS has developed and implemented a common governance and organisation structure, with the same committee structure supporting each Board within the CFS Group.

The Board is responsible for approving the CFS strategy, its principal markets and the level of acceptable risks articulated through its statement of risk appetite. It is also responsible for overall corporate governance which includes ensuring that there is an adequate system of risk management and that the level of capital and liquidity held is consistent with the risk profile of the business.

The Board has established Board committees and senior management committees to administer, oversee and challenge the risk management process, identifying the key risks facing the business and assessing the effectiveness of planned management actions.

Specific Board authority has been delegated to Board committees and the Chief Executive who may, in turn, delegate elements of his discretions to appropriate executive directors and their senior line managers.

Risk management structure



The CFS Board delegates authority to the CFS Risk Management Committee (RMC) for monitoring compliance with the Board approved risk appetite statements. This includes:

- setting limits for individual types of risk; and
- approving (at least annually) and monitoring compliance with risk policies and delegated levels of authority.

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Risk management structure continued

CFS Risk Management Committee (RMC): this committee is responsible for the review and challenge of the adequacy of capital for all risks (including operational risk), and for technical risk management activities (including liiquidity) and portfolio exposures across CFS including:

- operation of mandates and limits and any breaches thereof;
- technical risk management policy approval;
- risk management information reporting and integrity of relevant data;
- risks adequately identified and measured;
- risk and portfolio exposure management strategy;
- adequacy of the risk mitigation process;
- review and discussion of technical risk issues identified as a result of internal audit work; and
- review and challenge the impact assessment of the strategic plan on the risk and capital profile of CFS.

CFS Audit & Regulatory Compliance Committee (ARCC): this committee provides oversight in relation to financial reporting, internal control, regulatory compliance, external and internal audit. It is responsible for approval of policies and review of adequacy of risk management activities in relation to operational risk.

CFS Exposures Committee: this committee ensures that non-executive directors are actively involved in major credit decisions (including sanctioning large counterparty transactions), monitors large exposures and problem loans and reviews the adequacy of individual credit provisions.

CFS Executive Team: the Executive Team manage the business in line with the Board risk appetite statement. It also maintains oversight of risk management processes and management information.

CFS risk and capital management sub committees

CFS Portfolio Credit Committee (PCC): this committee is a designated committee reporting to RMC and chaired by the Business Leader Banking Risk. It is responsible for defining Bank Group credit risk appetite; providing oversight and timely action in relation to credit risk management; monitoring, challenging and approving changes to Basel rating systems; and reviewing lending and arrears policies.

CFS Asset & Liability Committees (ALCO): these committees are management committees of the Board which are chaired by the Chief Financial Officer. They are primarily responsible for overseeing the management of interest rate, market, liquidity and funding risks and to advise on capital utilisation, in addition to, the composition and sourcing of adequate capital.

CFS Risk Management Group (RMG): this committee is a designated committee reporting to RMC and chaired by the Chief Risk Officer. Its purpose is to provide a mechanism to ensure that CFS wide technical risk management requirements, developments and processes are reviewed, challenged and approved (with escalation to RMC where required) and embedded within and across CFS. The committee also monitors all significant and emerging technical risks, and oversees the development and implementation of stress testing and risk appetite across CFS.

CFS Credit Committee: this committee is chaired by the Business Leader Banking Risk. The chair has delegated authority for approving credit facilities within approved strategies and delegated authorities.

CFS Operational Risk Committee (ORC): this committee interfaces with both the Executive Team and ARCC and is chaired by the Business Leader Regulatory Compliance and Operational Risk. 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. This includes business continuity arrangements and insurance cover to protect the CFS business. Capital requirements in relation to operational risk are monitored by the RMC.

There is also a framework of sector specific management committees supporting risk and capital management, implementing changes in business strategy, optimising performance, adherence to and setting of policy, and development of management information and training.

Bank significant risks

The Bank's significant risks arise in four broad categories:

- credit risk;
- market risk;
- liquidity risk; and
- operational risk.

Credit risk

Credit risk is 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 its failure to perform as agreed.

Credit risk is an integral part of many of our business activities and is inherent in 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, options, repurchase agreements and securities borrowing and lending transactions).

The credit risk policies are approved by RMC (delegated authority from the Board) annually and are the responsibility of the Business Leader Banking Risk. The policies determine the criteria for the management of retail, corporate and wholesale risk, including securitisation, market exposures and credit management standards, country, sector and counterparty limits, along with risk appetites and delegated authorities.

All authority to take credit risk derives from the CFS Board. This is delegated through authorities to individuals or committees via the Chief Executive. The level of credit risk authority delegated depends on seniority and experience, varying according to the quality of the counterparty or any associated security or collateral held.

Credit risk continued

The Bank's retail secured and unsecured credit policy is to establish credit criteria which determine the optimum balance between volume growth (generating higher income) and higher bad debts, so as to maximise overall profitability within the Bank's risk appetite. The majority of retail credit risk related decisions are based on well founded and robust decision mechanisms designed to segregate customers into risk categories. There is a suite of bespoke, externally and internally developed application and behavioural scorecards derived from sound historic data. It is the responsibility of the Credit Risk Control Unit to design, select, implement, maintain and monitor these systems. The PCC and RMC receive regular reports on the performance of the portfolios.

The Bank's corporate sector policy is to maintain a broad sectoral spread of exposures which reflect the Bank's areas of expertise. Credit exposures to corporate and business banking customers are assessed individually. The quality of the overall portfolio is monitored using a credit grading system calibrated to expected loss. All aspects of credit management are controlled centrally. The PCC and RMC receive regular reports on the performance of the portfolio. The Exposures Committee receives regular reports on new facilities, bad debt provisions and the management of problem loans.

The Bank's wholesale market credit risk framework takes a holistic approach to risk management with, at its centre, a credit risk policy which governs the types of exposure the business can take and sets concentration parameters. To complement this, individual authority is delegated in terms of Internal Rating Grade (IRG) and associated Probability of Default (PD) to approve limits to individual counterparties within the parameters established by the credit risk policy. The PCC and RMC receive regular reports on the performance of the portfolio. The exposures committee receives regular reports on changes in exposure limits, watchlist and problem counterparty information.

Cash and balances at central banks are considered to be risk free and have been excluded from the following analysis of credit exposure.

Credit exposure

Group	Notes	**Gross balance 2010**	**Credit commitments 2010**	**Credit risk exposure 2010**	Gross balance 2009	Credit commitments 2009	Credit risk exposure 2009
Loans and receivables							
Loans and advances to banks	14	**2,394.1**	**176.0**	**2,570.1**	1,781.5	113.8	1,895.3
Loans and advances to customers	15	**35,199.9**	**4,717.7**	**39,917.6**	34,267.7	5,021.3	39,289.0
Investment securities	16	**1,930.3**	**–**	**1,930.3**	2,500.7	–	2,500.7
Available for sale financial assets							
Investment securities	16	**3,058.1**	**–**	**3,058.1**	4,529.2	–	4,529.2
Derivative financial instruments	17	**931.9**	**–**	**931.9**	1,023.0	–	1,023.0
		43,514.3	**4,893.7**	**48,408.0**	44,102.1	5,135.1	49,237.2
Allowance for impairment losses on loans and advances	15			**(222.6)**			(194.0)
Impairment losses on investments	16			**(85.3)**			(86.4)
Total carrying amount				**48,100.1**			48,956.8
Bank							
Loans and receivables							
Loans and advances to banks	14	**1,728.6**	**176.0**	**1,904.6**	1,220.1	113.8	1,333.9
Loans and advances to customers	15	**24,055.4**	**4,576.3**	**28,631.7**	23,242.8	4,763.6	28,006.4
Investment securities	16	**1,999.8**	**–**	**1,999.8**	2,570.1	–	2,570.1
Available for sale financial assets							
Investment securities	16	**2,722.4**	**–**	**2,722.4**	4,132.5	–	4,132.5
Derivative financial instruments	17	**661.0**	**–**	**661.0**	660.8	–	660.8
		31,167.2	**4,752.3**	**35,919.5**	31,826.3	4,877.4	36,703.7
Allowance for impairment losses on loans and advances	15			**(210.5)**			(192.0)
Impairment losses on investments	16			**(85.3)**			(86.4)
Total carrying amount				**35,623.7**			36,425.3

Credit commitments include revocable commitments which are unused credit card limits in Group and Bank of £2,344.9m (2009: £2,621.9m).

Notes 15 and 16 provide further analysis on concentration of credit risk.

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Credit risk continued
Credit risk analysis

2010 Group	**Loans and advances to banks**	**Loans and advances to customers**	**Investment securities loans and receivables**	**Investment securities available for sale**	**Derivative financial instruments**	**Total**
Individually impaired						
90 days past due or evidence of impairment	**–**	**1,715.4**	**25.0**	**72.3**	**–**	**1,812.7**
Impairment recognised	**–**	**(64.4)**	**(8.5)**	**(72.3)**	**–**	**(145.2)**
Carrying amount	**–**	**1,651.0**	**16.5**	**–**	**–**	**1,667.5**
Collectively impaired						
Less than 90 days past due	**–**	**243.7**	**119.2**	**–**	**–**	**362.9**
90–179 days past due	**–**	**18.4**	**–**	**–**	**–**	**18.4**
180 days plus past due	**4.6**	**143.4**	**–**	**–**	**–**	**148.0**
Impairment recognised	**–**	**(158.2)**	**(4.5)**	**–**	**–**	**(162.7)**
Carrying amount	**4.6**	**247.3**	**114.7**	**–**	**–**	**366.6**
Past due but not impaired						
0–29 days past due	**–**	**253.7**	**–**	**–**	**–**	**253.7**
30–59 days past due	**–**	**125.3**	**–**	**–**	**–**	**125.3**
60–89 days past due	**–**	**123.6**	**–**	**–**	**–**	**123.6**
Carrying amount	**–**	**502.6**	**–**	**–**	**–**	**502.6**
Neither past due nor impaired						
Low to medium risk	**2,565.5**	**32,134.9**	**1,786.1**	**2,974.9**	**931.9**	**40,393.3**
Medium to high risk	**–**	**5,159.2**	**–**	**10.9**	**–**	**5,170.1**
Carrying amount	**2,565.5**	**37,294.1**	**1,786.1**	**2,985.8**	**931.9**	**45,563.4**
Total carrying amount	**2,570.1**	**39,695.0**	**1,917.3**	**2,985.8**	**931.9**	**48,100.1**

2009 Group	Loans and advances to banks	Loans and advances to customers	Investment securities loans and receivables	Investment securities available for sale	Derivative financial instruments	Total
Individually impaired						
90 days past due or evidence of impairment	–	2,100.3	25.0	71.9	–	2,197.2
Impairment recognised	–	(53.6)	(8.5)	(71.9)	–	(134.0)
Carrying amount	–	2,046.7	16.5	–	–	2,063.2
Collectively impaired						
Less than 90 days past due	–	212.1	124.3	–	–	336.4
90–179 days past due	–	22.6	–	–	–	22.6
180 days plus past due	4.6	143.0	–	–	–	147.6
Impairment recognised	–	(140.4)	(6.0)	–	–	(146.4)
Carrying amount	4.6	237.3	118.3	–	–	360.2
Past due but not impaired						
0–29 days past due	–	281.0	–	–	–	281.0
30–59 days past due	–	125.0	–	–	–	125.0
60–89 days past due	–	52.1	–	–	–	52.1
Carrying amount	–	458.1	–	–	–	458.1
Neither past due nor impaired						
Low to medium risk	1,890.7	28,723.1	2,351.4	4,457.3	1,023.0	38,445.5
Medium to high risk	–	7,629.8	–	–	–	7,629.8
Carrying amount	1,890.7	36,352.9	2,351.4	4,457.3	1,023.0	46,075.3
Total carrying amount	1,895.3	39,095.0	2,486.2	4,457.3	1,023.0	48,956.8

Credit risk continued

2010 Bank	Loans and advances to banks	Loans and advances to customers	Investment securities loans and receivables	Investment securities available for sale	Derivative financial instruments	Total
Individually impaired						
90 days past due or evidence of impairment	**–**	**245.2**	**25.0**	**72.3**	**–**	**342.5**
Impairment recognised	**–**	**(52.3)**	**(8.5)**	**(72.3)**	**–**	**(133.1)**
Carrying amount	**–**	**192.9**	**16.5**	**–**	**–**	**209.4**
Collectively impaired						
Less than 90 days past due	**–**	**55.2**	**119.2**	**–**	**–**	**174.4**
90–179 days past due	**–**	**18.4**	**–**	**–**	**–**	**18.4**
180 days plus past due	**4.6**	**143.4**	**–**	**–**	**–**	**148.0**
Impairment recognised	**–**	**(158.2)**	**(4.5)**	**–**	**–**	**(162.7)**
Carrying amount	**4.6**	**58.8**	**114.7**	**–**	**–**	**178.1**
Past due but not impaired						
0–29 days past due	**–**	**52.0**	**–**	**–**	**–**	**52.0**
30–59 days past due	**–**	**39.3**	**–**	**–**	**–**	**39.3**
60–89 days past due	**–**	**29.6**	**–**	**–**	**–**	**29.6**
Carrying amount	**–**	**120.9**	**–**	**–**	**–**	**120.9**
Neither past due nor impaired						
Low to medium risk	**1,900.0**	**25,607.7**	**1,855.6**	**2,639.2**	**661.0**	**32,663.5**
Medium to high risk	**–**	**2,440.9**	**–**	**10.9**	**–**	**2,451.8**
Carrying amount	**1,900.0**	**28,048.6**	**1,855.6**	**2,650.1**	**661.0**	**35,115.3**
Total carrying amount	**1,904.6**	**28,421.2**	**1,986.8**	**2,650.1**	**661.0**	**35,623.7**

2009 Bank	Loans and advances to banks	Loans and advances to customers	Investment securities loans and receivables	Investment securities available for sale	Derivative financial instruments	Total
Individually impaired						
90 days past due or evidence of impairment	–	258.0	25.0	71.9	–	354.9
Impairment recognised	–	(51.6)	(8.5)	(71.9)	–	(132.0)
Carrying amount	–	206.4	16.5	–	–	222.9
Collectively impaired						
Less than 90 days past due	–	67.9	124.3	–	–	192.2
90–179 days past due	–	22.6	–	–	–	22.6
180 days plus past due	4.6	136.7	–	–	–	141.3
Impairment recognised	–	(140.4)	(6.0)	–	–	(146.4)
Carrying amount	4.6	86.8	118.3	–	–	209.7
Past due but not impaired						
0–29 days past due	–	52.2	–	–	–	52.2
30–59 days past due	–	29.6	–	–	–	29.6
60–89 days past due	–	15.0	–	–	–	15.0
Carrying amount	–	96.8	–	–	–	96.8
Neither past due nor impaired						
Low to medium risk	1,329.3	25,013.2	2,420.8	4,060.6	660.8	33,484.7
Medium to high risk	–	2,411.2	–	–	–	2,411.2
Carrying amount	1,329.3	27,424.4	2,420.8	4,060.6	660.8	35,895.9
Total carrying amount	1,333.9	27,814.4	2,555.6	4,060.6	660.8	36,425.3

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Credit risk continued

Analysis of impaired assets and associated collateral

Impaired assets

Loans and securities are considered impaired where it is determined that the Bank will be unable to collect all principal and interest outstanding, according to the contractual terms of the agreements.

The loan portfolios are reviewed on a periodic basis, usually once a month, to assess impairment. A loan will be deemed to be impaired where there is objective evidence that a loss event has occurred after recognition of an asset and prior to the balance sheet date.

Objective evidence of impairment on the loan portfolios includes:

Portfolio	Impairment definition
Corporate	• an instalment on a loan account is overdue, or has been in excess of its limit (or is overdrawn without an agreed limit) for 90 days or more;
	• if, as a result of lending being (either now or previously) at risk in distress, the Bank has agreed to a material postponement or forgiveness of interest and/or 'soft' rates or to a waiver and/or reduction of normal fees and charges, the accounts must be considered impaired while such favourable terms are being applied;
	• there has been a full or partial write off of debt, following which the account must remain impaired for at least six months;
	• there has been an event likely to result in insolvency which may involve bankruptcy, or the appointment of an administrative receiver, liquidator or administrator; or
	• if the Bank considers that at some point (normally taken as within the next 12 months) actions such as an issue of formal demand will be required in order to achieve full repayment.
Mortgages	• arrears outstanding are equivalent to three or more monthly instalments; or
	• we have commenced litigation against the borrower for repossession of the property against which the loan is secured.
Unsecured	• loans with any amount of arrears are treated as impaired.

For all portfolios the actual provision will depend on the expected roll rate to charge off or anticipated cash flow, and the estimated value of any supporting collateral.

Once a loan is defined as impaired the provision will be calculated as the difference between the current carrying value of the asset and the expected future recovery, discounted at the loan's effective interest rate, taking into account the expected charge-off rate and any supporting collateral. The table below shows the impairment rates of the various portfolios, shown by customer balance outstanding:

	2010				2009			
	Customer balance	**%**	**Impaired**	**%**	Customer balance	%	Impaired	%
Corporate	**10,456.0**	**28.1**	**664.0**	**6.4**	10,188.0	28.1	648.0	6.4
Mortgages	**25,222.0**	**68.0**	**1,838.8**	**7.3**	24,571.0	67.7	1,976.2	8.0
Unsecured:								
Credit cards	**606.0**	**1.6**	**96.2**	**15.9**	661.0	1.8	99.8	15.1
Loans	**810.0**	**2.2**	**43.0**	**5.3**	783.0	2.2	37.3	4.8
Overdrafts	**52.0**	**0.1**	**13.1**	**25.2**	56.0	0.2	14.5	25.9
	37,146.0	**100.0**	**2,655.1**	**7.1**	36,259.0	100.0	2,775.8	7.7

At the balance sheet date, the Bank assesses its debt securities for objective evidence that an impairment loss has occurred. For a debt security this may be the disappearance of an active market. For available for sale debt securities particular consideration is given to evidence of any significant difficulty of the issuer or measurable decrease in the estimated cash flows from the investments.

Renegotiation of retail lending

The Bank is committed to supporting borrowers who are in financial difficulties and will consider a range of treatments to help a borrower meet their loan commitments and clear any outstanding arrears. On secured lending, repossession of the property is always considered a last resort.

Alternative treatments for borrowers include arrangements to repay arrears over an extended period, or temporary concessions where arrears are allowed to increase for a temporary period. Such arrangements may be negotiated directly with the borrower or via a third party. Where such arrangement is made the loan will continue to be treated as impaired until such time as the arrears have been cleared in full.

In certain circumstances, as defined in the Bank's policy, we may agree to renegotiate a loan to repay outstanding arrears over the remaining term of the loan.

- On mortgages where such a renegotiation takes place, known as capitalisation, the loan will be classified as neither past due nor impaired, for so long as the mortgagors comply with the terms of their renegotiated contracts. During 2010, 541 secured loans (2009: 534) in the Group were renegotiated, including 86 (2009: eight) in the Bank. The balance of these loans as at 31 December 2010 in the Group was £63.2m (2009: £95.2m), including £5.8m (2009: £28.1m) in the Bank.
- On unsecured lending renegotiated loans, known as re-aged loans, will continue to be treated as impaired for a period of 12 months, or until three payments have been missed on the re-aged loan. The expected charge off rate will be based on the performance of other re-aged loans. At the end of 2010 there were £23.9m of re-aged loans.

Credit risk continued

Past due but not impaired

Loans and securities are considered past due where the contractual interest or principal payment are in arrears, however there are certain mitigating circumstances that may deem it necessary not to raise a provision for past due accounts (eg amount/days past due are immaterial). Provisions can be raised where accounts are not past due, this could be the stage of collection of amounts owed to the Bank or a specific event such as bankruptcy.

In the table past due but not impaired represents the outstanding balances on mortgages and unsecured retail lending where borrowers have failed to make payments when contractually due and the Bank expects that all contractual payments will be collected. This includes credit card exposures less than 30 days and 45 days for other retail unsecured lending. For mortgages, accounts up to 90 days in arrears but with no provision are classed as past due but not impaired.

Within the credit risk analysis table, low to medium risk has been defined as exposures where the PD is 1% or below over a one year time horizon for exposures on IRB approach under Basel II and slotting category strong/good/satisfactory for specialised lending exposures under the slotting approach. Medium to high risk has been defined as a PD of greater than 1% over a one year time horizon for exposure on IRB approach under Basel II and slotting category weak for specialised lending exposures under the slotting approach.

Within the treasury debt security portfolio 82% (2009: 82%) of exposures have an external credit rating equivalent to Fitch A or above.

The factors considered in determining if financial assets are individually impaired are stated above and within critical judgments on pages 79 to 81.

Fair value adjustments and provisions held against impaired exposures

When Britannia merged with The Co-operative Bank, the Britannia lending portfolios were carried into the newly merged entity at their fair value, taking account of future lifetime expected loss on the lending portfolios at 31 July 2009. The lifetime expected loss adjustment is offset against the Britannia gross lending balances in the combined entity's financial statements. The utilisation and allocation of the fair value adjustment is reviewed on a regular basis.

Description of collateral

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 not eligible financial collateral, it is residential real estate collateral for retail mortgages or either residential or commercial real estate collateral held against corporate lending.

When calculating the value of collateral for regulatory capital risk mitigation purposes, the appropriate valuation criteria contained within BIPRU is applied. When assessing the collateral valuations for corporate lending policy purposes, a more conservative written down value is used, stepped according to the risk level of the asset.

Where exposures are agreed on a secured basis, security cover is taken into account 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.

Eligible financial collateral includes gilts held as part of reverse repo agreements, and cash as part of collateralised swaps or against corporate lending. The guarantees include parental guarantees held against subsidiary exposures.

At the reporting date the value of collateral held as security against financial assets was as follows:

	2010	2009
Fair value of collateral on financial assets which are past due but not impaired	**895.4**	966.9
Fair value of collateral on individually impaired financial assets	**1,956.1**	2,037.3
Carrying value of assets obtained by taking possession of collateral or calling on guarantees	**186.6**	229.0

Eurozone risk

All Eurozone exposures continue to be closely monitored especially those to financial institutions in Portugal, Ireland, Italy, Spain and Belgium. The Bank has no exposure to Greece.

Underlying term assets are deemed to be in run off, with associated counterparty and country limits reducing as assets mature and there is no new term exposure. All of the residual direct wholesale term exposure to these countries matures by mid 2012.

The Bank's exposure to these Eurozone countries (as valued for credit risk purposes) represented 2.4% of total Bank exposures.

Market risk

Market risk arises from the effect of changes in market prices of financial instruments, on income derived from the structure of the balance sheet, execution of customer and interbank business and proprietary trading. The majority of the risk arises from changes in interest rates.

Interest rate risk

Interest rate risk policy statements, approved by the RMC 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 Bank's ALCO which meets monthly and its prime task is to assess the interest rate risk inherent in the maturity and repricing characteristics of the Bank's assets and liabilities. It sets limits within which treasury and balance sheet management manage the effect of interest rate changes on the Bank's overall net interest income. 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.

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Market risk continued

The Board receives reports on the management of balance sheet risk and, each month, ALCO reviews the balance sheet risk position and the utilisation of wholesale market risk limits.

Non-treasury interest rate risk

The Bank (excluding wholesale) uses a gap report and earnings approach to managing interest rate risk, focusing in detail on the sensitivity of assumed changes in interest rates on net interest income for one year. Higher level analysis is performed for subsequent years.

ALCO 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 set 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) is no more than a set limit.

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. Treasury undertake hedges for interest rate risk using derivative instruments and investment securities which are executed via the dealing room to wholesale markets, and loans and deposits which are executed internally with treasury.

The table below illustrates the sensitivity analysis relating to the 'core' Bank, a primary measure in the approach to managing interest rate risk.

The table illustrates the Present Value (PV) change based on a 1% shock in interest rates at the end of the year across the yield curve on the Bank's balances excluding wholesale treasury and customer currency balances (subject to a 0% floor), which are managed within the treasury risk framework. The shock results are driven by product pricing and product mix. The extent of rate movements and low rate environment have impacted the repricing of liability products resulting in larger exposure to rate shocks.

	100bp increase	100bp decrease
2010		
At the year end	**(9.0)**	**10.7**
Average for the period	**(12.8)**	**13.5**
Maximum sensitivity for the period	**(35.3)**	**37.3**
Minimum sensitivity for the period	**(0.2)**	**0.4**
2009		
At the year end	(0.2)	1.9
Average for the period	(4.4)	5.7
Maximum sensitivity for the period	(23.3)	25.6
Minimum sensitivity for the period	3.4	(3.7)

Treasury interest rate risk

Treasury executes short term funding and hedging transactions with the wholesale markets on behalf of the Bank and its customers. It also generates incremental income from proprietary trading within strict risk limits. There are two prime measures of risk supplemented by additional controls such as maturity and stop loss limits. Risk units express the various repricing and maturity mismatches as a common unit of measurement. Value at Risk (VaR) measures the daily maximum potential gain or loss due to market volatility within a statistical confidence level of 95% and a one day holding period. Simulation is being developed to provide VaR calculations to cover the combined core banking book positions. The VaR methodology has inherent limitations in that market volatility in the past, may not be a reliable predictor of the future, and may not reflect the time required to hedge or dispose of the position, hence VaR is not used as the sole measure of risk.

PV100

This illustrates the change in valuation on a fixed income portfolio experienced given a 1% increase and decrease in interest rates for treasury, representing treasury banking book and trading book combined. PV100 is the effect on the net present value (NPV) of the treasury portfolio to a parallel shift of 100 basis points upon the base yield curve. The effects of a 1% increase in interest rates are (£11.0m) (2009: £0.4m) and a 1% decrease £9.1m (2009: (£0.2m)).

Currency risk

The Bank's treasury foreign exchange activities are primarily:

- 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.

The table below provides an analysis of the Group's and Bank's assets and liabilities by currency.

Group	£ 2010	$ 2010	€ 2010	Other 2010	Total 2010	£ 2009	$ 2009	€ 2009	Other 2009	Total 2009
Assets										
Cash and balances at central banks	**1,735.6**	**–**	**–**	**–**	**1,735.6**	1,706.8	–	–	–	1,706.8
Loans and advances to banks	**1,879.9**	**35.4**	**475.3**	**3.5**	**2,394.1**	1,377.9	101.5	293.8	8.3	1,781.5
Loans and advances to customers	**34,683.2**	**61.6**	**217.4**	**15.1**	**34,977.3**	33,724.9	72.2	261.0	15.6	34,073.7
Fair value adjustments for hedged risk	**166.8**	**–**	**–**	**–**	**166.8**	66.1	–	–	–	66.1
Investment securities – loans and receivables	**1,500.0**	**68.1**	**294.0**	**55.2**	**1,917.3**	1,862.7	137.3	426.6	59.6	2,486.2
Investment securities – available for sale	**1,900.4**	**379.8**	**444.9**	**260.7**	**2,985.8**	2,441.0	613.3	1,042.4	360.6	4,457.3
Derivative financial instruments	**931.5**	**0.1**	**0.3**	**–**	**931.9**	1,022.7	–	0.3	–	1,023.0
Equity shares	**7.2**	**–**	**–**	**–**	**7.2**	7.2	–	–	–	7.2
Investments in joint ventures	**2.5**	**–**	**–**	**–**	**2.5**	1.8	–	–	–	1.8
Goodwill	**0.6**	**–**	**–**	**–**	**0.6**	0.6	–	–	–	0.6
Intangible fixed assets	**45.1**	**–**	**–**	**–**	**45.1**	46.1	–	–	–	46.1
Investment properties	**162.3**	**–**	**–**	**–**	**162.3**	137.7	–	–	–	137.7
Property, plant and equipment	**98.5**	**–**	**–**	**–**	**98.5**	121.5	–	–	–	121.5
Amounts owed by other Co-operative Group undertakings	**0.6**	**–**	**–**	**–**	**0.6**	91.0	–	–	–	91.0
Other assets	**47.2**	**0.7**	**2.9**	**1.7**	**52.5**	20.9	0.3	0.8	0.1	22.1
Prepayments and accrued income	**16.2**	**–**	**–**	**–**	**16.2**	30.1	–	–	–	30.1
Deferred tax assets	**87.0**	**–**	**–**	**–**	**87.0**	86.1	–	–	–	86.1
Total assets	**43,264.6**	**545.7**	**1,434.8**	**336.2**	**45,581.3**	42,745.1	924.6	2,024.9	444.2	46,138.8

Group	£ 2010	$ 2010	€ 2010	Other 2010	Total 2010	£ 2009	$ 2009	€ 2009	Other 2009	Total 2009
Liabilities										
Deposits by banks	**1,480.8**	**473.0**	**840.4**	**144.4**	**2,938.6**	4,056.5	488.0	1,397.5	140.4	6,082.4
Customer accounts	**32,205.8**	**23.6**	**88.9**	**1.7**	**32,320.0**	30,755.6	22.4	46.3	3.9	30,828.2
Customer accounts – capital bonds	**1,794.7**	**–**	**–**	**–**	**1,794.7**	1,647.1	–	–	–	1,647.1
Debt securities in issue	**4,007.4**	**–**	**204.8**	**–**	**4,212.2**	3,201.0	123.8	9.5	–	3,334.3
Derivative financial instruments	**689.2**	**5.2**	**6.8**	**1.2**	**702.4**	580.3	4.2	6.8	–	591.3
Other borrowed funds	**975.4**	**–**	**–**	**–**	**975.4**	946.5	–	–	–	946.5
Amounts owed to other Co-operative Group undertakings	**188.5**	**–**	**–**	**–**	**188.5**	329.2	–	–	–	329.2
Other liabilities	**141.3**	**1.5**	**2.8**	**1.2**	**146.8**	220.2	0.9	0.8	–	221.9
Accruals and deferred income	**131.3**	**–**	**–**	**–**	**131.3**	158.0	–	–	–	158.0
Provisions for liabilities and charges	**55.8**	**–**	**–**	**–**	**55.8**	52.8	–	–	–	52.8
Current tax liabilities	**42.5**	**–**	**–**	**–**	**42.5**	71.0	–	–	–	71.0
Total liabilities	**41,712.7**	**503.3**	**1,143.7**	**148.5**	**43,508.2**	42,018.2	639.3	1,460.9	144.3	44,262.7
Net on balance sheet position	**1,551.9**	**42.4**	**291.1**	**187.7**	**2,073.1**	726.9	285.3	564.0	299.9	1,876.1

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Currency risk continued

Bank	**£ 2010**	**$ 2010**	**€ 2010**	**Other 2010**	**Total 2010**	£ 2009	$ 2009	€ 2009	Other 2009	Total 2009
Assets										
Cash and balances at central banks	**1,735.6**	**–**	**–**	**–**	**1,735.6**	1,706.8	–	–	–	1,706.8
Loans and advances to banks	**1,214.4**	**35.4**	**475.3**	**3.5**	**1,728.6**	816.5	101.5	293.8	8.3	1,220.1
Loans and advances to customers	**23,665.1**	**50.3**	**114.4**	**15.1**	**23,844.9**	22,816.3	60.9	158.0	15.6	23,050.8
Fair value adjustments for hedged risk	**164.6**	**–**	**–**	**–**	**164.6**	60.6	–	–	–	60.6
Investment securities – loans and receivables	**1,569.5**	**68.1**	**294.0**	**55.2**	**1,986.8**	1,932.1	137.3	426.6	59.6	2,555.6
Investment securities – available for sale	**1,564.7**	**379.8**	**444.9**	**260.7**	**2,650.1**	2,044.3	613.3	1,042.4	360.6	4,060.6
Derivative financial instruments	**660.6**	**0.1**	**0.3**	**–**	**661.0**	660.5	–	0.3	–	660.8
Equity shares	**7.2**	**–**	**–**	**–**	**7.2**	7.2	–	–	–	7.2
Investments in Group undertakings	**1,458.9**	**–**	**–**	**–**	**1,458.9**	1,572.4	–	–	–	1,572.4
Goodwill	**0.6**	**–**	**–**	**–**	**0.6**	0.6	–	–	–	0.6
Intangible fixed assets	**43.8**	**–**	**–**	**–**	**43.8**	44.9	–	–	–	44.9
Property, plant and equipment	**79.1**	**–**	**–**	**–**	**79.1**	101.6	–	–	–	101.6
Amounts owed by other Co-operative Group undertakings	**14,168.8**	**–**	**64.9**	**–**	**14,233.7**	11,751.7	10.7	99.2	–	11,861.6
Other assets	**46.2**	**0.7**	**2.9**	**1.7**	**51.5**	44.6	0.3	0.8	0.1	45.8
Prepayments and accrued income	**14.5**	**–**	**–**	**–**	**14.5**	27.4	–	–	–	27.4
Deferred tax assets	**154.0**	**–**	**–**	**–**	**154.0**	210.3	–	–	–	210.3
Total assets	**46,547.6**	**534.4**	**1,396.7**	**336.2**	**48,814.9**	43,797.8	924.0	2,021.1	444.2	47,187.1

Bank	**£ 2010**	**$ 2010**	**€ 2010**	**Other 2010**	**Total 2010**	£ 2009	$ 2009	€ 2009	Other 2009	Total 2009
Liabilities										
Deposits by banks	**1,413.0**	**473.0**	**840.4**	**144.4**	**2,870.8**	3,587.1	488.0	1,397.5	140.4	5,613.0
Customer accounts	**29,797.8**	**23.6**	**88.9**	**1.7**	**29,912.0**	28,587.4	22.4	46.3	3.9	28,660.0
Customer accounts – capital bonds	**1,744.0**	**–**	**–**	**–**	**1,744.0**	1,581.7	–	–	–	1,581.7
Debt securities in issue	**1,652.0**	**–**	**204.8**	**–**	**1,856.8**	1,606.0	123.8	9.5	–	1,739.3
Derivative financial instruments	**684.2**	**5.2**	**6.8**	**1.2**	**697.4**	556.2	4.2	6.8	–	567.2
Other borrowed funds	**975.4**	**–**	**–**	**–**	**975.4**	946.5	–	–	–	946.5
Amounts owed to other Co-operative Group undertakings	**8,340.9**	**–**	**–**	**–**	**8,340.9**	5,765.0	–	–	–	5,765.0
Other liabilities	**135.0**	**1.5**	**2.8**	**1.2**	**140.5**	209.1	0.9	0.8	–	210.8
Accruals and deferred income	**117.0**	**–**	**–**	**–**	**117.0**	134.3	–	–	–	134.3
Provisions for liabilities and charges	**39.3**	**–**	**–**	**–**	**39.3**	45.0	–	–	–	45.0
Current tax liabilities	**17.3**	**–**	**–**	**–**	**17.3**	56.8	–	–	–	56.8
Total liabilities	**44,915.9**	**503.3**	**1,143.7**	**148.5**	**46,711.4**	43,075.1	639.3	1,460.9	144.3	45,319.6
Net on balance sheet position	**1,631.7**	**31.1**	**253.0**	**187.7**	**2,103.5**	722.7	284.7	560.2	299.9	1,867.5

At 31 December 2010 the Group and Bank's open position was £0.4m (2009: £0.7m) representing a potential loss of £nil given a 3% depreciation in sterling (2009: £nil). The open position is monitored against limits in addition to limits in place on individual currencies. All figures are in £ sterling equivalent.

Liquidity risk

Liquidity risk arises from the timing of cash flows generated from the Group's assets and liabilities (including derivatives). The Group's liquidity management policies are reviewed and approved annually by the RMC and compliance reviewed monthly by ALCO.

Liquidity risk arising from the structure of the balance sheet (structural liquidity) is managed to policies developed by ALCO. Liquidity risk is defined as the Board approved survival period under stress scenarios. The Bank undertakes various stress tests on a weekly basis.

The Bank has enhanced its liquidity management by introducing a liquidity risk framework which has a number of strategic and tactical measures that feed into an overall liquidity status score. The Bank's liquidity management framework is designed in line with FSA BIPRU regulations and industry guidelines, including Institute of International Finance and Bank for International Settlements recommendations.

The Bank manages liquidity risk by applying:

- a systematic control process embedded in the Bank's operations; and
- controlled end to end liquidity management with:
  - net outflows monitored to ensure they are within FSA limits;
  - maintenance of a well diversified deposit base;
  - management of stocks: high quality primary liquidity including cash, and secondary liquidity including certificates of deposit;
  - target strategic ratios; and
  - stress testing.

The strategic measures set by ALCO and monitored monthly are:

- wholesale borrowing ratio – the amount of wholesale borrowing compared to total liabilities;
- liquid asset ratio – amount of total assets that are liquid assets; and
- customer loan/deposit ratio – amount of customer loans funded by customer deposits.

Day to day cash flow (tactical liquidity) is managed by treasury within guidelines laid down by ALCO and in accordance with the standards established for all banks by the FSA.

The Bank has a high proportion of retail assets funded by retail deposits, ensuring there is no over reliance on wholesale funding. There are customer funding and wholesale funding ratios as described above which are set in line with the Board approved strategic plan. The Group's structural liquidity risk management is therefore retail based and is dependent on behavioural analysis of both customer demand and deposit and loan drawdown profiles by product category based on experience over the last ten years. The behaviour of retail products is reviewed by ALCO and in addition the Group has maturity mismatch limits to control the exposure to longer term mismatches.

The Bank's liquidity position is monitored on a daily basis and reported to ALCO each month. Treasury holds a pool of liquid assets on behalf of the Bank, and management actions are in place to provide additional liquidity when required. These sources of liquidity are held in order to be available to meet unexpected liquidity requirements.

Marketable assets are maintained as a liquidity pool against potential retail outflows; the liquidity pool is the highest quality debt and consists of high quality government issued debt, and cash at the Bank of England.

The Bank has access to a variety of medium term wholesale funding sources: securitisation, covered bond and Euro Medium Term Notes. The Bank will issue from the programmes as funding requirements and market conditions permit.

ALCO meets monthly and discusses the actual liquidity position and projected position incorporating business plans. As required a more regular meeting is held, this is typically when the markets have a heightened period of stress or liquidity shortage. The meetings ensure that the business plans are accurate and can be flexed as required.

Liquidity gap

The following table analyses assets and liabilities into relevant maturity groupings based on the remaining period of the balance sheet date to the contractual maturity date.

The Bank manages liquidity on a behavioural rather than contractual basis, reflecting where actual behaviour differs from contractual maturity:

- retail and corporate deposit bases are very stable, with deposits being attracted to the Bank by good customer service and its ethical policy. As a result, the deposit base remains stable whereas the contractual maturity is immediate for instant access deposits; and
- personal loan and visa balances are repaid earlier than their contractual maturity date.

These behavioural adjustments are based on historical experience of customer behaviour over a period of up to ten years.

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Liquidity risk continued

Gross contractual cash flow maturity analysis

Gross contractual cash flows include interest and other revenue cash flows. The following is an analysis of gross contractual cash flows of financial liabilities held at the balance sheet date:

2010 Group	**Carrying value**	**Gross nominal outflow**	**Less than 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**
Non-derivative liabilities							
Deposits by banks	**2,938.6**	**2,931.0**	**776.3**	**415.8**	**774.4**	**964.5**	**–**
Customer accounts	**32,320.0**	**32,588.8**	**20,347.0**	**1,856.8**	**6,811.5**	**3,573.5**	**–**
Customer accounts – capital bonds	**1,794.7**	**1,749.4**	**11.4**	**64.1**	**254.8**	**1,362.6**	**56.5**
Debt securities in issue	**4,212.2**	**5,006.4**	**303.9**	**695.6**	**397.4**	**1,172.4**	**2,437.1**
Other borrowed funds	**975.4**	**1,799.6**	**45.8**	**4.7**	**58.0**	**420.8**	**1,270.3**
Amounts owed to other Co-operative Group undertakings	**188.5**	**188.5**	**188.5**	**–**	**–**	**–**	**–**
	42,429.4	**44,263.7**	**21,672.9**	**3,037.0**	**8,296.1**	**7,493.8**	**3,763.9**
Derivative liabilities							
Net outflow	**702.4**	**794.2**	**139.5**	**37.5**	**121.6**	**295.5**	**200.1**
	43,131.8	**45,057.9**	**21,812.4**	**3,074.5**	**8,417.7**	**7,789.3**	**3,964.0**
Other liabilities	**376.4**	**–**	**–**	**–**	**–**	**–**	**–**
Total recognised liabilities	**43,508.2**	**45,057.9**	**21,812.4**	**3,074.5**	**8,417.7**	**7,789.3**	**3,964.0**
Unrecognised loan commitments	**4,759.5**	**4,759.5**	**4,499.3**	**62.5**	**188.2**	**9.5**	**–**
Total liabilities	**48,267.7**	**49,817.4**	**26,311.7**	**3,137.0**	**8,605.9**	**7,798.8**	**3,964.0**

2009 Group	Carrying value	Gross nominal outflow	Less than 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
Non-derivative liabilities							
Deposits by banks	6,082.4	6,092.8	531.4	4,309.4	710.3	540.5	1.2
Customer accounts	30,828.2	30,894.6	21,020.5	1,173.6	6,330.9	2,369.6	–
Customer accounts – capital bonds	1,647.1	1,594.3	11.6	42.8	343.8	1,139.9	56.2
Debt securities in issue	3,334.3	4,256.5	570.0	232.6	898.0	2,515.7	40.2
Other borrowed funds	946.5	2,119.8	115.4	64.2	82.0	438.1	1,420.1
Amounts owed to other Co-operative Group undertakings	329.2	329.2	92.6	236.6	–	–	–
	43,167.7	45,287.2	22,341.5	6,059.2	8,365.0	7,003.8	1,517.7
Derivative liabilities							
Net outflow	591.3	773.1	89.1	34.8	217.7	377.6	53.9
	43,759.0	46,060.3	22,430.6	6,094.0	8,582.7	7,381.4	1,571.6
Other liabilities	503.7	–	–	–	–	–	–
Total recognised liabilities	44,262.7	46,060.3	22,430.6	6,094.0	8,582.7	7,381.4	1,571.6
Unrecognised loan commitments	4,642.3	4,642.3	4,517.8	60.7	–	63.8	–
Total liabilities	48,905.0	50,702.6	26,948.4	6,154.7	8,582.7	7,445.2	1,571.6

Liquidity risk continued

2010 Bank	**Carrying value**	**Gross nominal outflow**	**Less than 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**
Non-derivative liabilities							
Deposits by banks	**2,870.8**	**2,931.0**	**776.3**	**415.8**	**774.4**	**964.5**	**–**
Customer accounts	**29,912.0**	**30,129.8**	**18,708.1**	**1,633.5**	**6,328.4**	**3,459.8**	**–**
Customer accounts – capital bonds	**1,744.0**	**1,652.8**	**9.3**	**58.0**	**232.1**	**1,296.9**	**56.5**
Debt securities in issue	**1,856.8**	**1,951.6**	**291.6**	**672.5**	**297.0**	**249.5**	**441.0**
Other borrowed funds	**975.4**	**1,799.6**	**45.8**	**4.7**	**58.0**	**420.8**	**1,270.3**
Amounts owed to other Co-operative Group undertakings	**8,340.9**	**8,340.9**	**8,340.9**	**–**	**–**	**–**	**–**
	45,699.9	**46,805.7**	**28,172.0**	**2,784.5**	**7,689.9**	**6,391.5**	**1,767.8**
Derivative liabilities							
Net outflow	**697.4**	**774.6**	**142.9**	**34.7**	**119.0**	**291.6**	**186.4**
	46,397.3	**47,580.3**	**28,314.9**	**2,819.2**	**7,808.9**	**6,683.1**	**1,954.2**
Other liabilities	**314.1**	**–**	**–**	**–**	**–**	**–**	**–**
Total recognised liabilities	**46,711.4**	**47,580.3**	**28,314.9**	**2,819.2**	**7,808.9**	**6,683.1**	**1,954.2**
Unrecognised loan commitments	**4,619.5**	**4,619.5**	**4,359.3**	**62.5**	**188.2**	**9.5**	**–**
Total liabilities	**51,330.9**	**52,199.8**	**32,674.2**	**2,881.7**	**7,997.1**	**6,692.6**	**1,954.2**

2009 Bank	Carrying value	Gross nominal outflow	Less than 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
Non-derivative liabilities							
Deposits by banks	5,613.0	5,623.3	530.5	3,915.9	709.7	467.2	–
Customer accounts	28,660.0	28,736.8	19,694.8	910.6	5,798.4	2,324.0	9.0
Customer accounts – capital bonds	1,581.7	1,531.8	7.5	41.5	329.4	1,097.4	56.0
Debt securities in issue	1,739.3	1,592.0	568.4	189.9	93.6	700.0	40.1
Other borrowed funds	946.5	1,828.1	113.7	60.9	65.6	318.5	1,269.4
Amounts owed to other Co-operative Group undertakings	5,765.0	5,765.0	5,528.4	236.6	–	–	–
	44,305.5	45,077.0	26,443.3	5,355.4	6,996.7	4,907.1	1,374.5
Derivative liabilities							
Net outflow	567.2	567.2	92.8	12.3	43.1	320.2	98.8
	44,872.7	45,644.2	26,536.1	5,367.7	7,039.8	5,227.3	1,473.3
Other liabilities	446.9	–	–	–	–	–	–
Total recognised liabilities	45,319.6	45,644.2	26,536.1	5,367.7	7,039.8	5,227.3	1,473.3
Unrecognised loan commitments	4,604.3	4,604.3	4,479.8	60.7	–	63.8	–
Total liabilities	49,923.9	50,248.5	31,015.9	5,428.4	7,039.8	5,291.1	1,473.3

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Liquidity risk continued

Gross expected cashflow maturity analysis – behavioural

The following is an analysis of gross expected cash flow maturity. Liquidity cash flows are managed on a behavioural basis reflecting the actual behaviour of customers based on historic cash flow profiles over a period of ten years.

2010 Group	**Carrying value**	**Gross nominal outflow**	**Less than 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**
Non-derivative liabilities							
Deposits by banks	**2,938.6**	**2,931.0**	**776.3**	**415.8**	**774.4**	**964.5**	**–**
Customer accounts	**32,320.0**	**32,588.7**	**2,187.8**	**2,091.0**	**4,213.8**	**24,096.1**	**–**
Customer accounts – capital bonds	**1,794.7**	**1,749.4**	**11.4**	**64.1**	**254.8**	**1,362.6**	**56.5**
Debt securities in issue	**4,212.2**	**4,980.8**	**303.9**	**670.0**	**397.4**	**1,172.4**	**2,437.1**
Other borrowed funds	**975.4**	**1,799.6**	**45.8**	**4.7**	**58.0**	**420.8**	**1,270.3**
Amounts owed to other Co-operative Group undertakings	**188.5**	**188.5**	**188.5**	**–**	**–**	**–**	**–**
	42,429.4	**44,238.0**	**3,513.7**	**3,245.6**	**5,698.4**	**28,016.4**	**3,763.9**
Derivative liabilities							
Net outflow	**702.4**	**794.2**	**139.5**	**37.5**	**121.6**	**295.5**	**200.1**
	43,131.8	**45,032.2**	**3,653.2**	**3,283.1**	**5,820.0**	**28,311.9**	**3,964.0**
Other liabilities	**376.4**	**–**	**–**	**–**	**–**	**–**	**–**
Total recognised liabilities	**43,508.2**	**45,032.2**	**3,653.2**	**3,283.1**	**5,820.0**	**28,311.9**	**3,964.0**
Unrecognised loan commitments	**4,759.5**	**4,759.5**	**4,499.3**	**62.5**	**188.2**	**9.5**	**–**
Total liabilities	**48,267.7**	**49,791.7**	**8,152.5**	**3,345.6**	**6,008.2**	**28,321.4**	**3,964.0**

2009 Group	Carrying value	Gross nominal outflow	Less than 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
Non-derivative liabilities							
Deposits by banks	6,082.4	6,092.7	531.4	4,309.3	710.3	540.5	1.2
Customer accounts	30,828.2	30,880.9	1,954.3	2,339.6	4,638.9	21,948.1	–
Customer accounts – capital bonds	1,647.1	1,594.3	11.6	42.8	343.8	1,139.9	56.2
Debt securities in issue	3,334.3	4,256.5	570.0	232.6	898.0	2,515.7	40.2
Other borrowed funds	946.5	2,119.8	115.4	64.2	82.0	438.1	1,420.1
Amounts owed to other Co-operative Group undertakings	329.2	329.2	92.6	236.6	–	–	–
	43,167.7	45,273.4	3,275.3	7,225.1	6,673.0	26,582.3	1,517.7
Derivative liabilities							
Net outflow	591.3	773.1	89.1	34.8	217.7	377.6	53.9
	43,759.0	46,046.5	3,364.4	7,259.9	6,890.7	26,959.9	1,571.6
Other liabilities	503.7	–	–	–	–	–	–
Total recognised liabilities	44,262.7	46,046.5	3,364.4	7,259.9	6,890.7	26,959.9	1,571.6
Unrecognised loan commitments	5,016.2	5,016.2	4,891.7	60.7	–	63.8	–
Total liabilities	49,278.9	51,062.7	8,256.1	7,320.6	6,890.7	27,023.7	1,571.6

Liquidity risk continued

2010 Bank	**Carrying value**	**Gross nominal outflow**	**Less than 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**
Non-derivative liabilities							
Deposits by banks	**2,870.8**	**2,931.0**	**776.3**	**415.8**	**774.4**	**964.5**	**–**
Customer accounts	**29,912.0**	**30,129.8**	**1,871.3**	**1,622.6**	**3,730.7**	**22,905.2**	**–**
Customer accounts – capital bonds	**1,744.0**	**1,637.4**	**9.3**	**58.0**	**231.7**	**1,283.6**	**54.8**
Debt securities in issue	**1,856.8**	**1,951.6**	**291.6**	**672.5**	**297.0**	**249.5**	**441.0**
Other borrowed funds	**975.4**	**1,799.6**	**45.8**	**4.7**	**58.0**	**420.8**	**1,270.3**
Amounts owed to other Co-operative Group undertakings	**8,340.9**	**8,340.9**	**8,340.9**	**–**	**–**	**–**	**–**
	45,699.9	**46,790.3**	**11,335.2**	**2,773.6**	**5,091.8**	**25,823.6**	**1,766.1**
Derivative liabilities							
Net outflow	**697.4**	**774.6**	**142.9**	**34.7**	**119.0**	**291.6**	**186.4**
	46,397.3	**47,564.9**	**11,478.1**	**2,808.3**	**5,210.8**	**26,115.2**	**1,952.5**
Other liabilities	**314.1**	**–**	**–**	**–**	**–**	**–**	**–**
Total recognised liabilities	**46,711.4**	**47,564.9**	**11,478.1**	**2,808.3**	**5,210.8**	**26,115.2**	**1,952.5**
Unrecognised loan commitments	**4,619.5**	**4,619.5**	**4,359.3**	**62.5**	**188.2**	**9.5**	**–**
Total liabilities	**51,330.9**	**52,184.4**	**15,837.4**	**2,870.8**	**5,399.0**	**26,124.7**	**1,952.5**

2009 Bank	Carrying value	Gross nominal outflow	Less than 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
Non-derivative liabilities							
Deposits by banks	5,613.0	5,623.3	530.5	3,915.9	709.7	467.2	–
Customer accounts	28,660.0	28,715.9	1,498.4	1,207.2	4,106.5	21,903.8	–
Customer accounts – capital bonds	1,581.7	1,531.8	7.5	41.5	329.4	1,097.4	56.0
Debt securities in issue	1,739.3	1,592.0	568.4	189.9	93.6	700.0	40.1
Other borrowed funds	946.5	1,828.1	113.7	60.9	65.6	318.5	1,269.4
Amounts owed to other Co-operative Group undertakings	5,765.0	5,765.0	5,528.4	236.6	–	–	–
	44,305.5	45,056.1	8,246.9	5,652.0	5,304.8	24,486.9	1,365.5
Derivative liabilities							
Net outflow	567.2	567.2	92.8	12.3	43.1	320.2	98.8
	44,872.7	45,623.3	8,339.7	5,664.3	5,347.9	24,807.1	1,464.3
Other liabilities	446.9	–	–	–	–	–	–
Total recognised liabilities	45,319.6	45,623.3	8,339.7	5,664.3	5,347.9	24,807.1	1,464.3
Unrecognised loan commitments	4,760.6	4,760.6	4,636.1	60.7	–	63.8	–
Total liabilities	50,080.2	50,383.9	12,975.8	5,725.0	5,347.9	24,870.9	1,464.3

Demand deposits are shown as less than one month in the analysis above.

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Fair values of financial assets and liabilities

The table below sets out a summary of the carrying and fair values of those financial assets and liabilities not presented on the Group and Bank balance sheets at fair value unless there is no significant difference between carrying and fair values.

Category (as defined by IAS 39)	Class (as determined by the Group)	Group		Bank	
		Carrying Value	Fair Value	Carrying Value	Fair Value
2010					
Financial assets					
Loans and receivables					
	Loans and advances to banks	**2,394.1**	**2,391.8**	**1,728.6**	**1,726.3**
	Loans and advances to customers	**35,144.1**	**35,771.0**	**24,009.5**	**24,510.1**
	Investment securities	**1,917.3**	**2,036.4**	**1,986.8**	**2,119.6**
Financial liabilities					
Financial liabilities at amortised cost					
	Deposits by banks	**2,938.6**	**2,971.1**	**2,870.8**	**2,903.3**
	Customer accounts	**32,320.0**	**32,400.8**	**29,912.0**	**29,985.7**
	Debt securities in issue	**4,212.2**	**4,831.7**	**1,856.8**	**1,898.6**
	Other borrowed funds	**975.4**	**1,107.4**	**975.4**	**1,107.4**

		Group		Bank	
		Carrying Value	Fair Value	Carrying Value	Fair Value
2009					
Financial assets					
Loans and receivables					
	Loans and advances to banks	1,781.5	1,780.5	1,220.1	1,219.1
	Loans and advances to customers	34,139.8	34,758.0	23,111.4	23,463.8
	Investment securities	2,486.2	2,489.4	2,555.6	2,558.8
Financial liabilities					
Financial liabilities at amortised cost					
	Deposits by banks	6,082.4	6,084.7	5,613.0	5,615.3
	Customer accounts	30,828.2	30,919.6	28,660.0	28,747.0
	Debt securities in issue	3,334.3	2,475.2	1,739.3	1,739.8
	Other borrowed funds	946.5	787.0	946.5	787.0

Key considerations in the calculation of fair values are as follows:

(a) Loans and advances to banks/deposits by banks

Loans and advances to banks include interbank placements and items in the course of collection.

The fair value of floating rate placements and overnight deposits is their carrying amount. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity. A credit loss adjustment has been applied based on expected loss amounts derived from the Bank's regulatory capital calculations.

(b) Loans and advances to customers

Fixed rate loans and advances to customers are revalued to fair value based on future interest cash flows (at funding rates) and principal cash flows discounted using the zero coupon rate. Forecast principal repayments are based on redemption at the earlier of maturity or repricing date with some overlay for historic behavioural experience where relevant. The eventual timing of future cash flows may be different from the forecast due to unpredictable customer behaviour. It is assumed there is no fair value adjustment required in respect of interest rate movement on variable rate assets. A credit loss adjustment has been applied based on expected loss amounts derived from the Bank's regulatory capital calculations.

(c) Customer accounts

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

(d) Customer accounts – capital bonds

The estimated fair value of customer accounts - capital bonds is based on independent third party valuations using forecast future movements in the appropriate indices.

Fair values of financial assets and liabilities continued

(e) Debt securities in issue and other borrowed funds

The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

(f) Investment securities

Fair value is based on market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

(g) Derivatives

Futures and options are marked to market using listed market prices. For interest rate swaps, the estimated fair value is based on discounted cash flows using prevailing money market interest rates for instruments with similar remaining maturity.

Use of financial instruments

The use of financial instruments is essential to the Bank's business activities and financial instruments constitute a significant proportion of the Bank's assets and liabilities. Risk management procedures are described earlier in this report, and analysis of the financial instruments is provided in the notes to the financial statements.

The table below analyses financial instruments by measurement basis as defined by IAS 39.

Balance sheet categories	Held for Trading	Designated at fair value	Loans and receivables	Available for sale	Other amortised cost	Cash flow hedges	Total
2010							
Group							
Assets							
Cash and balances at central banks	–	–	**1,735.6**	–	–	–	**1,735.6**
Loans and advances to banks	–	–	**2,394.1**	–	–	–	**2,394.1**
Loans and advances to customers	–	**74.1**	**35,070.0**	–	–	–	**35,144.1**
Investment securities	–	**28.7**	**1,917.3**	**2,957.1**	–	–	**4,903.1**
Derivative financial instruments	**67.0**	**646.1**	–	–	–	**218.8**	**931.9**
Equity shares	–	–	–	**7.2**	–	–	**7.2**
Amounts owed by other Co-operative Group undertakings	–	–	**0.6**	–	–	–	**0.6**
Total financial assets	**67.0**	**748.9**	**41,117.6**	**2,964.3**	–	**218.8**	**45,116.6**
Non-financial assets							**464.7**
Total assets							**45,581.3**
Liabilities							
Deposits by banks	–	–	–	–	**2,938.6**	–	**2,938.6**
Customer accounts	–	–	–	–	**32,320.0**	–	**32,320.0**
Customer accounts – capital bonds	–	**1,794.7**	–	–	–	–	**1,794.7**
Debt securities in issue	–	–	–	–	**4,212.2**	–	**4,212.2**
Derivative financial instruments	**52.9**	**487.6**	–	–	–	**161.9**	**702.4**
Other borrowed funds	–	–	–	–	**975.4**	–	**975.4**
Amounts owed to other Co-operative Group undertakings	–	–	–	–	**188.5**	–	**188.5**
Total financial liabilities	**52.9**	**2,282.3**	–	–	**40,634.7**	**161.9**	**43,131.8**
Non-financial liabilities							**376.4**
Total liabilities							**43,508.2**
Capital and reserves							**2,073.1**
Total liabilities and equity							**45,581.3**

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Fair values of financial assets and liabilities continued
Use of financial instruments

Balance sheet categories	Held for Trading	Designated at fair value	Loans and receivables	Available for sale	Other amortised cost	Cash flow hedges	Total
2009							
Group							
Assets							
Cash and balances at central banks	–	–	1,706.8	–	–	–	1,706.8
Loans and advances to banks	–	–	1,781.5	–	–	–	1,781.5
Loans and advances to customers	–	48.2	34,091.6	–	–	–	34,139.8
Investment securities	–	–	2,486.2	4,457.3	–	–	6,943.5
Derivative financial instruments	48.9	855.5	–	–	–	118.6	1,023.0
Equity shares	–	–	–	7.2	–	–	7.2
Amounts owed by other Co-operative Group undertakings	–	–	91.0	–	–	–	91.0
Total financial assets	48.9	903.7	40,157.1	4,464.5	–	118.6	45,692.8
Non-financial assets							446.0
Total assets							46,138.8
Liabilities							
Deposits by banks	–	103.8	–	–	5,978.6	–	6,082.4
Customer accounts	–	–	–	–	30,828.2	–	30,828.2
Customer accounts – capital bonds	–	1,647.1	–	–	–	–	1,647.1
Debt securities in issue	–	–	–	–	3,334.3	–	3,334.3
Derivative financial instruments	40.2	480.6	–	–	–	70.5	591.3
Other borrowed funds	–	–	–	–	946.5	–	946.5
Amounts owed to other Co-operative Group undertakings	–	–	–	–	329.2	–	329.2
Total financial liabilities	40.2	2,231.5	–	–	41,416.8	70.5	43,759.0
Non-financial liabilities							503.7
Total liabilities							44,262.7
Capital and reserves							1,876.1
Total liabilities and equity							46,138.8

Fair values of financial assets and liabilities continued

Use of financial instruments

Balance sheet categories	Held for Trading	Designated at fair value	Loans and receivables	Available for sale	Other amortised cost	Cash flow hedges	Total
2010							
Bank							
Assets							
Cash and balances at central banks	–	–	1,735.6	–	–	–	1,735.6
Loans and advances to banks	–	–	1,728.6	–	–	–	1,728.6
Loans and advances to customers	–	74.1	23,935.4	–	–	–	24,009.5
Investment securities	–	28.7	1,986.8	2,621.4	–	–	4,636.9
Derivative financial instruments	70.4	371.8	–	–	–	218.8	661.0
Equity shares	–	–	–	7.2	–	–	7.2
Amounts owed by other Co-operative Group undertakings	–	–	14,233.7	–	–	–	14,233.7
Total financial assets	70.4	474.6	43,620.1	2,628.6	–	218.8	47,012.5
Non-financial assets							1,802.4
Total assets							48,814.9
Liabilities							
Deposits by banks	–	–	–	–	2,870.8	–	2,870.8
Customer accounts	–	–	–	–	29,912.0	–	29,912.0
Customer accounts – capital bonds	–	1,744.0	–	–	–	–	1,744.0
Debt securities in issue	–	–	–	–	1,856.8	–	1,856.8
Derivative financial instruments	56.3	479.2	–	–	–	161.9	697.4
Other borrowed funds	–	–	–	–	975.4	–	975.4
Amounts owed to other Co-operative Group undertakings	–	5,848.7	–	–	2,492.2	–	8,340.9
Total financial liabilities	56.3	8,071.9	–	–	38,107.2	161.9	46,397.3
Non-financial liabilities							314.1
Total liabilities							46,711.4
Capital and reserves							2,103.5
Total liabilities and equity							48,814.9

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Fair values of financial assets and liabilities continued
Use of financial instruments

Balance sheet categories	Held for Trading	Designated at fair value	Loans and receivables	Available for sale	Other amortised cost	Cash flow hedges	Total
2009							
Bank							
Assets							
Cash and balances at central banks	–	–	1,706.8	–	–	–	1,706.8
Loans and advances to banks	–	–	1,220.1	–	–	–	1,220.1
Loans and advances to customers	–	48.2	23,063.2	–	–	–	23,111.4
Investment securities	–	–	2,555.6	4,060.6	–	–	6,616.2
Derivative financial instruments	52.7	489.5	–	–	–	118.6	660.8
Equity shares	–	–	–	7.2	–	–	7.2
Amounts owed by other Co-operative Group undertakings	–	–	11,861.6	–	–	–	11,861.6
Total financial assets	52.7	537.7	40,407.3	4,067.8	–	118.6	45,184.1
Non-financial assets							2,003.0
Total assets							47,187.1
Liabilities							
Deposits by banks	–	103.8	–	–	5,509.2	–	5,613.0
Customer accounts	–	–	–	–	28,660.0	–	28,660.0
Customer accounts – capital bonds	–	1,581.7	–	–	–	–	1,581.7
Debt securities in issue	–	–	–	–	1,739.3	–	1,739.3
Derivative financial instruments	43.8	452.9	–	–	–	70.5	567.2
Other borrowed funds	–	–	–	–	946.5	–	946.5
Amounts owed to other Co-operative Group undertakings	–	3,397.6	–	–	2,367.4	–	5,765.0
Total financial liabilities	43.8	5,536.0	–	–	39,222.4	70.5	44,872.7
Non-financial liabilities							446.9
Total liabilities							45,319.6
Capital and reserves							1,867.5
Total liabilities and equity							47,187.1

Fair values of financial assets and liabilities continued

Valuation of financial instruments

The following table analyses financial assets and liabilities at fair value by the three level fair value hierarchy as defined within IFRS 7.

Group 2010		**Fair value measurement at end of the reporting period using:**			
Category (as defined by IAS 39)	**Class (as determined by the Group)**	**Quoted market prices in active markets Level 1**	**Valuation techniques using observable inputs Level 2**	**Valuation techniques using unobservable inputs Level 3**	**Total**
Financial assets					
Loans and receivables designated at fair value					
	Loans and advances to customers	**–**	**62.3**	**11.8**	**74.1**
	Total loans and receivables designated at fair value	**–**	**62.3**	**11.8**	**74.1**
Available for sale financial assets					
	Investment securities – available for sale	**902.9**	**2,054.2**	**–**	**2,957.1**
	Investment securities – designated at fair value	**–**	**28.7**	**–**	**28.7**
	Equity shares	**–**	**–**	**7.2**	**7.2**
	Total available for sale financial assets	**902.9**	**2,082.9**	**7.2**	**2,993.0**
Derivative financial instruments					
	Interest rate swaps				
	– designated as fair value hedges	**–**	**75.0**	**–**	**75.0**
	– designated as cash flow hedges	**–**	**218.8**	**–**	**218.8**
	– at fair value through income and expense	**–**	**90.1**	**–**	**90.1**
	Other	**–**	**548.0**	**–**	**548.0**
	Total derivative financial instruments	**–**	**931.9**	**–**	**931.9**
Total assets carried at fair value		**902.9**	**3,077.1**	**19.0**	**3,999.0**

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Fair values of financial assets and liabilities continued
Valuation of financial instruments

Group 2010		**Fair value measurement at end of the reporting period using:**			
Category (as defined by IAS 39)	**Class (as determined by the Group)**	**Quoted market prices in active markets Level 1**	**Valuation techniques using observable inputs Level 2**	**Valuation techniques using unobservable inputs Level 3**	**Total**
Financial liabilities					
Financial liabilities designated at fair value					
	Capital bonds	**–**	**1,794.7**	**–**	**1,794.7**
	Total financial liabilities designated at fair value	**–**	**1,794.7**	**–**	**1,794.7**
Derivative financial instruments					
	Interest rate swaps				
	– designated as fair value hedges	**–**	**411.0**	**–**	**411.0**
	– designated as cash flow hedges	**–**	**161.9**	**–**	**161.9**
	– at fair value through income and expense	**–**	**86.6**	**–**	**86.6**
	Cross currency interest rate swaps				
	– designated as fair value hedges	**–**	**1.2**	**–**	**1.2**
	Other	**–**	**41.7**	**–**	**41.7**
	Total derivative financial instruments	**–**	**702.4**	**–**	**702.4**
Total liabilities carried at fair value		**–**	**2,497.1**	**–**	**2,497.1**

Fair values of financial assets and liabilities continued

Valuation of financial instruments

Group 2009		Fair value measurement at end of the reporting period using:			
Category (as defined by IAS 39)	**Class (as determined by the Group)**	Quoted market prices in active markets Level 1	Valuation techniques using observable inputs Level 2	Valuation techniques using unobservable inputs Level 3	Total
Financial assets					
Loans and receivables designated at fair value					
	Loans and advances to customers	–	36.4	11.8	48.2
	Total loans and receivables designated at fair value	–	36.4	11.8	48.2
Available for sale financial assets					
	Investment securities – available for sale	942.7	3,514.6	–	4,457.3
	Equity shares	–	–	7.2	7.2
	Total available for sale financial assets	942.7	3,514.6	7.2	4,464.5
Derivative financial instruments					
	Interest rate swaps				
	– designated as fair value hedges	–	0.5	–	0.5
	– designated as cash flow hedges	–	118.1	–	118.1
	– at fair value through income and expense	–	170.1	–	170.1
	Cross currency interest rate swaps				
	– designated as fair value hedges	–	635.5	–	635.5
	Other	–	98.8	–	98.8
	Total derivative financial instruments	–	1,023.0	–	1,023.0
Total assets carried at fair value		942.7	4,574.0	19.0	5,535.7

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Fair values of financial assets and liabilities continued
Valuation of financial instruments

Group
2009

Category (as defined by IAS 39)	**Class (as determined by the Group)**	Fair value measurement at end of the reporting period using: Quoted market prices in active markets Level 1	Valuation techniques using observable inputs Level 2	Valuation techniques using unobservable inputs Level 3	Total
Financial liabilities					
Financial liabilities designated at fair value					
	Deposits from banks	–	103.8	–	103.8
	Capital bonds	–	1,647.1	–	1,647.1
	Total financial liabilities designated at fair value	–	1,750.9	–	1,750.9
Derivative financial instruments					
	Interest rate swaps				
	– designated as cash flow hedges	–	70.5	–	70.5
	– at fair value through income and expense	–	479.1	–	479.1
	Other	–	41.7	–	41.7
	Total derivative financial instruments	–	591.3	–	591.3
Total liabilities carried at fair value		–	2,342.2	–	2,342.2

The floating rate notes within available for sale assets have been restated from level 1 to level 2 in 2009 in line with emerging industry practice.

Fair values of financial assets and liabilities continued

Valuation of financial instruments

Bank 2010		**Fair value measurement at end of the reporting period using:**			
Category (as defined by IAS 39)	**Class (as determined by the Group)**	**Quoted market prices in active markets Level 1**	**Valuation techniques using observable inputs Level 2**	**Valuation techniques using unobservable inputs Level 3**	**Total**
Financial assets					
Loans and receivables designated at fair value					
	Loans and advances to customers	**–**	**62.3**	**11.8**	**74.1**
	Total loans and receivables designated at fair value	**–**	**62.3**	**11.8**	**74.1**
Available for sale financial assets					
	Investment securities – available for sale	**902.9**	**1,718.5**	**–**	**2,621.4**
	Investment securities – designated at fair value	**–**	**28.7**	**–**	**28.7**
	Equity shares	**–**	**–**	**7.2**	**7.2**
	Total available for sale financial assets	**902.9**	**1,747.2**	**7.2**	**2,657.3**
Derivative financial instruments					
	Interest rate swaps				
	– designated as fair value hedges	**–**	**75.0**	**–**	**75.0**
	– designated as cash flow hedges	**–**	**218.8**	**–**	**218.8**
	– at fair value through income and expense	**–**	**74.1**	**34.0**	**108.1**
	Other	**–**	**259.1**	**–**	**259.1**
	Total derivative financial instruments	**–**	**627.0**	**34.0**	**661.0**
Total assets carried at fair value		**902.9**	**2,436.5**	**53.0**	**3,392.4**

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Fair values of financial assets and liabilities continued
Valuation of financial instruments

Bank 2010		**Fair value measurement at end of the reporting period using:**			
Category (as defined by IAS 39)	**Class (as determined by the Group)**	**Quoted market prices in active markets Level 1**	**Valuation techniques using observable inputs Level 2**	**Valuation techniques using unobservable inputs Level 3**	**Total**
Financial liabilities					
Financial liabilities designated at fair value					
	Capital bonds	**–**	**1,744.0**	**–**	**1,744.0**
	Amounts owed to other Co-operative Group undertakings	**–**	**–**	**5,848.7**	**5,848.7**
	Total financial liabilities designated at fair value	**–**	**1,744.0**	**5,848.7**	**7,592.7**
Derivative financial instruments					
	Interest rate swaps				
	– designated as fair value hedges	**–**	**403.8**	**–**	**403.8**
	– designated as cash flow hedges	**–**	**161.9**	**–**	**161.9**
	– at fair value through income and expense	**–**	**67.5**	**21.3**	**88.8**
	Cross currency interest rate swaps				
	– designated as fair value hedges	**–**	**1.2**	**–**	**1.2**
	Other	**–**	**41.7**	**–**	**41.7**
	Total derivative financial instruments	**–**	**676.1**	**21.3**	**697.4**
Total liabilities carried at fair value		**–**	**2,420.1**	**5,870.0**	**8,290.1**

Fair values of financial assets and liabilities continued

Valuation of financial instruments

Bank
2009

Category (as defined by IAS 39)	**Class (as determined by the Group)**	Fair value measurement at end of the reporting period using: Quoted market prices in active markets Level 1	Valuation techniques using observable inputs Level 2	Valuation techniques using unobservable inputs Level 3	Total
Financial assets					
Loans and receivables designated at fair value					
	Loans and advances to customers	–	36.4	11.8	48.2
	Total loans and receivables designated at fair value	–	36.4	11.8	48.2
Available for sale financial assets					
	Investment securities – available for sale	942.7	3,117.9	–	4,060.6
	Equity shares	–	–	7.2	7.2
	Total available for sale financial assets	942.7	3,117.9	7.2	4,067.8
Derivative financial instruments					
	Interest rate swaps				
	– designated as fair value hedges	–	0.5	–	0.5
	– designated as cash flow hedges	–	118.1	–	118.1
	– at fair value through income and expense	–	170.1	39.2	209.3
	Cross currency interest rate swaps				
	– designated as fair value hedges	–	233.1	–	233.1
	Other	–	99.8	–	99.8
	Total derivative financial instruments	–	621.6	39.2	660.8
Total assets carried at fair value		942.7	3,775.9	58.2	4,776.8

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Fair values of financial assets and liabilities continued
Valuation of financial instruments

Bank
2009

Category (as defined by IAS 39)	**Class (as determined by the Group)**	Fair value measurement at end of the reporting period using: Quoted market prices in active markets Level 1	Valuation techniques using observable inputs Level 2	Valuation techniques using unobservable inputs Level 3	Total
Financial liabilities					
Financial liabilities designated at fair value					
	Deposits from banks	–	103.8	–	103.8
	Capital bonds	–	1,581.7	–	1,581.7
	Amounts owed to other Co-operative Group undertakings	–	–	3,397.6	3,397.6
	Total financial liabilities designated at fair value	–	1,685.5	3,397.6	5,083.1
Derivative financial instruments					
	Interest rate swaps				
	– designated as cash flow hedges	–	70.5	–	70.5
	– at fair value through income and expense	–	444.7	–	444.7
	Cross currency interest rate swaps				
	– designated as fair value hedges	–	11.9	–	11.9
	Other	–	40.1	–	40.1
	Total derivative financial instruments	–	567.2	–	567.2
Total liabilities carried at fair value		–	2,252.7	3,397.6	5,650.3

The floating rate notes within available for sale assets have been restated from level 1 to level 2 in 2009 in line with emerging industry practice.

Fair values of financial assets and liabilities continued

Movements in fair values of instruments with significant unobservable inputs were:

2010	Fair value at the beginning of the year	Purchases	Sales	Transfer of engagements	Profit or loss including impairment	Fair value at the end of the year
Group						
Loans and advances to customers	**11.8**	**–**	**–**	**–**	**–**	**11.8**
Equity shares	**7.2**	**–**	**–**	**–**	**–**	**7.2**
	19.0	**–**	**–**	**–**	**–**	**19.0**
Bank						
Loans and advances to customers	**11.8**	**–**	**–**	**–**	**–**	**11.8**
Derivative assets	**39.2**	**–**	**–**	**–**	**(5.2)**	**34.0**
Equity shares	**7.2**	**–**	**–**	**–**	**–**	**7.2**
Derivative liabilities	**–**	**–**	**–**	**–**	**(21.3)**	**(21.3)**
Amounts owed to other Co-operative Group undertakings	**(3,397.6)**	**(3,076.2)**	**625.1**	**–**	**–**	**(5,848.7)**
	(3,339.4)	**(3,076.2)**	**625.1**	**–**	**(26.5)**	**(5,817.0)**

2009	Fair value at the beginning of the year	Purchases	Sales	Transfer of engagements	Profit or loss including impairment	Fair value at the end of the year
Group						
Loans and advances to customers	13.8	(0.5)	–	–	(1.5)	11.8
Equity shares	8.8	–	–	1.5	(3.1)	7.2
	22.6	(0.5)	–	1.5	(4.6)	19.0
Bank						
Loans and advances to customers	13.8	(0.5)	–	–	(1.5)	11.8
Derivatives	29.9	–	–	–	9.3	39.2
Equity shares	8.8	–	–	1.5	(3.1)	7.2
Amounts owed to other Co-operative Group undertakings	(1,996.3)	(250.7)	648.9	(1,799.5)	–	(3,397.6)
	(1,943.8)	(251.2)	648.9	(1,798.0)	4.7	(3,339.4)

Valuation techniques

Fair values are determined according to the following hierarchy:

(a) Level 1 – Quoted market prices in active markets

Financial instruments with quoted prices for identical instruments in active markets. The best evidence of fair value is a quoted market price in an actively traded market.

(b) Level 2 – Valuation techniques using observable inputs

Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

The valuation techniques used to value these instruments employ only observable market data and relate to the following assets and liabilities:

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Fair values of financial assets and liabilities continued

Loans and advances to customers
Loans and advances to customers include corporate loans of £62.3m (2009: £36.4m) which are fair valued through income or expense using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

Investment securities – available for sale
Debt securities classified under valuation techniques using observable inputs are described in the critical judgments section on page 79.

Derivative financial instruments
OTC (ie non-exchange traded) derivatives are valued using valuation models which are based on observable market data. Valuation models calculate the present value of expected future cash flows, based upon 'no arbitrage' principles. The Bank enters into vanilla foreign exchange and interest rate swap derivatives, for which modelling techniques are standard across the industry. Examples of inputs that are generally observable include foreign exchange spot and forward rates, and benchmark interest rate curves.

(c) Level 3 – Valuation techniques using unobservable inputs
This is used for financial instruments valued using models where one or more significant inputs are not observable.

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

Loans and advances to customers
Loans and advances to customers include 25 year fixed rate mortgages £11.8m (2009: £11.8m) which are fair valued through income or expense using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (5 years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has decreased the valuation by £0.1m in 2010 (2009: increase of £0.2m). A reasonable change in the assumptions would not result in any material change in the valuation.

Equity shares
Primarily, equity shares relate to investments held in Vocalink Limited which are unquoted shares. The valuation of such shares is based on our percentage shareholding of the most recent public information valuation issued by the company.

Derivative financial instruments
Derivative financial instruments including internal interest rate swaps have been entered into during the year between the Bank and The Covered Bond LLP (LLP) and the Bank and Silk Road Finance Number One (Silk Rd 1).

The purpose of the swap is to convert the fixed and base rate linked revenue receipts of the pool of mortgage assets to the same LIBOR linked basis as the intercompany loan. Under this swap arrangement the LLP or Silk Rd 1 pays to the swap counterparty, the monthly mortgage revenue receipts of the pool of assets and receives from the swap counterparty LIBOR plus a contractual spread on the same notional balance; the spread being sufficient to cover the intercompany loan and any expenses.

The swap is valued based on an assumed amortisation profile of the pool of assets to the bond maturity date (assuming some annual prepayment), an assumed profile of customer receipts over this period, and LIBOR prediction using forward rates. Swap cash flows are discounted to present value using mid-yield curve zero coupon rates, ie no adjustment is made for credit losses, nor for transaction or any other costs.

The fair value of the swap is based on a valuation model that reflects the mortgage cash flows over a three year period using a discount rate based on LIBOR spreads. This derivative eliminates on consolidation.

Amounts owed to other Co-operative Group undertakings
Deposits from customers includes deposits by the LLP and Silk Rd 1 subsidiaries relating to the legal transfer of loans and advances on issue of the Bank's covered bonds and securitisation. The deposit is fair valued to eliminate an accounting mismatch of the swap derivative as discussed above.

Revaluation of the £5.9bn (2009: £3.4bn) mortgage pool from carrying to fair value is based on assumed timing of future mortgage capital and revenue receipts, discounted to present value using a credit adjusted discount rate.

The amortisation profile is as per the swaps valuation methodology, assuming some annual prepayment, but is extended beyond any bond maturity, until all the mortgages themselves mature, which is circa 25 years. Similarly, the revenue receipts are calculated as per the swap valuation methodology, but extended until all the mortgages mature. For fixed rate mortgages, revenue receipts are based on fixed customer rates within the assumed amortisation profile. For tracker, SVR and discount products, revenue receipts are assumed to be based on forward LIBOR rates plus the product margins. Fixed and tracker mortgages are assumed to revert to SVR at the end of any offer period. All mortgages in the covered bond pool were originated pre 31 December 2007.

The fair value of the swap is based on a valuation model that reflects the mortgage cash flows over a three year period using a discount rate based on LIBOR spreads. This derivative eliminates on consolidation.

Primary financial instruments used by the Bank

The main financial instruments used by the Bank, and the purposes for which they are held, are outlined below:

Customer loans and deposits

The provision of banking facilities to customers is the prime activity of the Bank and customer loans and deposits are major constituents of the balance sheet. Customer loans include retail mortgages, corporate loans, credit cards, unsecured retail lending and overdrafts. Customer deposits include retail and corporate current and saving accounts. The Bank has detailed policies and procedures to manage risks. In addition to mortgage lending, much of the lending to corporate and business banking customers is secured.

Debt securities, wholesale market loans and deposits

Debt securities include structured investments and credit trading vehicles. Further details are provided in critical judgments on page 79. Debt securities also underpin the Bank's liquidity requirements and generate incremental net interest and trading income.

The Bank issues medium term notes within an established euro medium term note programme and also issues certificates of deposit and commercial paper as part of its normal treasury activities. These sources of funds alongside wholesale market loans are invested in marketable, investment grade debt securities, short term wholesale market placements and used to fund customer loans.

Capital funds – subordinated note issues and preference shares

The Bank has a policy of maintaining prudent capital ratios and utilises a broad spread of capital funds. In addition to ordinary share capital and retained earnings, the Bank has issued £60m preference shares and, when appropriate, also issues perpetual and fixed term subordinated notes.

Foreign exchange

The Bank undertakes foreign exchange dealing to facilitate customer requirements and to generate incremental income from short term trading in the major currencies. Structured risk and trading related risk are managed formally within position limits approved by the Board.

Derivatives

A derivative is a financial instrument that derives its value from an underlying rate or price such as interest rates, exchange rates and other market prices. Derivatives are an efficient means of managing market risk and limiting counterparty exposure. The Bank uses them mainly for hedging purposes and to meet the needs of customers.

The most frequently used derivative contracts are interest rate swaps, exchange traded futures and options, caps and floors, forward rate agreements, currency swaps and forward currency transactions. Terms and conditions are determined by using standard industry documentation. Derivatives are subject to the same market and credit risk control procedures as are applied to other wholesale market instruments and are aggregated with other exposures to monitor total counterparty exposure which is managed within approved limits for each counterparty.

Risk management continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

Unaudited risk management disclosures
The following risk management disclosure, operational risk and additional risks do not form part of the audited accounts and are not audited.

Operational risk
Operational risk is defined within CFS as 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.

Examples of such include internal and external fraud, loss or theft of confidential customer information, loss of key personnel, system capacity issues or program failure, process failures affecting payment settlement and external events over which CFS has limited controls such as terrorist attack, floods and contagious disease.

Operational risks are identified, managed and mitigated through ongoing risk management practices including risk assessments, formal control procedures, training, segregation of duties, delegated authorities and contingency planning. Operational risks are formally reviewed on a regular basis. Significant operational risks are regularly reported to executive directors, a management operational risk committee, and the ARCC (a formal Board sub-committee). These meet regularly to monitor the suitability of the risk management framework and management of significant risks within CFS. Capital requirements in relation to operational risk are monitored by the RMC.

Business continuity is managed from within the operational risk team and sets out to take appropriate steps to minimise the risk of disruption in the event of a sudden, unplanned occurrence that could seriously disrupt customer service, or pose a risk to employees, business operations and/or reputation. This includes developing and exercising crisis and incident management teams to maintain appropriate preparedness in the event of a major operational disruption. 2010 has seen a continued focus on developing our capability to respond to these threats.

CFS also has a corporate insurance programme to transfer specific risks to insurers as part of its risk management approach.

During 2009–2012 CFS has a significant change agenda to integrate and transform the combined business. Delivery and implementation of this change agenda is robustly planned and closely managed to ensure delivery is within clearly defined time, cost and quality criteria. As part of this the impact on the CFS operational risk profile (especially in terms of impact on our people, processes and systems) is assessed and managed (both in terms of reduction of risks through implementation of enhanced systems, and through close management of implementation of change).

Additional risks
In addition to the significant risks covered above, the following risks are also reported and managed in the CFS risk management framework:

- group wide risks, to include pensions, reputational and contagion risk;
- business risk; and
- securitisation risk.

Group wide risks

Pensions risk: the risk of the Group being unable to meet pension scheme commitments. Risks are identified at The Co-operative Group level, with the impact of any potential changes to contribution assessed under the Bank risk management framework.

The combined entity is exposed to two distinct areas of pension risk:

- PACE – CFS Management Services Ltd (CFSMS) and the Bank are participating members of The Co-operative Group Pension (Average Career Earnings) – defined benefit scheme; and
- Britannia Pension Scheme – the Bank is a participating member of the Britannia Pension Scheme – defined benefit and contribution sections (defined benefit section closed to new members since 2001).

The Co-operative Group, alongside the scheme trustees, are responsible for the risk management arrangements for PACE, agreeing suitable contribution rates, investment strategies and for taking professional advice as appropriate.

CFSMS, alongside the scheme trustee, are responsible for the risk management arrangements for the Britannia Pension Scheme, agreeing suitable contribution rates, investment strategies and for taking professional advice as appropriate.

The Bank is therefore exposed to potential future increases in required contributions.

Reputational risk: failure to proactively develop, protect and optimise the value of the brands of the CFS group of companies through inappropriate strategic decisions, poor business performance, or operational failure. Reputational risks are identified at the Bank entity level. As part of the assessment of this risk, we consider the impact of other CFS entities and Co-operative Group entities to the Bank.

Contagion risk: risks originating from elsewhere in the Group impacting upon the Bank.

Business risk

Business risk arises from changes to the Bank's business, specifically the risk of not being able to carry out the Bank's business plan and desired strategy.

Securitisation risk

Securitisation is the process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities. This allows the credit quality of the assets to be separated from the credit rating of the original company and transfers risk to external investors. The Bank has established securitisation structures as part of its funding and capital management activities. These securitisation structures use retail mortgages as the asset pool.

Asset based securitisation is 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.

Securitisation risk is the residual credit risk arising from retaining an interest in the Bank's securitisation companies through the provision of subordinated debt and/or start up expense loans where applicable. The Bank has historically entered into securitisation transactions in which it sells mortgages to special purpose entities (SPEs). These SPEs are included as subsidiaries in the consolidated financial statements. The Bank continues to recognise these securitised assets as loans and advances to customers on the balance sheet and income from the securitised assets continues to be recognised as income. Securitisations provide a committed and linked source of funding for higher risk mortgage lending.

The Bank has 14 years' experience of issuing securitisations under various programmes, and has built up a depth of knowledge, processes and management information to deal effectively with these funding vehicles. Securitisation has historically been used as part of a balanced portfolio management approach whilst helping to increase the diversification of funding sources available whilst managing maturity mismatch risk and also assisting overall credit risk management.

The appetite for securitisation risk is cautious, and the Bank has only acted as mortgage originator and servicing agent. The Bank does not provide liquidity facilities, bridging loans or repackaging, nor does it act as underwriter or dealer in the securitisations. All transactions have relevant accounting and legal advice to ensure compliance with applicable regulatory/statutory rules and are also approved at Board level.

The Bank entered into one securitisation transaction in February 2010, Silk Rd 1, which was not subject to significant risk transfer rules under BIPRU 9.
The transaction, rated by Fitch and Moody's re-established the Bank's presence in debt capital markets following the merger with Britannia Building Society in August 2009. Silk Rd 1 generated £2.5bn of Class A1 notes – £375m were publicly placed with third party investors, £1.0bn was pre-placed with a JPMorgan affiliate and £1.125bn was retained by the Bank.

Capital management

For the year ended 31 December 2010

All amounts are stated in £m unless otherwise indicated

Capital resources

The Group's policy is to maintain a strong base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Group's policy is to be more prudent than industry norms by having a higher proportion of core tier one as the Group is not able to raise equity externally. However, the Group still recognises the need to maintain a balance between the potential higher returns that might be achieved with greater gearing, and the advantages and security afforded by a sound capital position.

On 15 December 2010, the Bank issued £180.0m of share capital to its immediate parent company the Co-operative Financial Services Limited. The transaction was to ensure that the Bank was in a position of strength in preparation for the implementation of new Basel III minimum equity ratio requirements.

Our submissions to the FSA in the year have shown that the Group and its individually regulated operations have complied with all externally imposed capital requirements throughout the period.

There have been no material changes in the Group's management of capital during the year.

	2010	2009
Core tier one capital		
Permanent share capital	**410.0**	230.0
Retained earnings	**1,562.8**	1,454.2
Minority interest	**31.6**	29.5
Interim profits	**16.1**	15.9
Share premium account	**8.8**	8.8
Total core tier one capital	**2,029.3**	1,738.4
Perpetual non-cumulative preference shares	**60.0**	60.0
Total tier one capital before regulatory deductions	**2,089.3**	1,798.4
Tier two capital		
Revaluation reserves	**2.9**	2.9
Long term subordinated debt	**884.6**	870.5
Total tier two capital before deductions	**887.5**	873.4

The Group's regulatory capital is analysed with two tiers:

Tier one capital

Tier one capital includes share capital, retained earnings, and perpetual non cumulative preference shares. The preference shares carry the right to fixed non cumulative preferential dividend at a rate of 9.25%, payable 31 May and 30 November. Retained earnings exclude gains or losses on cash flow hedges and available for sale assets.

Tier two capital

Revaluation reserves relating to net gains on equity held in the available for sale financial assets category are included in tier two capital.

The tier two capital includes five subordinated debt issues. The rights of payment to the holders of subordinated debt are subordinated to the claims of depositors and other creditors of the Bank. More information on these can be found in note 29.

Upon transfer of engagements, the Britannia permanent interest bearing shares were converted into perpetual subordinated debt of CFS (Perpetual Subordinated Bonds). This debt also ranks as tier two capital.

The capital ratios reported in the business and financial review are based on the Pillar I capital requirement.

Capital allocation

The allocation of capital between specific operations and activities is driven by optimisation of the return achieved on the capital allocated, and is based upon the regulatory capital. Capital allocation is undertaken independently of those responsible for capital management and is reviewed by ALCO.

Critical judgments and estimates

For the year ended 31 December 2010

All amounts are stated in £m unless otherwise indicated

The Bank makes critical judgments and estimates that affect the reported assets, liabilities and profits. Estimates are calculated using various assumptions. Critical judgments and the assumptions used in calculating estimates are continually assessed and reviewed, and are based on historical experience and reasonable expectations of future events.

Financial asset and liability classification

The Bank's accounting policies provide scope for assets and liabilities designated at inception into different accounting categories in certain circumstances as outlined on pages 37 to 44 and defined as follows:

- in classifying financial assets and liabilities as 'trading', the Bank has determined that it meets the description of trading assets for those assets and liabilities it acquires or incurs principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is managed together for short term profit or position taking as set out in accounting policy (e) iii);
- in designating financial assets or liabilities at fair value through income or expense, the Bank has determined that it has met one of the criteria for this designation as set out in accounting policy (e) iii); and
- in classifying assets as loans and receivables at amortised cost, the Bank has determined it meets the description as set out in accounting policy (e) i).

Qualifying hedge relationships

In designating a financial instrument as part of a qualifying hedge relationship, the Bank has determined that the hedge is expected to be highly effective over the life of the hedging instrument. In accounting for a derivative as a cash flow hedge, the Bank has determined that the hedged cash flow exposure relates to highly probable future cash flows.

Valuation of financial instruments

Background

Investment securities

The Bank's investment portfolio primarily comprises bank and building society certificates of deposit (CDs), floating rate notes (FRNs), asset backed securities, mortgage backed securities and government issued securities. Additionally, the Bank has a small portfolio of three structured investments vehicles (SIVs) and one credit trading vehicle (CTV) investment.

Loans and advances

Some financial instruments that were originally recognised as investment securities were subsequently reclassified as loans and receivables due to the loss of an active market caused by the 'credit crunch' restricting the availability of traded prices for these assets.

Valuation approach

Investment securities

The accounting treatment for these assets is primarily available for sale which means that they are fair valued in the balance sheet with movements passing through reserves, unless the assets are deemed to be impaired which results in movements being recognised in the income statement.

Loans and advances

As explained in note 16, the assets that have been reclassified as loans and receivables, are held on the balance sheet at amortised cost less any associated impairment.

Except for those assets reclassified to loans and receivables the Bank's CDs, FRNs and government issued securities are valued daily based upon an observable market price feed data, with all non-moving valuations validated against an alternative price source. No significant assumptions are required.

Impairment of financial instruments

Investment securities

Impairment has been assessed by:

- whether there is evidence that a loss event has occurred; and
- whether the loss event has a negative impact on future cash flows.

Each of the Bank's SIVs and its CTV do not meet these criteria in 2010 and therefore no impairment provision has been made. These assessments have particularly given consideration to evidence of any significant financial difficulty of the issuer or measurable decrease in the estimated cash flows from the investments.

During the year there have been no further impairments of investment securities.

Further information on the Bank's accounting policy for impairment is given on page 40.

Critical judgments and estimates continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

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

Collective provisions
Personal advances are identified as impaired by taking account of the age of the debt's delinquency, by product type.

The provision is calculated by applying a percentage rate to different categories and ages of impairment debt.

The provision rates reflect the likelihood that the debt in that category/age will be written off or charged off at some point in the future. The rates are based on historical experience and current trends, incorporate the effects of discounting at the customer interest rate and are subject to regular review. The provision is the product of the rate and the spot balance for the relevant arrears bucket.

Individual provisions
Mortgage accounts are identified as impaired by taking account of the age of the debt's delinquency on a case by case basis based on arrears data held within the mortgages system.

Individual provisions are raised on a case by case basis for each mortgage account in arrears.

Each corporate account is assessed and allocated a 'risk grade' to enable the Bank to monitor the overall quality of its lending assets. Those of lesser quality, where the lending is potentially at risk and provisions for future loss may be required, are centrally monitored with specific management actions taken at each stage within laid down procedures and specific provisioning criteria. Provisions represent the likely net loss after realisation of any security.

For further information on credit risk and impairment see 'Risk management' pages 45 to 77.

Effective interest rate
IAS 39 requires interest income to be recognised on an effective interest rate (EIR) basis, inclusive of directly attributable incremental transaction costs and fees, and discounts and premiums where appropriate.

The EIR basis spreads the interest income over the expected life of the instrument. The expected life of an instrument is the period from its inception up to its redemption or maturity date, ie for the mortgage portfolio it would be its redemption date, whilst the non-mortgage portfolio would be its maturity date.

On applying this approach to the mortgage portfolio, judgments are made in relation to estimating the average life of that portfolio. These judgments are made based on specific factors including product terms and historical repayment data. The estimates are updated in each reporting period to reflect actual performance. A key judgment area is the average life of the mortgage portfolio. A change in the average life by one year would have an impact of 0.2% to gross interest income.

For non-mortgage portfolios, see 'Fair values' below.

Corporation taxes
The Bank is subject to corporation taxes in three jurisdictions. Significant estimates are required in determining the provision for corporation taxes. There are certain significant transactions and calculations for which the ultimate tax determination is uncertain at the balance sheet date. In the opinion of the directors, the judgments made are appropriate and the level of provision is adequate to cover the likely liability.

Financial Services Compensation Scheme levy

The Financial Services Compensation Scheme (FSCS) provides compensation to customers of financial institutions in the event that an institution is unlikely, or is likely to be unable, to pay claims against it. As a result of a number of institutions' failures during 2008, the FSCS has borrowed £19.7bn on an interest only basis until March 2012 from HM Treasury in order to meet its obligations to the depositors. These borrowings are anticipated to be repaid wholly or substantially from the realisation of the assets of the failed institutions. The FSCS raises annual levies from the banking industry in order to meet its management expenses and compensation costs. The annual levies are based upon the individual institutions proportion of protected deposits of the total market protected deposits at 31 December of each year. The Group has provided £20.9m for its share of levies that will be raised by the FSCS including the interest on the loan from HM Treasury in respect of the levy years to 31 March 2012. The provision includes estimates for the interest that the FSCS will pay on the loan and of the Group's market participation in the relevant periods.

At the date of these financial statements, it is not possible to estimate whether there will be ultimately additional levies on the industry, the level of the Group's market participation or other factors that may affect amounts or the timing of amounts that may ultimately become payable, nor the effect that such levies may have upon operating results in any particular periods.

Provisions

Provisions are carried in respect of certain known or forecast future expenditure, as described in note 32.

Transfer of engagements of Britannia Building Society

The transfer of engagements of Britannia Building Society did not involve any cash consideration, other than the maintenance of Britannia Membership Reward (BMR) payments and the payment of joining fees for Britannia members to become members of Co-operative Financial Services.

Goodwill

This is based on a discounted cash flow of further BMR payments which would have been paid to Britannia members in perpetuity. The judgments and estimates in this calculation are set out in note 19. The principal judgments and estimates are forecasted profit, the discount rate and the proportion of profit after tax that would have been paid out in the form of BMR.

In the event that consideration was 5% higher or lower, goodwill on acquisition would be higher or lower by £58m.

Fair values

The fair value adjustment to loans and advances to customers comprises:

- an interest rate adjustment on a discounted cash flow basis to reflect the value inherent in fixed rate, base and tracker products compared to current market pricing;
- the inclusion of a credit risk adjustment to reflect future lifetime expected credit losses; and
- the write off of existing EIR balances and fair value adjustment for hedged risk.

The initial fair value adjustments fully unwind over their associated financial instruments' future expected lives or such shorter period as deemed reasonable. This judgment of future expected lives is therefore a critical judgment and estimate.

It has been assumed that debt securities will be redeemed in full at five years after their interest step up date. This has the impact of decreasing profit by £6m in 2010.

During 2010, as part of the Bank's regular review of its critical judgments and estimates, the rate of mortgage redemptions was considered in the light of current experience. As a result, the Optimum mortgages expected lives were extended up to 2023 and the expected lives of the debt securities, that only redeem as and when the underlying mortgages repay, were also extended.

The impact of increasing the mortgage redemptions by 10% per annum on the mortgage interest fair value adjustment is not material; however on the debt securities in issue fair value adjustment the impact is to decrease profits by a total of £17m in the years up to 2013 and to increase profits by the same amount in the following years up to 2017.

Another critical judgment and estimate is the release of the credit risk fair value adjustment. On the transfer of engagements with Britannia Building Society, £5.3bn of loans and advances to customers were acquired at a deep discount due to incurred credit losses. For these loans, the effective interest rate does not include estimated future credit losses. This credit risk fair value adjustment is utilised instead on the actual redemptions of the associated mortgages.

Notes to the financial statements

For the year ended 31 December 2010

All amounts are stated in £m unless otherwise indicated

1. Segmental information

At the highest level, the Group's internal reporting structure is split between Retail, Corporate and Markets (CAM) and Other, based on differences in products and services. CAM has been split further into Corporate, Treasury, Optimum and Platform, and Other. This level of information is regularly presented to the Board. Revenues are attributed to the segment in which they are generated. Transactions between the reportable segments are on normal commercial terms. Internal charges and transfer pricing adjustments have been reflected in each segment.

The Group is comprised of the following main reportable segments:

- **Retail** – customer focused products and services for individuals, sole traders and small partnerships. This includes mortgages, credit cards, consumer loans, current accounts and savings products;
- **Corporate** – customer focused products and services for businesses. This includes large corporate and commercial entities and small to medium entities. It includes loans, asset finance, current accounts and savings products;
- **Treasury** – this is the asset and liability management across the Bank's balance sheet, including trading activities;
- **Optimum and Platform** – this is the specialist mortgage team dealing with intermediary lending;
- **Other CAM** – the business services part of the CAM segment; and
- **Other** – includes Unity Trust, a subsidiary bank operating in the corporate banking and social economy sectors on behalf of trade unions.

	Retail	Corporate	Treasury	Optimum and Platform	Other CAM	Sub total CAM	Other	Total
2010								
Interest margin	**351.8**	**121.9**	**22.3**	**125.7**	**1.4**	**271.3**	**9.2**	**632.3**
Non-interest income	**149.7**	**37.2**	**(25.4)**	**9.4**	**17.0**	**38.2**	**1.6**	**189.5**
Segment operating income	**501.5**	**159.1**	**(3.1)**	**135.1**	**18.4**	**309.5**	**10.8**	**821.8**
Operating expenses	**(440.9)**	**(58.8)**	**(21.2)**	**(42.5)**	**(11.8)**	**(134.3)**	**(6.3)**	**(581.5)**
Impairment losses on loans and advances	**(63.8)**	**(30.4)**	**–**	**1.4**	**–**	**(29.0)**	**(4.5)**	**(97.3)**
Impairment gains on investments	**–**	**–**	**1.5**	**–**	**–**	**1.5**	**–**	**1.5**
Segment operating profit	**(3.2)**	**69.9**	**(22.8)**	**94.0**	**6.6**	**147.7**	**–**	**144.5**
Fair value amortisation								**(14.2)**
Financial Services Compensation Scheme levies								**(11.5)**
Share of post tax profits from joint ventures								**0.7**
Profit based payments to members of The Co-operative Group								**(10.8)**
Significant items								**(59.8)**
Profit before taxation								**48.9**
Income tax								**(13.1)**
Profit for the financial year								**35.8**

The Board relies primarily on net interest revenue to assess the performance of each segment. As a result interest margin is reported on a net basis to the Board.

	Retail	Corporate	Treasury	Optimum and Platform	Other CAM	Sub total CAM	Other	Total
Other segment information 2010								
Segment assets	**17,316.0**	**8,172.0**	**8,312.0**	**9,284.7**	**4.7**	**25,773.4**	**–**	**43,089.4**
Unallocated assets								**1,680.7**
Total assets	**17,316.0**	**8,172.0**	**8,312.0**	**9,284.7**	**4.7**	**25,773.4**	**–**	**44,770.1**
Segment liabilities	**28,591.7**	**4,449.3**	**8,647.1**	**–**	**38.1**	**13,134.5**	**–**	**41,726.2**
Unallocated liabilities								**1,013.4**
Total liabilities	**28,591.7**	**4,449.3**	**8,647.1**	**–**	**38.1**	**13,134.5**	**–**	**42,739.6**
Amount of investment in associate/ joint ventures	**2.5**	**–**	**–**	**–**	**–**	**–**	**–**	**2.5**
Depreciation	**21.4**	**1.3**	**0.1**	**0.8**	**–**	**2.2**	**0.3**	**23.9**
Amortisation	**11.0**	**0.5**	**–**	**–**	**–**	**0.5**	**0.1**	**11.6**

The Group's activities are in the UK.

1. Segmental information continued

Reconciliation to statutory income statement	**2010**
Interest margin	
Total interest margin for reportable segments	**632.3**
Reclassification of gains less losses on derivatives	**(1.6)**
Interest fair value unwind	**(22.3)**
Net interest income	**608.4**
Non-interest income	
Total non-interest income for reportable segments	**189.5**
Reclassification of gains less losses on derivatives	**1.6**
Interest fair value unwind	**(1.5)**
Non-interest income	**189.6**
Operating expenses	
Total operating expenses for reportable segments	**(581.5)**
Operating expenses fair value unwind	**9.6**
Operating expenses	**(571.9)**
Fair value amortisation	
Total interest fair value unwind for reportable segments	**(14.2)**
Interest margin unwind	**22.3**
Non-interest income unwind	**1.5**
Operating expenses unwind	**(9.6)**
	–
Reconciliation of other segment information	
Assets	
Total assets for reportable segments	**44,770.1**
Statutory reclassifications	**811.2**
Consolidated total assets	**45,581.3**
Liabilities	
Total liabilities for reportable segments	**42,739.6**
Statutory reclassifications	**768.6**
Consolidated total liabilities	**43,508.2**

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

1. Segmental information continued

	Retail	Corporate	Treasury	Optimum and Platform	Other CAM	Sub total CAM	Other	Total
2009								
Interest margin	262.2	108.8	33.5	56.8	0.3	199.4	12.4	474.0
Non-interest income	134.5	37.4	(8.6)	6.0	8.1	42.9	1.5	178.9
Segment operating income	396.7	146.2	24.9	62.8	8.4	242.3	13.9	652.9
Operating expenses	(327.8)	(58.5)	(11.4)	(16.1)	(4.3)	(90.3)	(7.5)	(425.6)
Impairment losses on loans and advances	(82.7)	(32.3)	–	–	–	(32.3)	(1.1)	(116.1)
Impairment gains on investments	–	–	4.0	–	–	4.0	–	4.0
Segment operating profit	(13.8)	55.4	17.5	46.7	4.1	123.7	5.3	115.2
Fair value amortisation								99.1
Financial Services Compensation Scheme levies								(3.7)
Share of post tax profits from joint ventures								(0.1)
Profit based payments to members of The Co-operative Group								(7.8)
Significant items								(38.1)
Profit before taxation								164.6
Income tax								(51.4)
Profit for the financial year								113.2
Other segment information 2009								
Segment assets	16,722.6	7,900.5	9,531.1	9,276.4	–	26,708.0	–	43,430.6
Unallocated assets								1,703.0
Total assets	16,722.6	7,900.5	9,531.1	9,276.4	–	26,708.0	–	45,133.6
Segment liabilities	28,324.0	3,148.0	10,863.8	–	–	14,011.8	–	42,335.8
Unallocated liabilities								860.3
Total liabilities	28,324.0	3,148.0	10,863.8	–	–	14,011.8	–	43,196.1
Amount of investment in associate/ joint ventures	1.8	–	–	–	–	–	–	1.8
Depreciation	17.7	1.6	0.5	0.5	–	2.6	0.3	20.6
Amortisation	6.5	0.6	–	0.1	–	0.7	0.1	7.3

1. Segmental information continued

Reconciliation to statutory income statement	2009
Interest margin	
Total interest margin for reportable segments	474.0
Reclassification of gains less losses on derivatives	(3.6)
Interest fair value unwind	109.3
Net interest income	579.7
Non-interest income	
Total non-interest income for reportable segments	178.9
Reclassification of gains less losses on derivatives	3.6
Non-interest fair value unwind	(6.8)
Non-interest income	175.7
Operating expenses	
Total operating expenses for reportable segments	(425.6)
Operating expenses fair value unwind	(3.4)
Operating expenses	(429.0)
Fair value amortisation	
Total interest fair value unwind for reportable segments	99.1
Interest margin unwind	(109.3)
Non-interest income unwind	6.8
Operating expenses unwind	3.4
Fair value amortisation	–
Reconciliation of other segment information	
Assets	
Total assets for reportable segments	45,133.6
Statutory reclassifications	1,005.2
Consolidated total assets	46,138.8
Liabilities	
Total liabilities for reportable segments	43,196.1
Statutory reclassifications	1,066.6
Consolidated total liabilities	44,262.7

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

2. Profit before taxation

	2010 £'000	2009 £'000
Profit before taxation is stated after:		
Audit of these financial statements	**457**	604
Amounts receivable by auditors and their associates in respect of:		
Audit of financial statements of subsidiaries pursuant to legislation	**392**	389
Other services pursuant to such legislation	**87**	16
Other services relating to taxation	**7**	21
Services relating to litigation	**2**	2
Services relating to information technology	**92**	56
Services relating to corporate finance transactions	**15**	77
All other services	**822**	377
	1,874	1,542

Amounts paid to the Bank's auditor in respect of services to the Bank, other than the audit of the Bank's financial statements, have not been disclosed as the information is required instead to be disclosed on a consolidated basis. Amounts capitalised are not disclosed above.

3. Directors' emoluments

	2010 £'000	2009 £'000
Executive directors	**4,002**	1,945
Compensation for loss of office	**–**	805
	4,002	2,750

Retirement benefits are accruing to five directors (2009: five) under defined benefit schemes.

All non-executive directors are appointed and their directors' fees are determined and paid by The Co-operative Group and therefore no amounts are shown above (2009: £nil). Further details of directors' emoluments are included in the remuneration report on pages 23 to 28. The remuneration report is unaudited.

4. Net interest income

	2010	2009
Interest receivable and similar income		
On financial assets not at fair value through income or expense:		
On loans and advances to customers	**1,605.0**	1,047.1
On loans and advances to banks	**9.3**	17.8
On investment securities	**277.5**	163.8
	1,891.8	1,228.7
On financial assets at fair value through income or expense:		
Net expense on financial instruments hedging assets	**(168.9)**	(167.5)
Net interest (expense)/income on financial instruments not in a hedging relationship	**(9.6)**	0.4
	1,713.3	1,061.6

Interest income accrued on impaired financial assets during the year was £90.5m (2009: £62.7m). Interest due to unwinding of discount on impairment provisions relating to impaired financial assets amounted to £2.2m (2009: £3.8m).

	2010	2009
Interest expense and similar charges		
On financial liabilities not at fair value through income or expense:		
On customer accounts	**471.9**	262.4
On bank and other deposits	**515.5**	197.2
On subordinated liabilities	**43.9**	31.1
On perpetual secured debt	**17.2**	11.7
	1,048.5	502.4
On financial liabilities at fair value through income or expense:		
Net income/(expense) on financial instruments hedging liabilities	**56.4**	(20.5)
	1,104.9	481.9

5. Net fee and commission income

	Before significant items 2010	Significant items 2010	After significant items 2010	Before and after significant items 2009
Fee and commission income				
On items not at fair value through income or expense	**235.9**	**(13.1)**	**222.8**	209.3
On trust or fiduciary activities that result from holding or investing in assets on behalf of others	**1.3**	**–**	**1.3**	1.5
	237.2	**(13.1)**	**224.1**	210.8
Fee and commission expense				
On items not at fair value through income or expense	**52.2**	**–**	**52.2**	47.1
On items at fair value through income or expense	**8.1**	**–**	**8.1**	0.1
	60.3	**–**	**60.3**	47.2

The significant items in 2010 relate to provisions made for customer redress as detailed in note 32.

6. Net trading income

	2010	2009
Foreign exchange	**6.5**	5.5
Other interest rate instruments	**(1.9)**	(0.3)
	4.6	5.2

Foreign exchange net trading income includes gains less losses from spot forward and forward contracts, options, futures and translated foreign currency assets and liabilities.

Other interest rate instruments include the result of transacting in government securities, money market instruments, interest rate and currency swaps, options and other derivatives.

7. Other operating income

	2010	2009
Rent receivable from investment properties (note 21)	**6.5**	2.1
Other rent receivable	**1.7**	0.8
Proceeds from equity shares	**–**	0.5
Change in fair value of investment properties (note 21)	**(0.1)**	3.5
	8.1	6.9

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

8. Operating expenses

	Before significant items 2010	Significant items 2010	After significant items 2010	Before significant items 2009	Significant items 2009	After significant items 2009
Staff costs (note 9)	**292.6**	**29.6**	**322.2**	200.5	26.4	226.9
Administrative expenses	**224.9**	**17.1**	**242.0**	173.7	11.7	185.4
Depreciation of property, plant and equipment (note 22)	**24.8**	**–**	**24.8**	21.0	–	21.0
Amortisation of intangible fixed assets (note 20)	**4.1**	**–**	**4.1**	5.1	–	5.1
Loss on sale of property, plant and equipment	**0.8**	**–**	**0.8**	1.4	–	1.4
Operating lease rentals	**27.7**	**–**	**27.7**	22.0	–	22.0
Property provisions for liabilities and charges provided in the year (note 32)	**3.4**	**–**	**3.4**	0.9	–	0.9
Property provisions for liabilities and charges released during the year (note 32)	**(0.3)**	**–**	**(0.3)**	(2.2)	–	(2.2)
Regulatory provisions for liabilities and charges provided in the year (note 32)	**3.5**	**–**	**3.5**	5.5	–	5.5
Regulatory provisions for liabilities and charges released during the year (note 32)	**(12.3)**	**–**	**(12.3)**	(0.1)	–	(0.1)
Direct expenses from investment properties that generated rental income in the year	**2.6**	**–**	**2.6**	1.1	–	1.1
Direct expenses from investment properties that did not generate rental income in the year	**0.1**	**–**	**0.1**	0.1	–	0.1
	571.9	**46.7**	**618.6**	429.0	38.1	467.1

The significant items in 2010 and 2009 relate to a programme of investment and integration.

9. Staff costs

	Before significant items 2010	Significant items 2010	After significant items 2010	Before significant items 2009	Significant items 2009	After significant items 2009
Wages and salaries	**221.1**	**16.5**	**237.6**	151.0	9.4	160.4
Social security costs	**20.6**	**0.3**	**20.9**	13.0	0.7	13.7
Bank payroll tax	**(0.1)**	**–**	**(0.1)**	0.3	–	0.3
Pension costs						
Defined benefit plans (note 34)	**0.2**	**–**	**0.2**	0.2	–	0.2
Defined contribution plans (note 34)	**28.2**	**0.5**	**28.7**	17.9	0.7	18.6
Other staff costs	**22.6**	**12.3**	**34.9**	18.1	15.6	33.7
	292.6	**29.6**	**322.2**	200.5	26.4	226.9

The Bank staff costs included above are £265.2m before significant items and £294.8m after significant items (2009: £186.7m before significant items, £213.1m after significant items).

In 2009, £0.3m was accrued for the estimated tax payable in respect of the bank payroll tax announced in the Finance Bill 2010. During the year, tax of £0.2m was paid and £0.1m was released to the income statement.

Average number of employees

The average number of persons working for the Group and the Bank during the year was made up as follows:

	Group		Bank	
	No. of employees 2010	No. of employees 2009	**No. of employees 2010**	No. of employees 2009
Full time	**6,499**	4,479	**5,843**	4,146
Part time	**2,247**	1,514	**2,117**	1,453
	8,746	5,993	**7,960**	5,599

Employee activities are undertaken across the Co-operative Financial Services Group and the figures above reflect the Bank's share of these services. Employee numbers include 4,724 staff who transferred on the transfer of engagements of Britannia Building Society on 1 August 2009.

10. Income tax

	Before significant items 2010	Significant items 2010	After significant items 2010	Before significant items 2009	Significant items 2009	After significant items 2009
Current tax – current year	**28.6**	**(16.7)**	**11.9**	42.2	(10.7)	31.5
Current tax – prior year	**0.8**	**–**	**0.8**	(0.7)	–	(0.7)
Deferred tax – current year (note 33)	**2.5**	**–**	**2.5**	20.9	–	20.9
Deferred tax – prior year (note 33)	**(2.1)**	**–**	**(2.1)**	(0.3)	–	(0.3)
	29.8	**(16.7)**	**13.1**	62.1	(10.7)	51.4

Further information about deferred income tax is presented in note 33. The tax on the Group's profit before taxation differs from the theoretical amount that would arise using the corporation tax rate in the UK as follows:

	2010	2009
Profit before tax	**48.9**	164.6
Tax calculated at a rate of 28% (2009: 28%)	**13.7**	46.1
Effects of:		
Preference share interest not deductible for tax purposes	**1.6**	1.6
Expenses not deductible for tax purposes	**(2.3)**	2.4
Depreciation of expenditure not qualifying for capital allowances	**2.2**	0.4
(Profits)/losses taxed at lower rates	**(3.7)**	2.0
Non-taxable income	**(1.2)**	(0.1)
Adjustments to tax charge in respect of prior periods	**(1.3)**	(1.0)
Change in rate of deferred tax (note 33)	**4.3**	–
Other differences	**(0.2)**	–
	13.1	51.4

11. Group profit attributable to equity shareholders dealt with in the accounts of The Co-operative Bank plc

	Before significant items 2010	Significant items 2010	After significant items 2010	Before significant items 2009	Significant items 2009	After significant items 2009
Net profit attributable to equity shareholders of the Bank	**108.1**	**(35.0)**	**73.1**	194.0	(27.4)	166.6

As permitted by Section 408 of the Companies Act 2006, the income statement of The Co-operative Bank plc has not been presented separately.

12. Earnings per share

Basic earnings per share is calculated by dividing the net profit attributable to equity shareholders of the Bank by the weighted average number of ordinary shares in issue during the year.

	Before significant items 2010	Significant items 2010	After significant items 2010	Before significant items 2009	Significant items 2009	After significant items 2009
Profit attributable to equity shareholders of the Bank	**79.5**	**(43.1)**	**36.4**	137.7	(27.4)	110.3
Ordinary shares in issue (millions)						
At beginning of year	**4,600**	**4,600**	**4,600**	1,100	1,100	1,100
Issued in the year (note 38)	**3,600**	**3,600**	**3,600**	3,500	3,500	3,500
At end of year	**8,200**	**8,200**	**8,200**	4,600	4,600	4,600
Weighted average number of ordinary shares in issue (millions)	**4,767.7**	**4,767.7**	**4,767.7**	3,827.7	3,827.7	3,827.7
Basic earnings per share (expressed in pence per share)	**1.67**	**(0.90)**	**0.77**	3.60	(0.72)	2.88

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

13. Cash and balances at central banks

	Group		Bank	
	2010	2009	**2010**	2009
Cash in hand	**255.8**	259.6	**255.8**	259.6
Balances with the Bank of England other than mandatory reserve deposits	**1,443.7**	1,413.2	**1,443.7**	1,413.2
Included in cash and cash equivalents	**1,699.5**	1,672.8	**1,699.5**	1,672.8
Mandatory reserve deposits with the Bank of England (note 35)	**36.1**	34.0	**36.1**	34.0
	1,735.6	1,706.8	**1,735.6**	1,706.8

Mandatory reserve deposits are not available for use in the Group and Bank's day to day operations, are non-interest bearing and are not included in cash and cash equivalents.

14. Loans and advances to banks

	Group		Bank	
	2010	2009	**2010**	2009
Items in course of collection from other banks	**139.9**	149.0	**139.7**	148.8
Placements with other banks	**1,338.8**	313.5	**1,326.8**	290.0
Included in cash and cash equivalents	**1,478.7**	462.5	**1,466.5**	438.8
Other loans and advances to banks	**915.4**	1,319.0	**262.1**	781.3
	2,394.1	1,781.5	**1,728.6**	1,220.1

15. Loans and advances to customers

	Group		Bank	
	2010	2009 restated	**2010**	2009
Gross loans and advances	**35,199.9**	34,267.7	**24,055.4**	23,242.8
Less: allowance for losses on loans and advances to customers	**(222.6)**	(194.0)	**(210.5)**	(192.0)
	34,977.3	34,073.7	**23,844.9**	23,050.8

Group and Bank loans and advances to customers include £74.1m (2009: £48.2m) of financial assets at fair value through income or expense designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency. Of these, £20.0m (2009: £21.0m) are secured by real estate collateral.

Loans and advances to customers includes £11,215.9m (2009: £9,492.7m) securitised under the Group's securitisation and covered bond programmes. The Group remains exposed to substantially all of the risks and rewards of ownership of these assets. Included within Group deposits by banks (note 25) are £67.2m (2009: £466.7m) of loans from external third parties and within Group debt securities in issue (note 28) are £1,898.1m (2009: £2,683.7m) of floating rate notes, all secured on these mortgage assets. Included within the Bank amounts owed by other Co-operative Group undertakings are £3,995.8m (2009: £2,969.0m) of floating rate notes issued to the Bank and £2,400.9m (2009: £2,400.4m) of other loans, secured on these mortgage assets.

Concentration of exposure

The Group's exposure is virtually all within the UK. The following industry concentrations of gross advances before provisions are considered significant:

	Group		Bank	
	2010	2009 restated	**2010**	2009
Property and construction	**4,544.6**	4,498.1	**2,606.9**	2,481.6
Retail distribution and services	**500.1**	446.9	**357.0**	313.9
Business and other services	**3,808.1**	3,658.2	**3,683.5**	3,525.0
Personal – unsecured	**1,613.1**	1,625.6	**1,613.1**	1,625.6
Personal – secured	**24,734.0**	24,038.9	**15,794.9**	15,296.7
	35,199.9	34,267.7	**24,055.4**	23,242.8

15. Loans and advances to customers continued

Allowance for losses on loans and advances

2010	Individual mortgage	Individual corporate	Collective	Total
Group				
At the beginning of the year	**2.3**	**51.3**	**140.4**	**194.0**
Charge against profits	**7.2**	**35.5**	**63.9**	**106.6**
Amounts written off	**(0.9)**	**(30.5)**	**(44.9)**	**(76.3)**
Unwind of discount allowance	**–**	**(1.0)**	**(1.2)**	**(2.2)**
Interest charged on impaired loans	**–**	**0.5**	**–**	**0.5**
At the end of the year	**8.6**	**55.8**	**158.2**	**222.6**
Bank				
At the beginning of the year	**2.3**	**49.3**	**140.4**	**192.0**
Charge against profits	**0.9**	**31.0**	**63.9**	**95.8**
Amounts written off	**(0.3)**	**(30.4)**	**(44.9)**	**(75.6)**
Unwind of discount allowance	**–**	**(1.0)**	**(1.2)**	**(2.2)**
Interest charged on impaired loans	**–**	**0.5**	**–**	**0.5**
At the end of the year	**2.9**	**49.4**	**158.2**	**210.5**

Allowance for losses on loans and advances

2009	Individual mortgage	Individual corporate	Collective	Total
Group				
At the beginning of the year	1.5	45.6	140.8	187.9
Charge against profits	1.5	33.3	81.2	116.0
Amounts written off	(0.7)	(26.5)	(79.2)	(106.4)
Unwind of discount allowance	–	(1.4)	(2.4)	(3.8)
Interest charged on impaired loans	–	0.3	–	0.3
At the end of the year	2.3	51.3	140.4	194.0
Bank				
At the beginning of the year	1.5	44.7	140.8	187.0
Charge against profits	1.5	32.2	81.2	114.9
Amounts written off	(0.7)	(26.5)	(79.2)	(106.4)
Unwind of discount allowance	–	(1.4)	(2.4)	(3.8)
Interest charged on impaired loans	–	0.3	–	0.3
At the end of the year	2.3	49.3	140.4	192.0

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

15. Loans and advances to customers continued

The net impairment charge in the Group income statement is £97.3m (2009: £116.1m). This includes amounts recovered by the Group of £9.3m (2009: charge of £0.1m) against amounts previously written off. The recoveries have been made from the mortgagors and from other parties involved in the origination or acquisition of the mortgages.

Loans and advances to customers include finance lease receivables.

	Group		Bank	
	2010	2009	**2010**	2009
Gross investment in finance leases may be analysed as follows:				
No later than one year	**28.4**	32.8	**22.4**	28.9
Later than one year and no later than five years	**66.2**	75.9	**44.8**	53.9
Later than five years	**78.7**	73.3	**56.5**	45.6
	173.3	182.0	**123.7**	128.4
Unearned future finance income on finance leases	**(44.2)**	(40.6)	**(29.1)**	(22.6)
Net investment in finance leases	**129.1**	141.4	**94.6**	105.8
The net investment in finance leases may be analysed as follows:				
No later than one year	**21.2**	25.4	**18.0**	24.4
Later than one year and no later than five years	**44.9**	54.5	**32.0**	42.0
Later than five years	**63.0**	61.5	**44.6**	39.4
	129.1	141.4	**94.6**	105.8

There are no unguaranteed residual values for any of the finance leases.

The Group enters into finance lease and hire purchase arrangements with customers in a wide range of sectors including transport, retail and utilities. The accumulated allowance for uncollectible minimum lease payments receivable is £0.8m (2009: £1.7m).

Fair value adjustments for hedged risk

The Group has entered into interest rate swaps that protect it from changes in interest rates on the floating rate liabilities that fund its portfolio of fixed rate mortgages. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed rate mortgages. The changes in fair value of fixed rate mortgages are disclosed on the balance sheet as fair value adjustments for hedged risk immediately below the loans and advances to customers.

Fair value adjustments to loans and advances to customers attributable to portfolio hedged risk in the Group are £166.8m (2009: £66.1m) and in the Bank are £164.6m (2009: £60.6m).

16. Investment securities

Loans and receivables

	Group		Bank	
	2010	2009	**2010**	2009
Loans and receivables				
Listed	**164.6**	124.3	**164.6**	124.3
Unlisted	**1,765.7**	2,376.4	**1,835.2**	2,445.8
	1,930.3	2,500.7	**1,999.8**	2,570.1
Less: allowance for losses	**(13.0)**	(14.5)	**(13.0)**	(14.5)
	1,917.3	2,486.2	**1,986.8**	2,555.6
Included in cash and cash equivalents	**–**	–	**–**	–

The movement in investment securities – loans and receivables excluding interest amounts may be summarised as follows:

At the beginning of the year	**2,483.5**	123.4	**2,552.8**	123.4
Arising on transfer of engagements	**–**	2,440.4	**–**	2,506.1
Disposals and maturities	**(735.8)**	(201.3)	**(748.9)**	(201.3)
Exchange adjustments	**0.4**	0.1	**0.4**	0.1
Fair value movements through equity	**(1.5)**	86.1	**(1.5)**	86.1
Fair value movements through income and expense	**–**	–	**11.7**	–
Amortisation	**166.6**	26.8	**168.2**	30.4
Impairment losses	**1.5**	8.0	**1.5**	8.0
At the end of the year	**1,914.7**	2,483.5	**1,984.2**	2,552.8

16. Investment securities continued

Impairment analysis of loans and receivables

	Group		Bank	
	2010	2009	**2010**	2009
At the beginning of the year	**14.5**	22.5	**14.5**	22.5
Release for the year	**(1.5)**	(8.0)	**(1.5)**	(8.0)
At the end of the year	**13.0**	14.5	**13.0**	14.5

Available for sale

	Group		Bank	
	2010	2009	**2010**	2009
Available for sale				
Listed	**2,417.7**	1,470.4	**2,417.7**	1,470.4
Unlisted	**640.4**	3,058.8	**304.7**	2,662.1
	3,058.1	4,529.2	**2,722.4**	4,132.5
Less: allowance for losses	**(72.3)**	(71.9)	**(72.3)**	(71.9)
	2,985.8	4,457.3	**2,650.1**	4,060.6
Included in cash and cash equivalents	**225.0**	252.0	**225.0**	252.0

Included within the listed available for sale investments for both Group and Bank is £28.7m of financial assets at fair value through income or expense designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency.

The movement in investment securities – available for sale excluding interest amounts may be summarised as follows:

	Group		Bank	
	2010	2009	**2010**	2009
At the beginning of the year	**4,444.1**	2,108.3	**4,049.0**	1,686.8
Arising on transfer of engagements	**–**	3,680.8	**–**	3,680.8
Acquisitions	**9,895.2**	15,820.7	**8,515.2**	14,630.8
Disposals and maturities	**(11,437.4)**	(17,293.6)	**(9,997.4)**	(16,078.6)
Exchange adjustments	**20.2**	92.4	**20.2**	92.4
Fair value movements through equity	**(19.8)**	64.6	**(19.8)**	65.9
Fair value movements through income and expense	**43.9**	(1.9)	**43.9**	(1.9)
Amortisation	**28.4**	(23.2)	**28.4**	(23.2)
Impairment losses	**–**	(4.0)	**–**	(4.0)
At the end of the year	**2,974.6**	4,444.1	**2,639.5**	4,049.0

Impairment analysis of investment securities – available for sale

	Group		Bank	
	2010	2009	**2010**	2009
At the beginning of the year	**71.9**	69.8	**71.9**	69.8
Impairment losses recycled through equity reserves	**–**	4.0	**–**	4.0
Charge for the year	**–**	4.0	**–**	4.0
Exchange adjustments	**0.4**	(1.9)	**0.4**	(1.9)
At the end of the year	**72.3**	71.9	**72.3**	71.9

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

16. Investment securities continued

Reclassification of available for sale assets

Pursuant to the amendments to IAS 39 and IFRS 7, during 2008 the Bank reclassified specific available for sale investment securities to loans and receivables at amortised cost. The Bank identified particular assets that would have met the definition of loans and receivables (if they had not been designated as available for sale) for which at 27 July 2008 it considered it had the intention and ability to hold them for the foreseeable future or until maturity, due to the market in such instruments being considered to be inactive.

As per the amendment to IAS 39, the reclassifications were made with effect from 27 July 2008 at fair value at that date. The table below sets out the carrying values and fair values for both the Group and Bank at the balance sheet date:

		2010		2009	
	Amounts reclassified in 2008	**Carrying value**	**Fair value**	Carrying value	Fair value
Available for sale financial assets transferred to loans and receivables	127.0	**131.2**	**134.1**	134.8	138.0

The amounts reclassified in 2008 are stated net of disposals of £4.9m in the period.

At the date of transfer fair value equated to carrying value. As at 31 December 2010 and 2009 fair value is based on quoted market prices, being the only indicator of fair value that is available.

The table below sets out the amounts actually recognised during the year in respect of the financial assets reclassified out of available for sale securities for both the Group and Bank:

	Income or expense 2010	**Other comprehensive income 2010**	Income or expense 2009	Other comprehensive income 2009
Period after reclassification				
Available for sale investments reclassified to loans and receivables:				
Interest income	**0.2**	**–**	3.1	–
Net impairment release/(charge)	**1.5**	**(1.5)**	8.0	(1.4)
Net change in fair value	**–**	**5.2**	–	4.7
	1.7	**3.7**	11.1	3.3

The table below sets out the amounts that would have been recognised for both the Group and Bank in 2010 and in 2009, if the reclassification in 2008 had not been made:

	Income or expense 2010	**Other comprehensive income 2010**	Income or expense 2009	Other comprehensive income 2009
Available for sale investments reclassified to loans and receivables:				
Interest income	**0.2**	**–**	3.1	–
Net impairment release/(charge)	**1.5**	**–**	8.0	(4.0)
Net change in fair value	**–**	**4.9**	–	25.6
	1.7	**4.9**	11.1	21.6

16. Investment securities continued

At 27 July 2008, the effective interest rates on available for sale assets reclassified to loans and receivables at amortised cost ranged from 8% to 12% with expected recoverable cash flows as at 31 December 2010 of £135.8m (2009: £144.2m).

Gains and losses from investment securities, included within interest income, comprise:

	2010	2009
Derecognition of available for sale assets	**(5.1)**	7.1

Analysis of investment securities by issuer

	Group		**Bank**	
	2010	2009	**2010**	2009
Investment securities issued by public bodies:				
Government securities	**903.0**	942.7	**903.0**	942.7
Other public sector securities	**57.3**	9.1	**57.3**	9.1
	960.3	951.8	**960.3**	951.8
Investment securities issued by other issuers:				
Bank and building society certificates of deposits	**560.8**	849.2	**225.1**	452.5
Other debt securities:				
Credit trading funds	**16.5**	16.5	**16.5**	16.5
Structured investment vehicles	**–**	–	**–**	–
Other floating rate notes	**1,624.9**	2,774.6	**1,624.9**	2,774.6
Mortgage backed securities	**1,740.6**	2,351.4	**1,810.1**	2,420.8
	3,382.0	5,142.5	**3,451.5**	5,211.9
	4,903.1	6,943.5	**4,636.9**	6,616.2

Other floating rate notes (FRNs) relate to sterling, euro, US dollar, Canadian dollar and Australian dollar denominated FRNs with maturities ranging from one month to three years from the balance sheet date.

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

17. Derivative financial instruments

The Bank has entered, as principal, into various derivatives either as a trading activity, which includes proprietary transactions and customer facilitation, or as a hedging activity for the management of interest rate risk, equity risk and foreign exchange rate risk. Positive and negative fair values have not been netted as the Group does not have a legal right of offset.

Derivatives held for trading purposes

The trading transactions are wholly interest rate related contracts including swaps, caps and floors, forward rate agreements and exchange traded futures. Trading transactions include derivatives where the Bank enters into a transaction to accommodate a customer together with the corresponding hedge transaction.

Non-trading derivatives

Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions of the Group. Derivatives used to manage interest rate related positions include swaps, caps and floors, forward rate agreements and exchange traded futures. The foreign exchange rate positions are managed using forward currency transactions and swaps. Equity risk is managed using equity swaps.

	Group			Bank		
	Contractual/ notional amount	Fair value		Contractual/ notional amount	Fair value	
		Assets	Liabilities		Assets	Liabilities
2010						
Derivatives held for trading purposes						
Interest rate derivatives:						
Interest rate swaps	**3,035.9**	**65.1**	**(51.0)**	**3,215.9**	**68.5**	**(54.4)**
Over The Counter (OTC) interest rate options	**241.8**	**1.9**	**(1.9)**	**241.8**	**1.9**	**(1.9)**
Exchange traded interest rate futures	**189.0**	**–**	**–**	**189.0**	**–**	**–**
Total derivative assets/(liabilities) held for trading purposes	**3,466.7**	**67.0**	**(52.9)**	**3,646.7**	**70.4**	**(56.3)**
Derivatives held for non-trading purposes						
Derivatives designated as cashflow hedges:						
Interest rate swaps	**14,006.9**	**218.8**	**(161.9)**	**14,006.9**	**218.8**	**(161.9)**
Derivatives designated as fair value hedges:						
Interest rate swaps	**9,245.2**	**75.0**	**(411.0)**	**7,211.5**	**75.0**	**(403.8)**
Cross currency interest rate swaps	**11.3**	**–**	**(1.2)**	**11.3**	**–**	**(1.2)**
Derivatives held for non-trading purposes for which hedge accounting has not been applied:						
Interest rate swaps	**9,803.4**	**23.1**	**(32.5)**	**5,844.6**	**37.7**	**(31.3)**
Embedded derivatives – options	**1,344.5**	**19.3**	**(17.8)**	**1,344.5**	**19.3**	**(17.8)**
Forward currency transactions	**3,282.1**	**431.4**	**(23.6)**	**1,741.7**	**147.4**	**(23.6)**
OTC interest rate options	**213.0**	**–**	**(1.2)**	**213.0**	**–**	**(1.2)**
Equity swaps	**1,137.1**	**97.3**	**(0.3)**	**1,090.9**	**92.4**	**(0.3)**
Credit default swaps	**–**	**–**	**–**	**79.4**	**–**	**–**
Total derivative assets/(liabilities) held for non-trading purposes	**39,043.5**	**864.9**	**(649.5)**	**31,543.8**	**590.6**	**(641.1)**
Total recognised derivative assets/(liabilities)	**42,510.2**	**931.9**	**(702.4)**	**35,190.5**	**661.0**	**(697.4)**

17. Derivative financial instruments continued

	Group			Bank		
	Contractual/ notional amount	Fair value		Contractual/ notional amount	Fair value	
		Assets	Liabilities		Assets	Liabilities
2009						
Derivatives held for trading purposes						
Interest rate derivatives:						
Interest rate swaps	2,938.1	45.0	(34.8)	3,108.2	48.8	(38.4)
Over The Counter (OTC) interest rate options	323.3	3.7	(3.7)	323.3	3.7	(3.7)
Exchange traded interest rate futures	1,000.0	–	–	1,000.0	–	–
Total derivative assets/(liabilities) held for trading purposes	4,261.4	48.7	(38.5)	4,431.5	52.5	(42.1)
Derivatives held for non-trading purposes						
Derivatives designated as cashflow hedges:						
Interest rate swaps	5,986.1	117.1	(69.6)	5,986.1	117.1	(69.6)
Derivatives designated as fair value hedges:						
Interest rate swaps	14,853.2	114.5	(433.0)	11,472.7	114.5	(405.9)
Cross currency interest rate swaps	192.4	6.5	(1.3)	192.4	6.5	(1.3)
Derivatives held for non-trading purposes for which hedge accounting has not been applied:						
Interest rate swaps	4,307.9	11.8	(14.4)	5,766.2	47.2	(13.8)
Embedded derivatives – options	268.3	5.4	(4.0)	268.3	5.4	(4.0)
Forward currency transactions	5,033.0	657.7	(23.4)	2,929.1	255.3	(23.4)
OTC interest rate options	25.0	–	(0.3)	25.0	–	(0.3)
Equity swaps	1,638.6	61.3	(6.8)	1,575.0	58.2	(6.8)
Credit default swaps	–	–	–	79.4	4.1	–
Total derivative assets/(liabilities) held for non-trading purposes	32,304.5	974.3	(552.8)	28,294.2	608.3	(525.1)
Total recognised derivative assets/(liabilities)	36,565.9	1,023.0	(591.3)	32,725.7	660.8	(567.2)

The derivatives designated as cashflow hedges are interest rate swaps used to hedge interest rate risk in the Bank's retail lending operations. Cash flows are hedged by quarterly time periods for durations up to ten years. During the year there were no forecast transactions for which hedge accounting had previously been used but are no longer expected to occur.

During the year the Bank has entered into fair value hedges to mitigate price movements due to interest rate sensitivities.

The number of non-margin exchange traded contracts held by the Bank as at 31 December 2010 was nil (2009: nil).

The Bank is aware that other financial institutions are moving to using overnight indexed swap (OIS) curves in the valuation of derivatives. The Bank is currently assessing the impact of what such a change would mean to the valuation of its own derivatives with a view to making any changes in 2011.

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

18. Equity shares

	Group and Bank	
	2010	2009
Investment securities – unlisted	**7.2**	7.2
Included above are the following trade investments:		
Vocalink Limited – 4,416,165 ordinary shares of £1 each (2009: 4,416,165)	**7.1**	7.1

Equity shares are classified as available for sale.

19. Goodwill

	Group and Bank	
	2010	2009
Net book amount		
At the beginning of the year	**0.6**	–
Amounts arising on transfer of engagements	**–**	0.6
At the end of the year	**0.6**	0.6

The Bank's goodwill recognised in 2009 relates to the transfer of engagements of Britannia Building Society. Further detail is provided in note 39.

In accordance with IAS 38 the goodwill has been assessed as having an indefinite useful life. In assessing the recoverable amount of the goodwill the Group allocates the goodwill to the lowest cash generating unit (CGU) within the Group that is expected to benefit from the synergies of the business combination. A CGU is the smallest identifiable group of assets that generates cash inflows which are largely independent of the cash inflows from other assets of the Group.

The CGUs to which the goodwill has been allocated are the Retail, Corporate, Wholesale and Optimum and Platform reportable segments of the Bank. The recoverable amounts have been calculated by considering their value in use to the Bank. The key assumptions used in the calculation are shown below. These have been determined using past experience, understanding of the business and its industry, the expected lives of the assets and liabilities and recognition of current market events with respect to retail deposit taking business:

- modest growth in assets of 2.5% per annum from 2014 onward;
- net interest margin of 1.39% by 2014 thereafter growing by 1.5bps per annum until 2024;
- other income of 0.14% of average total assets by 2014, thereafter growing by 0.2bps per annum until 2024;
- management expenses of 0.72% of average total assets in 2014 reducing gradually to 0.57% by 2024;
- loss provisions of 0.10% of total average assets each year from 2014 onward;
- additional payments that would have been made to the members of Britannia Building Society had the transfer of engagements not occurred of 35% of profit before taxation in 2014, growing by 2.5% per annum to 40% in 2016 and remaining at 40% thereafter; and
- a discount rate of 11% has been applied to the additional payments that would have been made to the members of Britannia Building Society.

The calculations have been flexed to assess the sensitivities to reasonable changes in the already conservative assumptions. This sensitivity analysis did not indicate any likely impairment of the goodwill.

20. Intangible fixed assets

	Group 2010			Group 2009		
	Internally generated intangible assets	**Other intangible assets**	**Total**	Internally generated intangible assets	Other intangible assets	Total
Cost						
At the beginning of the year	**18.9**	**46.0**	**64.9**	19.5	–	19.5
Amounts arising on transfer of engagements	**–**	**–**	**–**	–	46.0	46.0
Additions	**3.1**	**–**	**3.1**	2.9	–	2.9
Disposals	**(8.1)**	**–**	**(8.1)**	(3.5)	–	(3.5)
At the end of the year	**13.9**	**46.0**	**59.9**	18.9	46.0	64.9
Accumulated amortisation						
At the beginning of the year	**15.1**	**3.7**	**18.8**	17.2	–	17.2
Charge for the year	**1.5**	**2.6**	**4.1**	1.4	3.7	5.1
Disposals	**(8.1)**	**–**	**(8.1)**	(3.5)	–	(3.5)
At the end of the year	**8.5**	**6.3**	**14.8**	15.1	3.7	18.8
Net book value						
At the end of the year	**5.4**	**39.7**	**45.1**	3.8	42.3	46.1
At the beginning of the year	3.8	42.3	46.1	2.3	–	2.3

	Bank 2010			Bank 2009		
	Internally generated intangible assets	**Other intangible assets**	**Total**	Internally generated intangible assets	Other intangible assets	Total
Cost						
At the beginning of the year	**17.3**	**46.0**	**63.3**	18.4	–	18.4
Amounts arising on transfer of engagements	**–**	**–**	**–**	–	46.0	46.0
Additions	**2.7**	**–**	**2.7**	2.4	–	2.4
Disposals	**(6.9)**	**–**	**(6.9)**	(3.5)	–	(3.5)
At the end of the year	**13.1**	**46.0**	**59.1**	17.3	46.0	63.3
Accumulated amortisation						
At the beginning of the year	**14.7**	**3.7**	**18.4**	16.9	–	16.9
Charge for the year	**1.2**	**2.6**	**3.8**	1.3	3.7	5.0
Disposals	**(6.9)**	**–**	**(6.9)**	(3.5)	–	(3.5)
At the end of the year	**9.0**	**6.3**	**15.3**	14.7	3.7	18.4
Net book value						
At the end of the year	**4.1**	**39.7**	**43.8**	2.6	42.3	44.9
At the beginning of the year	2.6	42.3	44.9	1.5	–	1.5

Internally generated intangible assets consist of software development costs.

Other intangible assets consist of a core deposit intangible of £44m and a brand intangible of £2m. The brand intangible has an indefinite useful life and is not amortised but is subject to an annual impairment review, using the same assumptions as those used for goodwill (refer to note 19). On the basis of this review the brand is considered to be unimpaired.

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

21. Investment properties

	Group	
	2010	2009
Fair value		
At the beginning of the year	**137.7**	–
Amounts arising on transfer of engagements	**–**	123.7
Additions – acquisitions	**21.6**	8.9
Additions – subsequent expenditure	**3.6**	1.6
Disposals	**(0.5)**	–
Changes in fair value (note 7)	**(0.1)**	3.5
At the end of the year	**162.3**	137.7

All investment properties are held to generate rental income until such time that the Group considers it appropriate to realise its investment. Investment properties are carried at fair value.

The range of yields applied to the net annual rental income to determine the fair value of property is 3% to 8%.

The Group lets investment properties on Assured Shorthold Tenancy agreements, most of which are for contract periods of no more than 12 months. The future minimum lease receipts under non-cancellable operating leases are £2.4m (2009: £1.8m). The Group has not recognised any contingent rent in the year (2009: £nil). None of the lease agreements are individually significant.

Included in Group other operating income for the year is £6.5m (2009: £2.1m) of rental income relating to investment properties (note 7).

22. Property, plant and equipment

2010 Group	**Land and buildings**	**Leasehold improvements**	**Computers and other equipment**	**Total**
Cost				
At the beginning of the year	**55.7**	**24.9**	**134.6**	**215.2**
Additions	**–**	**–**	**2.6**	**2.6**
Disposals	**–**	**–**	**(12.1)**	**(12.1)**
At the end of the year	**55.7**	**24.9**	**125.1**	**205.7**
Accumulated depreciation				
At the beginning of the year	**4.1**	**2.8**	**86.8**	**93.7**
Charge for the year	**1.3**	**5.2**	**18.3**	**24.8**
Disposals	**–**	**–**	**(11.3)**	**(11.3)**
At the end of the year	**5.4**	**8.0**	**93.8**	**107.2**
Net book value				
At the end of the year	**50.3**	**16.9**	**31.3**	**98.5**
At the beginning of the year	51.6	22.1	47.8	121.5

2010 Bank	**Land and buildings**	**Leasehold improvements**	**Computers and other equipment**	**Total**
Cost				
At the beginning of the year	**34.8**	**24.8**	**130.9**	**190.5**
Additions	**–**	**–**	**1.6**	**1.6**
Disposals	**–**	**–**	**(11.5)**	**(11.5)**
At the end of the year	**34.8**	**24.8**	**121.0**	**180.6**
Accumulated depreciation				
At the beginning of the year	**1.4**	**2.8**	**84.7**	**88.9**
Charge for the year	**0.8**	**5.1**	**17.4**	**23.3**
Disposals	**–**	**–**	**(10.7)**	**(10.7)**
At the end of the year	**2.2**	**7.9**	**91.4**	**101.5**
Net book value				
At the end of the year	**32.6**	**16.9**	**29.6**	**79.1**
At the beginning of the year	33.4	22.0	46.2	101.6

22. Property, plant and equipment continued

2009 Group	Land and buildings	Leasehold improvements	Computers and other equipment	Total
Cost				
At the beginning of the year	10.1	–	144.2	154.3
Amounts arising on transfer of engagements	45.6	24.8	12.2	82.6
Additions	–	0.1	1.6	1.7
Disposals	–	–	(23.4)	(23.4)
At the end of the year	55.7	24.9	134.6	215.2
Accumulated depreciation				
At the beginning of the year	3.5	–	91.2	94.7
Charge for the year	0.6	2.8	17.6	21.0
Disposals	–	–	(22.0)	(22.0)
At the end of the year	4.1	2.8	86.8	93.7
Net book value				
At the end of the year	51.6	22.1	47.8	121.5
At the beginning of the year	6.6	–	53.0	59.6

2009 Bank	Land and buildings	Leasehold improvements	Computers and other equipment	Total
Cost				
At the beginning of the year	2.6	–	141.9	144.5
Amounts arising on transfer of engagements	32.2	24.7	11.1	68.0
Additions	–	0.1	1.2	1.3
Disposals	–	–	(23.3)	(23.3)
At the end of the year	34.8	24.8	130.9	190.5
Accumulated depreciation				
At the beginning of the year	1.0	–	89.6	90.6
Charge for the year	0.4	2.8	16.9	20.1
Disposals	–	–	(21.8)	(21.8)
At the end of the year	1.4	2.8	84.7	88.9
Net book value				
At the end of the year	33.4	22.0	46.2	101.6
At the beginning of the year	1.6	–	52.3	53.9

	Group		Bank	
	2010	2009	**2010**	2009
The net book value of land and buildings comprises:				
Freehold	**49.7**	51.0	**31.8**	32.8
Leasehold	**0.6**	0.6	**0.6**	0.6
	50.3	51.6	**32.4**	33.4

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

23. Other assets

	Group		Bank	
	2010	2009	**2010**	2009
Amounts recoverable within one year:				
Trade debtors	**1.4**	1.7	**1.3**	1.7
Current tax assets	**–**	–	**–**	21.2
Other assets	**51.1**	20.4	**50.2**	22.9
	52.5	22.1	**51.5**	45.8

24. Prepayments and accrued income

	Group		Bank	
	2010	2009	**2010**	2009
Amounts recoverable within one year:				
Other	**16.2**	30.1	**14.5**	27.4

25. Deposits by banks

	Group		Bank	
	2010	2009	**2010**	2009
Items in course of collection	**45.3**	53.9	**45.3**	53.9
Deposits from other banks	**2,893.3**	6,028.5	**2,825.5**	5,559.1
	2,938.6	6,082.4	**2,870.8**	5,613.0

Included within deposits from other banks are liabilities of £1,349.1m (2009: £2,998.8m) secured on investment securities with a carrying value of £1,550.9m (2009: £3,697.0m) which have been sold under sale and repurchase agreements (note 35).

26. Customer accounts

	Group		Bank	
	2010	2009	**2010**	2009
Retail	**26,846.6**	26,700.1	**26,081.7**	26,041.5
Corporate and Markets	**4,900.1**	3,577.1	**3,830.3**	2,618.5
Other	**573.3**	551.0	**–**	–
	32,320.0	30,828.2	**29,912.0**	28,660.0

The Group has entered into interest rate swaps that protect it from changes in interest rates on the floating rate assets that are funded by its fixed rate customer accounts. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed rate customer accounts. Included within customer accounts are 'fair value hedged' fixed rate accounts with a total nominal value of £84.7m (2009: £3,359.3m) against which there are fair value adjustments for hedged risk of £0.2m (2009: £9.7m), giving a total carrying value of £84.9m (2009: £3,369.0m).

27. Customer accounts – capital bonds

	Group		Bank	
	2010	2009	**2010**	2009
Retail	**1,794.7**	1,647.1	**1,744.0**	1,581.7

The capital bonds are fixed term customer accounts with returns based on the movement in an index (eg FTSE100) over the term of the bond.

The capital bonds have been designated on initial recognition at fair value through income and expense and are carried at their fair value.

The fair values for the capital bonds are obtained on a monthly basis from the third parties that issue these products. These external valuations are reviewed independently using valuation software to ensure the fair values are priced on a consistent basis.

None of the change in the fair value of the capital bonds is attributable to changes in the liability's credit risk.

The maximum amount the Group would contractually be required to pay at maturity for all the capital bonds is £1,756.0m (2009: £1,653.2m).

The Group uses swaps to create economic hedges against all of its capital bonds. The gain on capital bonds in the income statement for the year is £28.5m (2009: £41.8m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the year is a loss of £0.3m (2009: loss of £0.2m).

28. Debt securities in issue

	Group		Bank	
	2010	2009	**2010**	2009
Certificates of deposit	**638.8**	294.9	**638.8**	294.9
Commercial paper	**20.1**	71.5	**20.1**	71.5
Fixed and floating rate notes	**3,553.3**	2,967.9	**1,197.9**	1,372.9
	4,212.2	3,334.3	**1,856.8**	1,739.3

The Group has entered into cross currency interest rate swaps that protect it from changes in exchange rates and interest rates on its debt securities in issue. Changes in the fair values of these swaps are largely offset by changes in the sterling equivalent carrying value of the debt securities in issue.

Debt securities in issue include fixed and floating rate notes, the majority of which are secured on portfolios of variable and fixed rate mortgages. The notes are redeemable in part from time to time, such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets. There is no requirement for the Group to make good any shortfall out of general funds. The maturity date of the notes matches the maturity date of the underlying assets.

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

29. Other borrowed funds

	Group		Bank	
	2010	2009 restated	**2010**	2009 restated
£150,000,000 Step up callable subordinated notes 2019	**150.0**	150.0	**150.0**	150.0
60,000,000 9.25% non-cumulative irredeemable preference shares of £1 each	**60.0**	60.0	**60.0**	60.0
Floating rate subordinated notes 2016	**104.1**	102.8	**104.1**	102.8
Subordinated notes 2021	**150.0**	150.0	**150.0**	150.0
Fixed rate subordinated notes 2024	**144.0**	130.6	**144.0**	130.6
Fixed rate subordinated notes 2033	**99.1**	91.9	**99.1**	91.9
Perpetual subordinated bonds	**253.2**	246.6	**253.2**	246.6
Issue costs, discounts and accrued interest	**15.0**	14.6	**15.0**	14.6
	975.4	946.5	**975.4**	946.5

The 2009 restatement relates to a reclassification of accrued interest.

Step up callable subordinated notes 2019
The notes were issued on 1 April 2004 at a discount of 0.946%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an interest rate of 5.875% per annum to (but excluding) 2 April 2014, and thereafter the interest rate will be determined by reference to the gross redemption yield on the five year benchmark gilt, and a margin of 2.25%. Interest is payable annually in arrears on 2 April.

The Bank may redeem all, but not less than all, of the notes at their principal amount on 2 April 2014.

60,000,000 9.25% non-cumulative irredeemable preference shares of £1 each
The preference shares carry the right to a fixed non-cumulative preferential dividend on the capital for the time being paid up, at the rate of 9.25% per annum exclusive of any associated tax credit. The dividends are payable on 31 May and 30 November each year and take priority over dividends to any other class of share in the capital of the Bank.

On a return of capital on winding up, the assets of the Bank shall be applied in repaying the preference share capital in priority to any payments to the holders of any other class of shares in the capital of the Bank. The amount receivable by the holders of the preference shares shall be the greater of the capital paid up or the average quoted price during the three months immediately preceding the date of the notice convening the meeting to consider the resolution to wind up.

The holders of the preference shares shall have the right to vote at a general meeting of the Bank only if and when, at the date of the notice convening the meeting, the dividend due to them has been in arrears for six months or more or if a resolution is to be proposed at the meeting abrogating or varying their rights or privileges or for the winding up of the Bank or other return of capital and then only on that resolution.

Floating rate subordinated notes 2016
The notes were issued on 18 May 2006 at a discount of 0.14%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes are denominated in euros and interest is calculated at three months EURIBOR plus a margin of 0.28%. The first interest coupon was paid in August 2006.

The notes are hedged with a cross currency swap converting the exposure into sterling which pays floating rate at three months LIBOR with a margin on interest coupon of 0.34125% and receives floating rate of three months EURIBOR plus a margin on interest coupon of 0.28%. The cross currency swap matures on 18 May 2011.

The Bank may redeem all, but not less than all, of the notes at the principal amount on 18 May 2011, and on any quarterly interest payment date thereafter.

Subordinated notes 2021
The notes were issued on 16 November 2006 at a discount of 0.189%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.625% up to and including the interest payment date on 16 November 2016, when the interest basis changes to floating rate. During the fixed rate period, interest is payable semi-annually in arrears on 16 May and 16 November.

From 17 November 2016, the notes carry a floating interest rate of three months LIBOR plus a margin of 1.75%. Interest is payable quarterly in arrears on 16 February, 16 May, 16 August and 16 November, commencing on the interest payment date falling in February 2017 up to and including the maturity date.

The Bank may redeem all, but not less than all, of the notes at the principal amount on 16 November 2016, and on any quarterly interest payment date thereafter.

29. Other borrowed funds continued

Fixed rate subordinated notes 2024

The notes were issued on 17 March 2004 at a discount rate of 1.148%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.75% to maturity. The notes are hedged with interest rate swaps that convert the interest rate payable into floating rates at six months LIBOR plus a margin of 0.72%. The fixed receipt leg of the swap is received annually to match the payment to the noteholders. The floating payment leg of the swap is payable semi-annually in June and December. The interest rate swaps mature on 2 December 2019.

The Bank may redeem all, but not less than all, of the notes at the principal amount on 2 December 2019, and on any quarterly interest payment date thereafter.

Fixed rate subordinated notes 2033

The notes were issued on 28 March 2002 at a discount rate of 0.93%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.875% to maturity. Interest is payable semi-annually in March and September.

Of the notes, £100m are hedged with interest rate swaps that have a floating payment leg at six months LIBOR payable in March and September. The fixed interest rate receivable legs on the swaps are £25m at 5.405% and £75m at 5.225%. The annual interest receivable leg on the swap is matched to the dates on the notes.

Perpetual subordinated bonds

Following the transfer of engagements of Britannia Building Society, the Britannia permanent interest bearing shares (PIBS) were converted into perpetual subordinated debt of the Co-operative Financial Services (perpetual subordinated bonds).

From 1 August 2009, the Bank assumed a liability to each PIBS holder for a subordinated deposit equal to the principal amount of their PIBS. These deposits have automatically been applied in subscription to either perpetual subordinated bonds having an annual interest rate of 13% in respect of the 'first perpetual subordinated bonds' or perpetual subordinated bonds having an annual interest rate of 5.5555% in respect of the 'second perpetual subordinated bonds' for an amount corresponding to the principal amount of that holder's PIBS.

The trustee for the holders of the perpetual subordinated bonds is The Law Debenture Trust Corporation plc whose registered office is Fifth Floor, 100 Wood Street, London, EC2V 7EX.

The FSA must give prior written consent to the early repayment, including the purchase of the notes or stock by the Group, for cancellation of any subordinated bond.

30. Other liabilities

	Group		Bank	
	2010	2009	**2010**	2009
Amounts falling due within one year:				
Other creditors	**142.8**	217.7	**136.7**	206.7
Amounts falling due after one year:				
Other creditors	**4.0**	4.2	**3.8**	4.1
	146.8	221.9	**140.5**	210.8

Other creditors for the Group and Bank include finance lease obligations as follows:

	Present value of lease payments		Future minimum lease payments	
	2010	2009	**2010**	2009
Due within one year	**–**	–	**–**	–
Due between one year and five years	**0.1**	0.1	**0.1**	0.1
Due after five years	**1.3**	1.2	**1.7**	1.8
	1.4	1.3	**1.8**	1.9

The future minimum lease payments have been discounted at LIBOR over the term of the lease to give the present value of these payments.

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

31. Accruals and deferred income

	Group		Bank	
	2010	2009	**2010**	2009
Amounts falling due within one year:				
Other	**85.3**	148.1	**71.1**	124.5
Amounts falling due after one year:				
Other	**46.0**	9.9	**45.9**	9.8
	131.3	158.0	**117.0**	134.3

32. Provisions for liabilities and charges

2010 Group	**Property**	**FSCS levies**	**Regulatory/ other**	**Total**
At the beginning of the year	**7.1**	**20.6**	**25.1**	**52.8**
Income statement movements:				
Provided in the year – operating expense (note 8)	**3.4**	**11.5**	**3.5**	**18.4**
Provided in the year – operating income (note 5)	**–**	**–**	**13.1**	**13.1**
Released during the year (note 8)	**(0.3)**	**–**	**(12.3)**	**(12.6)**
Utilised during the year	**(1.4)**	**(11.2)**	**(3.3)**	**(15.9)**
At the end of the year	**8.8**	**20.9**	**26.1**	**55.8**
Provisions were analysed as follows:				
Amounts falling due within one year	**1.2**	**10.6**	**24.1**	**35.9**
Amounts falling due after one year	**7.6**	**10.3**	**2.0**	**19.9**
	8.8	**20.9**	**26.1**	**55.8**

2010 Bank	**Property**	**FSCS levies**	**Regulatory/ other**	**Total**
At the beginning of the year	**5.4**	**20.1**	**19.5**	**45.0**
Income statement movements:				
Provided in the year – operating expense	**3.2**	**11.0**	**–**	**14.2**
Provided in the year – operating income	**–**	**–**	**4.3**	**4.3**
Released during the year	**(0.2)**	**–**	**(12.2)**	**(12.4)**
Utilised during the year	**(1.0)**	**(10.8)**	**–**	**(11.8)**
At the end of the year	**7.4**	**20.3**	**11.6**	**39.3**
Provisions were analysed as follows:				
Amounts falling due within one year	**1.0**	**9.7**	**11.6**	**22.3**
Amounts falling due after one year	**6.4**	**10.6**	**–**	**17.0**
	7.4	**20.3**	**11.6**	**39.3**

32. Provisions for liabilities and charges continued

2009 restated Group	Property	FSCS levies	Regulatory/ other	Total
At the beginning of the year	5.1	10.5	0.2	15.8
Arising on transfer of engagements	4.0	10.1	19.5	33.6
Income statement movements:				
Provided in the year – operating expense (note 8)	0.9	10.1	5.5	16.5
Released during the year (note 8)	(2.2)	(6.4)	(0.1)	(8.7)
Utilised during the year	(0.7)	(3.7)	–	(4.4)
At the end of the year	7.1	20.6	25.1	52.8
Provisions were analysed as follows:				
Amounts falling due within one year	1.6	11.6	21.4	34.6
Amounts falling due after one year	5.5	9.0	3.7	18.2
	7.1	20.6	25.1	52.8

2009 restated Bank	Property	FSCS levies	Regulatory/ other	Total
At the beginning of the year	4.5	10.2	–	14.7
Arising on transfer of engagements	2.7	10.1	19.5	32.3
Income statement movements:				
Provided in the year	0.9	9.7	–	10.6
Released during the year	(2.0)	(6.3)	–	(8.3)
Utilised during the year	(0.7)	(3.6)	–	(4.3)
At the end of the year	5.4	20.1	19.5	45.0
Provisions were analysed as follows:				
Amounts falling due within one year	0.9	11.2	19.5	31.6
Amounts falling due after one year	4.5	8.9	–	13.4
	5.4	20.1	19.5	45.0

Property

The Group has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases using the discount rate applied in the goodwill calculations of 11%.

FSCS levies

In common with other financial institutions authorised by the FSA, the Group contributes to the Financial Services Compensation Scheme (FSCS). The FSCS covers financial institutions authorised to do business in the UK. When an institution is unlikely, or likely to be unable, to pay claims against it, its customers may be able to claim compensation from the FSCS. The FSCS raises funds to meet the known compensation claims through levies on other FSA authorised institutions.

As a result of a number of institutions failing during 2008, the FSCS received funds from HM Treasury in order to meet its obligations to depositors. These borrowings are anticipated to be repaid wholly or substantially from the realisation of the assets of the failed institutions.

The FSCS raises annual levies from the banking industry in order to meet its management expenses and compensation costs. The annual levies are based upon each individual institution's proportion of protected deposits of the total market protected deposits at 31 December each year.

The Group has provided £20.9m (2009: £20.6m) for its share of the levies that will be raised by the FSCS including the interest on the loan from the HM Treasury in respect of the levy years 31 March 2011 to 31 March 2012 respectively. The provision includes estimates for the interest the FSCS will pay on the loan and of the Group's market participation in the relevant years.

At the date of these financial statements, it is not possible to estimate whether there will ultimately be additional levies on the industry, the level of the Group's market participation or other factors that may affect amounts or the timing of amounts that may ultimately become payable, nor the effect that such levies may have upon operating results in any particular year.

The Financial Services Commission in the Isle of Man operates a similar scheme. Britannia International Limited has provided £0.3m (2009: £0.3m) for the year ended 31 December 2010 in respect of this scheme.

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

32. Provisions for liabilities and charges continued

Regulatory/other

Provisions have been made in respect of various potential customer compensation claims. Claims are investigated on an individual basis and, where appropriate, compensation payments are made.

The release of regulatory/other provision relates to a disputed claim which was resolved during the year.

33. Deferred tax

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 27% (2009: 28%).

The movements on the deferred tax accounts are as follows:

	Group		Bank	
	2010	2009 restated	**2010**	2009
Net deferred tax at the beginning of the year	**86.1**	(27.0)	**210.3**	(22.5)
Amounts arising on transfer of engagements	**–**	124.6	**–**	233.0
Income statement charge	**(2.5)**	(20.9)	**(57.8)**	(9.3)
Prior year adjustments	**2.1**	0.3	**0.2**	–
Charged to equity:				
Unrealised appreciation on investments	**–**	1.1	**–**	1.1
Pension fund deficit	**0.1**	0.1	**0.1**	0.1
Cashflow hedges	**1.2**	7.9	**1.2**	7.9
Net deferred tax at the end of the year	**87.0**	86.1	**154.0**	210.3
Net deferred tax comprises:				
Deferred tax asset	**203.3**	285.2	**154.0**	230.9
Deferred tax liability	**(116.3)**	(199.1)	**–**	(20.6)
	87.0	86.1	**154.0**	210.3
Deferred tax				
Cashflow hedges	**(13.4)**	(11.1)	**(13.4)**	(11.1)
Unrealised appreciation on investments	**(1.1)**	(2.9)	**(1.1)**	(2.8)
Capital allowances on fixed assets	**32.6**	(3.1)	**33.6**	(2.0)
Capital allowances on assets leased to customers	**(3.5)**	(4.0)	**0.2**	–
Pensions and other post-retirement benefits	**1.0**	1.0	**1.0**	1.0
Fair value adjustments	**34.5**	26.3	**129.0**	198.4
Other temporary differences	**36.9**	74.9	**4.7**	21.8
Tax losses carried forward	**–**	5.0	**–**	5.0
	87.0	86.1	**154.0**	210.3

Other temporary differences for the Group of £36.9m (2009: £74.9m) include deferred tax assets/liabilities as a result of interest deductible when paid, loss provisions on mortgage assets held by Special Purpose Entities (SPEs), taxation of SPEs under the securitisation regime and spreading of the tax effect of IFRS transitional adjustments.

The deferred tax charge in the income statement comprises the following temporary differences:

	Group		Bank	
	2010	2009	**2010**	2009
Cashflow hedges	**–**	0.2	**–**	0.2
Capital allowances on fixed assets	**4.2**	(1.4)	**4.3**	(1.6)
Capital allowances on assets leased to customers	**(0.5)**	(0.3)	**(0.2)**	(0.2)
Fair value adjustments	**(44.3)**	46.8	**33.4**	13.1
Other temporary differences	**41.0**	(37.6)	**20.1**	(14.0)
Tax losses carried forward	**–**	12.9	**–**	11.8
	0.4	20.6	**57.6**	9.3

The Budget on 23 March 2011 announced that the UK corporation tax rate will reduce from 28% to 23% over a period of four years from 2011. The first reduction in the UK corporation tax rate from 28% to 27% was substantively enacted on 20 July 2010 and would have been effective from 1 April 2011. The budget on 23 March now proposes that a UK corporation tax rate of 26% will be effective from 1 April 2011. This will reduce the Group's future current tax charge accordingly. The tax disclosures for the period reflect the deferred tax at the 27% substantively enacted rate. It has not yet been possible to quantify the full anticipated effect of the further rate reductions, although this will further reduce the Group's future tax charge and reduce the Group's deferred tax assets/liabilities accordingly.

34. Pensions

Defined contribution basis

With effect from 6 April 2006 the Bank Group, along with other businesses within The Co-operative Group has participated in the Co-operative Group Pension (Average Career Earnings) Scheme (the PACE scheme). This scheme is a defined benefit scheme, the assets of which are held in a separate fund administered by trustees. As a group wide pension scheme, the PACE scheme exposes the participating businesses to actuarial risks associated with the current and former employees of other Group companies, with the result that there is no consistent and reliable basis for allocating liabilities, assets and costs to individual companies participating in the scheme. Therefore the pension cost shown in these accounts in respect of the PACE scheme for the period after 6 April 2006 is the actual contributions paid by the Bank.

Key assumptions of the Group pension scheme

The key aspects of The Co-operative Group's PACE scheme are as follows:

	2010	2009
The principal assumptions used to determine the liabilities of the PACE scheme are:		
Discount rate	**5.20%**	5.60%
Rate of increase in salaries	**5.20%**	5.30%
Future pension increases where capped at 5.0% per annum	**3.70%**	3.80%
Future pension increases where capped at 2.5% per annum	**2.50%**	2.50%
Assumptions used to determine net pension cost for the PACE scheme are:		
Discount rate	**5.60%**	5.70%
Expected long term return on scheme assets	**6.50%**	6.40%
Rate of increase in salaries	**5.30%**	4.75%

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the PACE scheme at the 2010 year end is:

	Male	**Female**
Life expectancy:		
Member currently aged 65 (current life expectancy)	**21.7**	**23.3**
Member currently aged 45 (life expectancy at age 65)	**23.2**	**24.9**

The amounts recognised in the balance sheet of The Co-operative Group are as follows:

	2010	2009
Present value of funded obligations	**(5,794.2)**	(5,509.0)
Present value of unfunded obligations	**(4.1)**	(3.8)
Fair value of plan assets	**6,071.3**	5,514.4
	273.0	1.6

The weighted average asset allocations at the year end were as follows:

	2010	2009
Equities	**31%**	35%
Liability driven investments	**54%**	54%
Alternative growth	**9%**	6%
Property	**4%**	4%
Cash	**2%**	1%

To develop the expected long term rate of return on assets assumption, the Group considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long term rate of return on assets assumption for the portfolio. This resulted in the selection of the 6.5% assumption for the year ended 31 December 2010.

Former Britannia Building Society pension scheme

Following the transfer of engagements of Britannia Building Society, the Britannia pension scheme transferred to the Co-operative Financial Services Management Services Limited (CFSMS). The pension cost shown in these accounts in respect of the Britannia defined benefit scheme for the period after 31 July 2009 is the actual contribution paid by the Bank.

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

34. Pensions continued
The key aspects of the Britannia defined benefit scheme are as follows:

	2010	2009
The principal assumptions used to determine the liabilities of the Britannia defined benefit scheme are:		
Discount rate	**5.20%**	5.60%
Rate of increase in salaries	**5.20%**	5.30%
Future pension increases where capped at 5.0% per annum	**3.70%**	3.80%
Future pension increases where capped at 2.5% per annum	**2.50%**	2.50%
Assumptions used to determine net pension cost for the Britannia defined benefit scheme are:		
Discount rate	**5.60%**	6.30%
Expected long term return on scheme assets	**6.20%**	6.40%
Rate of increase in salaries	**5.30%**	5.30%

The average life expectancy (in years) for mortality tables used to determine defined benefit scheme liabilities for the former Britannia Building Society scheme at the 2010 year end is:

	Male	Female
Life expectancy:		
Member currently aged 65 (current life expectancy)	**23.4**	**25.7**
Member currently aged 40 (life expectancy at age 60)	**24.9**	**27.3**

	2010	2009
Present value of funded obligations	**(549.4)**	(478.1)
Present value of unfunded obligations	**(5.6)**	(4.7)
Fair value of plan assets	**509.2**	449.6
	(45.8)	(33.2)

	2010	2009
The weighted average asset allocations at the year end were as follows:		
Equities	**28%**	26%
Diversified growth	**17%**	20%
Liability driven investments	**54%**	54%
Property	**1%**	–

Bank (unfunded) pension scheme
The Bank also operates a small unfunded pension scheme.

	2010	2009	2008	2007	2006
Expected return on scheme assets	**N/A**	N/A	N/A	N/A	N/A
Rate of increase of pensions in payment	**3.7%**	3.8%	3.3%	3.4%	2.9%
Rate of increase in salaries	**5.2%**	5.3%	4.8%	4.9%	4.4%
Discount rate	**5.2%**	5.6%	5.7%	5.7%	4.9%

The assumptions used by the actuary were the best estimates chosen from a range of possible actuarial assumptions which, due to the timescales covered, may not necessarily be borne out in practice.

The values of the assets and liabilities of the unfunded pension scheme were:

	Group		Bank	
	2010	2009	2010	2009
Present value of unfunded obligations	**(3.8)**	(3.5)	**(3.8)**	(3.5)
Deficit in scheme	**(3.8)**	(3.5)	**(3.8)**	(3.5)
Related deferred tax asset	**1.0**	1.0	**1.0**	1.0
Net pension liability	**(2.8)**	(2.5)	**(2.8)**	(2.5)
Analysis of amount charged to income statement:				
Current service cost	**–**	–	**–**	–
Interest on pension scheme liabilities	**0.2**	0.2	**0.2**	0.2
	0.2	0.2	**0.2**	0.2

34. Pensions continued

Changes in the present value of the scheme liabilities are as follows:

	Group		Bank	
	2010	2009	**2010**	2009
Opening defined benefit liabilities	**3.5**	3.2	**3.5**	3.2
Current service cost	**–**	–	**–**	–
Interest on liabilities	**0.2**	0.1	**0.2**	0.1
Actuarial losses	**0.3**	0.3	**0.3**	0.3
Benefits paid	**(0.2)**	(0.1)	**(0.2)**	(0.1)
Closing defined benefit liabilities	**3.8**	3.5	**3.8**	3.5

Amounts recognised in the statement of comprehensive income:

	Group		Bank	
	2010	2009	**2010**	2009
Actuarial losses on scheme liabilities during the year	**(0.3)**	(0.3)	**(0.3)**	(0.3)
Actuarial gains on scheme assets during the year	**–**	–	**–**	–
Total scheme losses during the year	**(0.3)**	(0.3)	**(0.3)**	(0.3)

The amounts for the current year are as follows:

	Group		Bank	
	2010	2009	**2010**	2009
Defined benefit obligation	**(3.8)**	(3.5)	**(3.8)**	(3.5)
Scheme assets	**–**	–	**–**	–
Deficit in scheme	**(3.8)**	(3.5)	**(3.8)**	(3.5)
Experience adjustment on scheme liabilities	**–**	–	**–**	–
Experience adjustment on scheme assets	**–**	–	**–**	–

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

35. Contingent liabilities and commitments

The tables below give, for the Group and Bank, the nominal principal amounts, credit equivalent amounts and risk weighted amounts of contingent liabilities and commitments. The nominal principal amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The credit equivalent and risk weighted amounts have been calculated in accordance with the FSA guidelines implementing the Capital Requirements Directive (CRD).

The contingent liabilities of the Group and the Bank as detailed below arise in the normal course of banking business and it is not practical to quantify their future financial effect.

	Contract amount 2010	**Credit equivalent amount[i] 2010**	**Average risk weight 2010**	**Risk weighted amount 2010**	Contract amount 2009	Risk weighted amount 2009
Group						
Contingent liabilities:						
Guarantees and irrevocable letters of credit	**134.2**	**108.9**	**91.0%**	**99.1**	118.9	89.5
Bank						
Contingent liabilities:						
Guarantees and irrevocable letters of credit	**132.8**	**108.2**	**90.9%**	**98.4**	116.8	88.5
Group						
Other commitments:						
Documentary credits and short term trade related transactions	**2.8**	**0.6**	**83.3%**	**0.5**	2.1	0.4
Forward asset purchases and forward deposits placed	**165.8**	**165.8**	**8.8%**	**14.6**	164.5	78.2
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[ii]	**4,590.9**	**2,782.0**	**39.2%**	**1,089.3**	4,822.9	1,032.9
	4,759.5	**2,948.4**	**37.5%**	**1,104.4**	4,989.5	1,111.5
Bank						
Other commitments:						
Documentary credits and short term trade related transactions	**2.8**	**0.6**	**83.3%**	**0.5**	2.1	0.4
Forward asset purchases and forward deposits placed	**165.8**	**165.8**	**8.8%**	**14.6**	164.5	78.2
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[ii]	**4,450.9**	**2,705.1**	**40.0%**	**1,081.5**	4,656.4	995.8
	4,619.5	**2,871.5**	**38.2%**	**1,096.6**	4,823.0	1,074.4

Notes

(i) Under the CRD credit conversion factors are applied to exposures subject to the Standard and Foundation IRB approach, primarily Corporate and Wholesale exposures as defined by BIPRU. Under the retail IRB approach the Credit Equivalent amount is defined as Exposure at Default.

(ii) Undrawn loan commitments include revocable commitments which are unused credit card limits of £2,344.9m (2009: £2,621.9m).

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Group's day to day operations. Mandatory reserve deposits are also held with the Bank of England in accordance with statutory requirements.

At 31 December 2010, the mandatory reserve deposits held with the Bank of England were £36.1m (2009: £34.0m) (see note 13).

Investment securities with a carrying value of £1,550.9m (2009: £3,697.0m) have been sold under sale and repurchase agreements. These assets have not been derecognised as the Group and Bank has retained substantially all the risks and rewards of ownership. Included within deposits by banks are the related liabilities of £1,349.1m (2009: £2,998.8m). Also £988.6m (2009: £nil) of amounts owed by other Co-operative Group undertakings, held by the Bank, have been sold under sale and repurchase agreements, included within deposits by banks are the related liabilities of £778.6m (2009: £nil).

The Group and Bank have loans and advances to banks of £70.0m (2009: £nil) under reverse sale and repurchase agreements and against which it holds gilts with a fair value of £70.0m (2009: £nil). These transactions are conducted under terms that are usual and customary to standard stock lending, securities borrowing and reverse purchase agreements. The Group is permitted to sell or repledge the assets received as collateral in the absence of their default. The Group is obliged to return equivalent securities. At 31 December 2010 the fair value of collateral repledged amounted to £70.0m (2009: £nil). The Group and Bank do not adjust for the fair value of securities received under reverse sale and repurchase agreements.

35. Contingent liabilities and commitments continued

Commitments under operating leases

The Group leases various properties and equipment under non-cancellable operating lease arrangements. The leases have various terms, ranging from six months to 999 years. None of these leases are individually material and none have any material clauses. The table below discloses the minimum operating lease payments the Group and the Bank will be required to make over the remaining lives of the leases.

	Land and buildings 2010	**Equipment 2010**	Land and buildings 2009	Equipment 2009
Group				
Falling due:				
Within one year	**24.4**	**0.4**	22.2	0.8
Between one and five years	**78.6**	**0.4**	74.8	0.7
In five years or more	**103.5**	**–**	110.5	0.1
	206.5	**0.8**	207.5	1.6
Bank				
Falling due:				
Within one year	**24.0**	**0.4**	22.0	0.8
Between one and five years	**75.9**	**0.4**	70.5	0.7
In five years or more	**84.5**	**–**	94.0	0.1
	184.4	**0.8**	186.5	1.6

The Group leases a number of branch and office premises under operating leases. The leases typically run for a period of up to 25 years, with an option to renew the lease after that period. Lease payments are generally reviewed every three to five years to reflect market rentals.

The total value of future minimum sub-lease payments expected to be received under non-cancellable sub-leases for the Group was £13.4m (2009: £13.3m) and for the Bank was £12.2m (2009: £12.2m).

Former Britannia Building Society pension scheme guarantee

Following the transfer of engagements of Britannia Building Society, the Britannia pension scheme transferred to CFSMS. Under the terms of this transfer the Bank entered into a deed of guarantee to provide assurance to the trustees of the pension scheme to support CFSMS in meeting its funding obligations to the scheme should CFSMS be unable to pay its obligations as they fall due.

Intra-group guarantee

The Bank has an indemnification agreement, accounted for as an intra-group guarantee under IFRS 4, with CFSMS in which the Bank has agreed to indemnify CFSMS against all and any liability, loss, damage, costs and expense arising from the agreement.

Payment protection insurance (PPI)

The Financial Services Authority (FSA) set out its requirements for this industry wide issue in a policy statement published on 10 August 2010. This amended the 'Disputes Resolution: Complaints' section of the FSA Handbook which sets out the rules for handling such complaints. Firms were initially required to comply with these new rules by 1 December 2010. However, in October 2010, the British Bankers Association (BBA) launched a judicial review on the basis that the FSA's policy statement applies incorrect standards for the management of complaints relating to PPI sales and also that it retrospectively applied rules with higher standards than those in place at the time of sale. Pending the outcome of this review, the implementation of the FSA's policy statement is on hold and therefore it is not practicable to make a reliable estimate of the amount of any provision that may be required.

The Bank stopped selling PPI at the beginning of 2009.

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

36. Investments in Group undertakings
Investments in equity shares and loans of subsidiary undertakings are financial assets.

	2010			2009 restated		
	Ordinary shares	**Capital contributions**	**Total**	Ordinary shares	Capital contributions	Total
At the beginning of the year	**576.4**	**996.0**	**1,572.4**	2.7	966.6	969.3
Arising on transfer of engagements	**–**	**–**	**–**	542.3	424.2	966.5
Additions	**11.5**	**386.0**	**397.5**	31.4	59.2	90.6
Impairment of investment in Co-operative Bank Financial Advisers Limited	**(18.9)**	**–**	**(18.9)**	–	–	–
Repayments	**–**	**(492.1)**	**(492.1)**	–	(454.0)	(454.0)
At the end of the year	**569.0**	**889.9**	**1,458.9**	576.4	996.0	1,572.4

Subsidiary undertakings
The Bank has, except in the case of Unity Trust Bank plc, a direct interest in the ordinary share capital of the following principal subsidiary undertakings trading in the businesses indicated. All subsidiary undertakings are included in the consolidated Group results.

Principal subsidiary undertakings which are registered in England and operating in the UK:

		Group interest 2010	Group interest 2009
Unity Trust Bank plc (held through subsidiary undertaking)	Banking	**27%**	27%
Co-operative Commercial Limited	Investment company	**100%**	100%
Roodhill Leasing Limited	Leasing	**100%**	100%
First Roodhill Leasing Limited	Leasing	**100%**	100%
Second Roodhill Leasing Limited	Leasing	**100%**	100%
Third Roodhill Leasing Limited	Leasing	**100%**	100%
Fourth Roodhill Leasing Limited	Leasing	**100%**	100%
Co-operative Bank Financial Advisers Limited	Financial advisers	**100%**	100%
The Covered Bond LLP	Mortgage acquisition and guarantor of covered bonds	**100%**	100%
Britannia Treasury Services Limited*	Holding company	**100%**	100%
Britannia Development and Management Company Limited*	Property investment	**100%**	100%
Britannia Asset Management Limited*	Holding company	**100%**	100%
Illius Properties Limited*	Property investment	**100%**	100%
Moorland Covered Bonds LLP* (formerly Britannia Covered Bonds LLP)	Mortgage acquisition and guarantor of covered bonds	**100%**	100%
Britannia Estate Agents Limited*	Former estate agents	**100%**	100%
Phoenix Credit Services Limited	In house debt recovery agents	**100%**	100%

During 2008, The Covered Bond LLP was established as a result of a £1.0bn covered bond issued by the Bank. Loans and advances to customers of £2.3bn were transferred to the LLP. The transfer was funded by a loan of £1.0bn and capital contribution of £1.3bn.

On the transfer of engagements of Britannia Building Society, the Bank obtained an interest in Moorland Covered Bonds LLP, which was established as a result of a £1.4bn covered bond issuance. Loans and advances to customers of £1.9bn were transferred to Moorland Covered Bonds LLP. The transfer was funded by a loan of £1.4bn and capital contribution of £0.5bn.

The loans issued by the Bank to fund the transfer of the loans and advances to customers are included within amounts owed by other Co-operative Group undertakings. The associated capital contribution invested by the Bank in both covered bond issuances is included within investments in Group undertakings. The covered bonds were immediately repurchased by the Bank and therefore no liability is recognised on the balance sheet.

The Covered Bond LLP and Moorland Covered Bonds LLP do not have ordinary share capital. The Bank's interest in The Covered Bond LLP and Moorland Covered Bonds LLP is in substance no different than a wholly owned subsidiary and consequently they are fully consolidated in the Group accounts.

The accounting policy for Special Purpose Entities (SPEs) is disclosed on pages 38 and 39.

Unity Trust Bank plc is considered to be a subsidiary undertaking of The Co-operative Bank plc as The Co-operative Bank plc elects a majority of the directors and appoints the chair and managing director. This provides the power to control.

Investments in equity shares and loans with subsidiary undertakings are shown net of impairments.

36. Investments in Group undertakings continued

Britannia Treasury Services Limited has the following wholly owned subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Mortgage Agency Services Number One Limited*	Mortgage and syndicated lending
Mortgage Agency Services Number Two Limited*	Mortgage lending
Mortgage Agency Services Number Three Limited*	Bank account custodian
Mortgage Agency Services Number Four Limited*	Mortgage lending
Mortgage Agency Services Number Five Limited*	Mortgage lending
Mortgage Agency Services Number Six Limited*	Mortgage lending
Mortgage Agency Services Number Seven Limited*	Mortgage lending
Western Mortgage Services Limited*	Mortgage book administration
Platform Group Holdings Limited*	Holding company

Platform Group Holdings Limited has the following wholly owned subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Platform Consumer Services Limited*	Mortgage lending
Platform Funding Limited*	Mortgage origination
Platform Funding No. 2 Limited*	Finance company
Platform Funding No. 3 Limited*	Finance company
Platform Funding No. 4 Limited*	Finance company
Platform Funding No. 5 Limited*	Finance company
Platform Funding No. 6 Limited*	Finance company
Platform Home Loans Limited*	Mortgage origination and servicing

Platform Consumer Services Limited is the only direct subsidiary of Platform Group Holdings Limited.

Registered in the Isle of Man and operating overseas:

Britannia International Limited*	Deposit taking

Registered in Scotland and operating in the UK:

Britannia Life Direct Limited*	Direct sales of financial services

Subsidiary undertaking, registered in Scotland and operating in the UK, where the Bank owns half the share capital represented by its holding of all the 'A' class ordinary shares and the majority of voting rights:

Britannia New Homes (Scotland) Limited*	Property development

Securitisation vehicles

The results of the following securitisation vehicles are consolidated into the results of the Group under IAS 27:

Leek Finance Holdings Limited*	Holding company
Leek Finance Number One plc*	Securitisation company
Leek Finance Holdings Number Two Limited*	Holding company
Leek Finance Number Two plc*	Securitisation company
Leek Finance Holdings Number Three Limited*	Holding company
Leek Finance Number Three plc*	Securitisation company
Leek Finance Holdings Number Four Limited*	Holding company
Leek Finance Number Four Limited*	Securitisation company
Leek Finance Holdings Number Five Limited*	Holding company
Leek Finance Number Five Limited*	Securitisation company
Leek Finance Holdings Number Six Limited*	Holding company
Leek Finance Number Six Limited*	Securitisation company
Leek Finance Holdings Number Seven Limited*	Holding company
Leek Finance Number Seven plc*	Securitisation company
Leek Finance Holdings Number Eight Limited*	Holding company
Leek Finance Number Eight Limited*	Securitisation company
Leek Finance Holdings Number Nine Limited*	Holding company
Leek Finance Number Nine Limited*	Securitisation company
Leek Finance Holdings Number Ten Limited*	Holding company
Leek Finance Number Ten plc*	Securitisation company
Leek Finance Holdings Number Eleven Limited*	Holding company
Leek Finance Number Eleven plc*	Securitisation company
Leek Finance Holdings Number Twelve Limited*	Holding company
Leek Finance Number Twelve plc*	Securitisation company
Leek Finance Holdings Number Fourteen Limited*	Holding company

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

36. Investments in Group undertakings continued

Leek Finance Number Fourteen plc*	Securitisation company
Leek Finance Holdings Number Fifteen Limited*	Holding company
Leek Finance Number Fifteen plc*	Securitisation company
Leek Finance Holdings Number Sixteen Limited*	Holding company
Leek Finance Number Sixteen plc*	Securitisation company
Leek Finance Holdings Number Seventeen Limited*	Holding company
Leek Finance Number Seventeen plc*	Securitisation company
Leek Finance Holdings Number Eighteen Limited*	Holding company
Leek Finance Number Eighteen plc*	Securitisation company
Leek Finance Holdings Number Nineteen Limited*	Holding company
Leek Finance Number Nineteen plc*	Securitisation company
Leek Finance Holdings Number Twenty Limited*	Holding company
Leek Finance Number Twenty plc*	Securitisation company
Leek Finance Holdings Number Twenty One Limited*	Holding company
Leek Finance Number Twenty One plc*	Securitisation company
Leek Finance Holdings Number Twenty Two Limited*	Holding company
Leek Finance Number Twenty Two plc*	Securitisation company
Meerbrook Finance Holdings Number One Limited*	Holding company
Meerbrook Finance Number One Limited*	Securitisation company
Meerbrook Finance Holdings Number Two Limited*	Holding company
Meerbrook Finance Number Two Limited*	Securitisation company
Meerbrook Finance Holdings Number Three Limited*	Holding company
Meerbrook Finance Number Three Limited*	Securitisation company
Meerbrook Finance Holdings Number Four Limited*	Holding company
Meerbrook Finance Number Four Limited*	Securitisation company
Meerbrook Finance Holdings Number Five Limited*	Holding company
Meerbrook Finance Number Five Limited*	Securitisation company
Meerbrook Finance Holdings Number Six Limited*	Holding company
Meerbrook Finance Number Six Limited*	Securitisation company
Rudyard Finance Holdings Number One Limited*	Holding company
Rudyard Finance Number One plc*	Securitisation company
Dovedale Finance Number One plc*	Securitisation company
Silk Road Finance Number One plc	Securitisation company
Silk Road Holdco Limited	Holding company
Prescot Finance Holdings Number One Limited	Holding company
Prescot Finance Number One plc	Securitisation company
Platform Home Loans Holdings Limited*	Holding company
Platform Home Loans Number One plc*	Securitisation company
Platform Home Loans Holdings Number Two Limited*	Holding company
Platform Home Loans Number Two plc*	Securitisation company
Plum Sterling Number One plc*	Securitisation company

The Bank holds one non-voting share in Leek Finance Holdings Limited, representing 12.5% of the issued share capital.

All securitisation vehicles are registered in England and operate in the UK, with the exception of Dovedale Finance Number One plc, which is registered and operates in the Republic of Ireland.

All of the above companies are related parties to the Group. See note 37 for the related party disclosures.

Joint ventures*

The Group's investment in joint ventures is £2.5m (2009: £1.8m).

The Bank owns 49% of the ordinary shares in Britannia Personal Lending Limited, a company registered in England and operating in the UK. The company trades in the business indicated:

Britannia Personal Lending Limited	Unsecured personal lending

* These subsidiary undertakings, securitisation vehicles and joint ventures were acquired following the transfer of engagements of Britannia Building Society (note 39).

36. Investments in Group undertakings continued

The Group's interest in Britannia Personal Lending Limited is as follows:

	2010	2009
Current assets	**21.7**	24.0
Long term assets	**22.6**	38.8
	44.3	62.8
Current liabilities	**27.3**	34.4
Long term liabilities	**17.0**	28.4
	44.3	62.8
Income	**2.5**	1.5
Expenses	**(1.5)**	(1.7)
Profit/(loss) before tax	**1.0**	(0.2)
Taxation	**(0.3)**	0.1
Profit/(loss) after tax	**0.7**	(0.1)

Joint ventures are accounted for using the equity method.

37. Related party transactions

Parent, subsidiary and ultimate controlling party

The Co-operative Financial Services Limited owns 100% of the issued ordinary share capital of the Bank and is the Bank's immediate holding company. The Co-operative Financial Services Limited is incorporated in England and is registered under the Industrial and Provident Societies Acts. The ultimate holding organisation is The Co-operative Group Limited (formerly known as Co-operative Group (CWS) Limited), which is incorporated in England and registered under the Industrial and Provident Societies Acts. The financial statements of the immediate and ultimate holding organisations are available from New Century House, Manchester, M60 4ES.

Further details of subsidiary undertakings and joint ventures are disclosed in note 36.

A number of banking transactions are entered into with related parties in the normal course of business on normal commercial terms. These include loans and deposits. Key management (as defined by IAS 24) are considered to be Board and executive members of the Group, and Board and executive members of the Group's immediate and ultimate holding organisations. The volume of related party transactions, outstanding balances at the year end, and related income and expense for the year are as follows:

Directors, key management personnel and close family members

	Group and Bank	
	2010	2009
Loans outstanding at the beginning of the year	**3.1**	1.3
Arising on transfer of engagements	**–**	0.8
Net movement	**(0.8)**	1.0
Loans outstanding at the end of the year	**2.3**	3.1
Deposits and investments at the beginning of the year	**2.0**	2.0
Arising on transfer of engagements	**–**	0.6
Net movement	**–**	(0.6)
Deposits and investments at the end of the year	**2.0**	2.0

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

37. Related party transactions continued
Directors' loans

	2010	
	Mortgages	**Credit cards**
Number of directors with loan type	**8**	**11**
Total value of directors' loans	**2.2**	**–**

	2009	
	Mortgages	Credit cards
Number of directors with loan type	6	7
Total value of directors' loans	2. 6	–

The Bank undertook the following transactions with Group companies during the year:

	Interest paid to Bank	**Interest received from Bank**	**Staff recharges paid to Bank**	**Rent received from Bank**	**Administration recharge paid to Bank**
2010					
First Roodhill Leasing Limited	**–**	**0.1**	**–**	**–**	**–**
Second Roodhill Leasing Limited	**0.2**	**–**	**–**	**–**	**–**
Third Roodhill Leasing Limited	**0.3**	**–**	**–**	**–**	**–**
Fourth Roodhill Leasing Limited	**0.1**	**–**	**–**	**–**	**–**
Co-operative Bank Financial Advisers Limited	**–**	**0.5**	**–**	**–**	**7.6**
The Covered Bond LLP	**11.9**	**12.0**	**–**	**–**	**–**
Britannia Treasury Services Limited	**0.3**	**–**	**–**	**–**	**–**
Britannia Development and Management Company Limited	**–**	**–**	**–**	**0.6**	**–**
Britannia Asset Management Limited	**–**	**0.3**	**–**	**–**	**–**
Mortgage Agency Services Number One Limited	**17.8**	**–**	**0.1**	**–**	**–**
Mortgage Agency Services Number Two Limited	**0.4**	**–**	**–**	**–**	**–**
Mortgage Agency Services Number Four Limited	**1.3**	**–**	**0.1**	**–**	**–**
Mortgage Agency Services Number Five Limited	**3.0**	**–**	**1.1**	**–**	**–**
Mortgage Agency Services Number Six Limited	**0.1**	**–**	**–**	**–**	**–**
Platform Group Holdings Limited	**44.2**	**–**	**–**	**–**	**–**
Britannia International Limited	**–**	**39.5**	**–**	**–**	**–**
Britannia Life Direct Limited	**–**	**0.7**	**–**	**–**	**–**
Illius Properties Limited	**3.5**	**–**	**1.0**	**–**	**–**
Moorland Covered Bonds LLP	**17.0**	**53.7**	**–**	**–**	**–**

37. Related party transactions continued

	Interest paid to Bank	Interest received from Bank	Staff recharges paid to Bank	Rent received from Bank	Administration recharge paid to Bank
2009					
Co-operative Commercial Limited	0.1	–	–	–	–
First Roodhill Leasing Limited	–	0.1	–	–	–
Second Roodhill Leasing Limited	0.2	–	–	–	–
Third Roodhill Leasing Limited	0.4	–	–	–	–
Fourth Roodhill Leasing Limited	0.1	–	–	–	–
Co-operative Bank Financial Advisers Limited	–	0.2	–	–	12.2
The Covered Bond LLP	20.9	21.2	–	–	–
Britannia Treasury Services Limited	0.2	–	–	–	–
Britannia Development and Management Company Limited	–	–	–	0.3	–
Britannia Asset Management Limited	–	0.1	–	–	–
Mortgage Agency Services Number One Limited	6.7	–	–	–	–
Mortgage Agency Services Number Two Limited	0.2	–	–	–	–
Mortgage Agency Services Number Four Limited	0.6	–	0.1	–	–
Mortgage Agency Services Number Five Limited	1.4	–	0.5	–	–
Platform Group Holdings Limited	23.3	–	–	–	–
Britannia International Limited	–	12.1	–	–	–
Britannia Life Direct Limited	–	0.3	–	–	–
Illius Properties Limited	0.4	–	0.4	–	–
Moorland Covered Bonds LLP	8.4	17.8	–	–	–

Interest accrues on outstanding balances at a transfer price rate agreed between the Bank and its subsidiaries.

	Interest and fees received from other Co-operative Group undertakings 2010	**Interest and fees paid to other Co-operative Group undertakings 2010**	Interest and fees received from other Co-operative Group undertakings 2009	Interest and fees paid to other Co-operative Group undertakings 2009
Parent undertakings	**5.7**	**0.5**	3.0	0.6
Fellow subsidiary undertakings	**2.1**	**–**	3.3	–
	7.8	**0.5**	6.3	0.6

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

37. Related party transactions continued
At the year end the following unsecured balances were outstanding:

	Loans owed to Bank 2010	**Loans owed by Bank 2010**	Loans owed to Bank 2009	Loans owed by Bank 2009
Co-operative Commercial Limited	**1.0**	**–**	1.4	–
Roodhill Leasing Limited	**–**	**0.9**	–	0.8
First Roodhill Leasing Limited	**–**	**3.1**	–	2.1
Second Roodhill Leasing Limited	**3.5**	**–**	4.2	–
Third Roodhill Leasing Limited	**5.4**	**–**	7.2	–
Fourth Roodhill Leasing Limited	**0.7**	**–**	2.1	–
Co-operative Bank Financial Advisers Limited	**–**	**10.3**	–	7.5
The Covered Bond LLP	**1,000.0**	**1,432.6**	1,000.0	1,537.5
Unity Trust Bank plc	**–**	**78.1**	–	0.5
Britannia Treasury Services Limited	**34.4**	**–**	48.6	–
Britannia Development and Management Company Limited	**–**	**2.3**	–	1.9
Britannia Asset Management Limited	**–**	**39.9**	–	40.2
Mortgage Agency Services Number One Limited	**2,169.3**	**–**	2,345.1	–
Mortgage Agency Services Number Two Limited	**55.9**	**–**	65.1	–
Mortgage Agency Services Number Four Limited	**165.7**	**–**	184.4	–
Mortgage Agency Services Number Five Limited	**365.6**	**–**	431.1	–
Mortgage Agency Services Number Six Limited	**33.4**	**–**	18.1	–
Mortgage Agency Services Number Seven Limited	**–**	**0.3**	–	0.3
Platform Group Holdings Limited	**2,929.6**	**–**	1,899.3	–
Britannia International Limited	**–**	**1,931.3**	–	1,733.4
Britannia Life Direct Limited	**–**	**95.5**	–	89.2
Britannia New Homes Limited	**–**	**0.1**	–	0.1
Britannia Independent Limited	**–**	**0.7**	–	0.9
The Mortgage Agency plc	**–**	**0.1**	–	0.1
Verso Limited	**2.5**	**–**	–	0.2
Britannia Shield Property Services Limited	**0.2**	**–**	0.2	–
Britannia Estate Agents Limited	**0.1**	**–**	0.2	–
Western Mortgage Services Limited	**0.7**	**–**	0.2	–
Illius Properties Limited	**144.1**	**–**	120.5	–
Moorland Covered Bonds LLP	**1,422.5**	**1,827.8**	1,417.4	1,843.5
First Co-operative Finance Limited	**0.8**	**–**	0.9	–
Cleveland Guaranty Limited	**1.0**	**–**	1.0	–
Cleveland Finance Limited	**0.6**	**–**	0.6	–
Second Pioneers Leasing Limited	**0.4**	**–**	0.4	–
Phoenix Credit Services Limited	**–**	**0.1**	–	0.1

	Loans owed by other Co-operative Group undertakings 2010	**Loans owed to other Co-operative Group undertakings 2010**	Loans owed by other Co-operative Group undertakings 2009	Loans owed to other Co-operative Group undertakings 2009
Parent undertakings	**–**	**110.5**	89.5	27.2
Fellow subsidiary undertakings	**0.6**	**78.0**	1.5	302.0
	0.6	**188.5**	91.0	329.2

There are no formal repayment terms with subsidiary companies.

37. Related party transactions continued

Transactions with SPEs

The Bank undertook the following transactions with SPEs during the year:

	Interest paid to Bank 2010	**Interest received from Bank 2010**	Interest paid to Bank 2009	Interest received from Bank 2009
Leek Finance Number Fourteen plc	**–**	**–**	0.3	–
Leek Finance Number Fifteen plc	**0.4**	**–**	0.4	–
Leek Finance Number Sixteen plc	**0.7**	**–**	0.3	–
Leek Finance Number Seventeen plc	**1.3**	**–**	0.6	–
Leek Finance Number Eighteen plc	**1.2**	**–**	0.5	–
Leek Finance Number Nineteen plc	**1.1**	**–**	0.7	–
Leek Finance Number Twenty plc	**26.4**	**–**	12.4	–
Leek Finance Number Twenty One plc	**17.7**	**–**	8.4	–
Leek Finance Number Twenty Two plc	**7.4**	**–**	3.5	–
Meerbrook Finance Number One Limited	**0.6**	**–**	0.3	–
Meerbrook Finance Number Three Limited	**0.3**	**–**	0.1	–
Meerbrook Finance Number Four Limited	**6.9**	**0.5**	2.1	0.3
Meerbrook Finance Number Six Limited	**0.1**	**–**	0.1	–
Silk Road Finance Number One plc	**24.4**	**–**	–	–

	Fees paid to Bank 2010	**Fees received from Bank 2010**	Fees paid to Bank 2009	Fees received from Bank 2009
Silk Road Holdco Limited	**2.0**	**–**	–	–
Silk Road Finance Number One plc	**–**	**2.1**	–	–
Meerbrook Finance Number Five Limited	**–**	**0.1**	–	–

At the year end the following balances were outstanding with SPEs:

	Loans owed to Bank 2010	**Loans owed by Bank 2010**	Loans owed to Bank 2009	Loans owed by Bank 2009
Leek Finance Number One plc	**–**	**0.1**	–	0.1
Leek Finance Number Four plc	**–**	**–**	–	0.1
Leek Finance Number Five Limited	**–**	**0.1**	–	0.1
Leek Finance Number Six Limited	**–**	**0.1**	–	0.1
Leek Finance Number Seven plc	**–**	**0.1**	–	0.1
Leek Finance Number Ten plc	**–**	**0.1**	–	0.1
Leek Finance Number Twelve plc	**–**	**0.1**	–	0.1
Leek Finance Number Fourteen plc	**–**	**0.2**	–	0.4
Leek Finance Number Fifteen plc	**–**	**0.1**	19.0	1.4
Leek Finance Number Sixteen plc	**–**	**0.1**	14.9	2.3
Leek Finance Number Seventeen plc	**35.0**	**2.1**	41.2	1.8
Leek Finance Number Eighteen plc	**31.6**	**0.3**	38.2	2.3
Leek Finance Number Nineteen plc	**56.7**	**0.3**	73.2	2.2
Leek Finance Number Twenty plc	**1,757.1**	**2.5**	1,863.2	2.8
Leek Finance Number Twenty One plc	**1,200.0**	**2.6**	1,271.8	2.9
Leek Finance Number Twenty Two plc	**487.1**	**1.6**	514.5	1.8
Meerbrook Finance Number One Limited	**41.5**	**27.8**	41.5	29.4
Meerbrook Finance Number Two Limited	**–**	**0.1**	1.3	0.4
Meerbrook Finance Number Three Limited	**10.1**	**2.8**	10.3	3.3
Meerbrook Finance Number Four Limited	**727.1**	**109.1**	391.7	120.7
Meerbrook Finance Number Five Limited	**–**	**–**	1.7	–
Meerbrook Finance Number Six Limited	**15.8**	**4.5**	15.9	4.8
Silk Road Finance Number One plc	**1,586.4**	**2,574.4**	–	–
Dovedale Finance Number One plc	**–**	**0.4**	–	0.2

The loans owed to the SPEs comprise cash balances deposited with the Bank.

Notes to the financial statements continued
For the year ended 31 December 2010
All amounts are stated in £m unless otherwise indicated

37. Related party transactions continued

Key management compensation

	Group and Bank	
	2010	2009
Salaries and short term benefits	**5.4**	4.5
Termination benefits	**–**	1.8
	5.4	6.3

Directors' remuneration

A listing of the members of the Board of directors is shown on pages 11 and 12. The total remuneration of directors was £4.5m (2009: £5.2m).

Further details of directors' remuneration are provided in the remuneration report on pages 23 to 28.

Recharges from CFSMS

During the year, operating costs of £433.5m (2009: £342.8m) incurred on its behalf were charged at cost to the Bank by CFSMS, a fellow subsidiary of Co-operative Financial Services Limited. At 31 December 2010, the Bank owed £4.4m (2009: £3.0m) to CFSMS.

38. Share capital

	Group and Bank	
	2010	2009
Authorised capital		
At the beginning of the year 4,600,000,000 ordinary shares of 5p each	**230.0**	55.0
Issued in the year 3,600,000,000 ordinary shares of 5p each	**180.0**	175.0
At the end of the year 8,200,000,000 ordinary shares of 5p each	**410.0**	230.0
Allotted called up and fully paid		
At the beginning of the year 4,600,000,000 ordinary shares of 5p each	**230.0**	55.0
Issued in the year 3,600,000,000 ordinary shares of 5p each	**180.0**	175.0
At the end of the year 8,200,000,000 ordinary shares of 5p each	**410.0**	230.0
Share premium account at the beginning and end of the year	**8.8**	8.8

On 15 December 2010, the Bank issued 3,600,000,000 ordinary shares of 5p each at a cost of £180.0m. These were issued to its immediate parent company, Co-operative Financial Services Limited.

The shareholders have one vote for every share held.

39. Transfer of engagements of Britannia Building Society

The initial accounting for Britannia was determined provisionally in the 2009 Financial Statements. In accordance with IFRS 3, adjustments to the initial provisional accounting for Britannia disclosed in the 2009 Financial Statements have been recognised as if the final accounting had been completed at the acquisition date. The impact of these adjustments is not material to the overall level of adjustments to the carrying values of Britannia assets and liabilities that were made on merger and there is no change to the amount of goodwill arising. Comparative information for the year ended 31 December 2009 has been adjusted; there was no material impact on the reported profit for 2009.

The revised fair values of the assets and liabilities of Britannia on merger are set out below:

		Final merger fair values	Provisional merger fair values
Cash and balances at central banks		**591.8**	**591.8**
Loans and advances to banks		**956.1**	**956.1**
Loans and advances to customers	(a)	**22,912.5**	**22,885.5**
Investment securities		**6,144.2**	**6,144.2**
Derivative financial instruments		**1,086.6**	**1,086.6**
Investments in joint ventures		**2.1**	**2.1**
Intangible fixed assets		**46.0**	**46.0**
Investment properties		**123.7**	**123.7**
Property, plant and equipment		**82.6**	**82.6**
Other assets		**9.4**	**9.4**
Prepayments and accrued income		**122.2**	**122.2**
Deferred tax assets		**132.2**	**132.2**
Total assets		**32,209.4**	**32,182.4**
Deposits by banks		**(6,117.6)**	**(6,117.6)**
Customer accounts		**(18,304.7)**	**(18,304.7)**
Capital bonds		**(1,593.2)**	**(1,593.2)**
Debt securities in issue		**(3,667.3)**	**(3,667.3)**
Derivative financial instruments		**(721.1)**	**(721.1)**
Other liabilities		**(54.0)**	**(54.0)**
Accruals and deferred income		**(242.4)**	**(242.4)**
Provisions for liabilities and charges	(b)	**(33.6)**	**(14.2)**
Current tax liabilities	(c)	**(53.5)**	**(45.9)**
Subordinated liabilities		**(309.5)**	**(309.5)**
Subscribed capital		**(240.0)**	**(240.0)**
Total liabilities and reserves		**(31,336.9)**	**(31,309.9)**
Net identifiable assets		**872.5**	**872.5**
Deferred consideration		**49.6**	**49.6**
Imputed consideration		**811.2**	**811.2**
Business combination costs		**12.3**	**12.3**
Goodwill recognised on business combination		**0.6**	**0.6**

Explanation of material changes to fair value adjustments:

(a) The carrying value of loans and advances to customers has been increased following a review of the probabilities of default of assets that were neither past due nor impaired at the merger date.

(b) Based on further information that became available, the Bank has reassessed the fair value of provisions for liabilities and charges.

(c) The above adjustments to fair values increase the expected level of the Bank's tax liabilities.

Responsibility statement

For the year ended 31 December 2010

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- the directors' report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By Order of the Board
Neville Richardson, Chief Executive

29 March 2011

Notice of Annual General Meeting 2011

NOTICE IS HEREBY GIVEN that the Annual General Meeting of The Co-operative Bank plc will be held on the 24th Floor, CIS Building, Miller Street, Manchester M60 0AL at 9am on Thursday, 12 May 2011 for the following purposes:

Ordinary Business:

1. To receive the notice convening the meeting.
2. To receive the annual reports and adopt the financial statements for the year ended 31 December 2010, together with the auditor's report.
3. To approve the remuneration report for the year ended 31 December 2010.
4. To accept the following recommendations of the Board in respect of the non-cumulative irredeemable preference shares:
   (i) that the payment of the dividend of 4.625p per £1 share on 30 November 2010 be confirmed.
   (ii) that a dividend of 4.625p per £1 share be declared and paid on 31 May 2011 to the registered holders as at 3 May 2011 providing a dividend rate of 9.25 per cent per annum and making a total distribution of £5,550,000.
5. To re-elect the following directors who retire by rotation, in accordance with the provisions of Article 105 and 105A:
   (i) Leonard Adrian Wardle, non-executive director
   (ii) Martyn James Wates, non-executive director
   (iii) Stephen Watts, non-executive director
6. To:
   (i) re-appoint KPMG Audit Plc as auditor of the Company, to hold office from the conclusion of this meeting until the conclusion of the Annual General Meeting of the Company's ultimate parent, The Co-operative Group Limited, on 21 May 2011, at a remuneration to be fixed by the directors; and
   (ii) give the directors the authority to appoint as the auditor of the Company, the auditor agreed by The Co-operative Group Limited at its Annual General Meeting on 21 May 2011, at a remuneration to be fixed by the directors, until the conclusion of the next General Meeting at which accounts are laid before the Company.

Registered Office
1 Balloon Street
Manchester M60 4EP
Reg. No. 990937 (England)
Tel: 0161 832 3456
Fax: 0161 829 4475
Tel: 0870 702 0003

Registrar
Computershare Investor Services PLC
P.O. Box 82
The Pavilions
Bridgwater Road
Bristol BS99 7NH

By Order of the Board
Moira Lees, Secretary

29 March 2011

A member entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote on his/her behalf. A proxy need not also be a member. Further information on Preference Shareholders' voting rights is given below.

Members should note that to attend the meeting their shareholding must be registered on the register of the Company not later than 9am on 10 May 2011. This applies to shares held in uncertified forms in CREST and to shares held in certified form.

Notes:

1. Director Information
The biographies of the directors up for re-election and re-appointment at the Annual General Meeting can be found on pages 11 and 12 of the Financial Statements.

2. Preference Shareholders – Extract from Articles of Association 4 (B)(c)
Voting and General Meetings

(i) The holders of the Preference Shares shall be entitled to receive notice of and attend (either in person or by proxy) all General Meetings of the Company. The holders of the Preference Shares shall have a right to speak and vote at a General Meeting of the Company only if and when, at the date of the notice convening such meeting, the fixed preferential dividend payable to them respectively has been in arrears for six months or more after any date fixed for payment thereof, or if a resolution is to be proposed at such meeting abrogating or varying any of the respective rights or privileges attaching to their shareholding or for the winding up of the Company or other return of capital and then on such resolution only.

(ii) Whenever the holders of the Preference Shares are entitled to vote at a General Meeting of the Company upon any resolution proposed at such meeting, on a show of hands every holder who (being an individual) is present in person or (being a corporation) is present by a representative or by proxy shall have one vote and, on a poll, shall have one vote in respect of each Preference Share registered in the name of such holder.

Glossary
For the year ended 31 December 2010

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

Terminology	Definition
Arrears	Customers are said to be in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan is unpaid or overdue. Corporate customers may also be considered non-performing prior to being behind in fulfilling their obligations. This can happen when a significant restructuring exercise begins.
Bank for International Settlements (BIS)	An international organisation which fosters international monetary and financial co-operation and serves as a bank for central banks. Based in Basel, Switzerland.
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.
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.
BIPRU	The prudential sourcebook for banks, building societies and investment firms which sets out the FSA's capital requirements.
Britannia membership reward (BMR)	This was designed to reward customers for the contribution they made to the continued success of Britannia's business. After an initial qualifying period, certain customers of Britannia were able to earn points each year. Each year, the Board decided the amount to be paid out as the reward pool, and distributed this to the customers in proportion to the number of points earned.
Business risk	Business risk arises from changes to the Bank's business, specifically the risk of not being able to carry out the Bank's business plan and desired strategy.
Capital bonds	Fixed term customer accounts with returns based on the movement in an index (eg FTSE100) over the term of the bond.
Capital ratio	Total of tier one capital plus tier two capital, all divided by risk weighted assets.
Capital Requirements Directive (CRD)	The common framework for the implementation of Basel II in the EU.
Carrying value	The value of an asset or liability as it appears in the balance sheet. For each asset or liability, the value is based on either of the amortised cost or fair value principles.
Certificates of deposits (CDs)	Debt issued by banks, savings and loan associations to individual investors with terms ranging from a few months to several years. Longer term CDs tend to bear a higher interest rate. At the expiration of the term, investors may (subject to penalties) withdraw both the principal and the accrued interest.
Commercial Paper	An unsecured promissory note issued to finance short term credit needs. It specifies the face amount paid to investors on the maturity date.
Commercial real estate	Includes office buildings, industrial property, medical centres, hotels, retail stores, shopping centres, blocks of residential flats, housing buildings, warehouses and garages.
Contagion risk	An international financial market term which describes a corrupting or harmful influence, spreading effects of shocks from one counterparty to another.
Corporate segment	The segment that comprises customer focused products and services for businesses. This includes large corporate and commercial entities and small to medium entities. It includes loans, asset finance, current accounts and savings products.
Cost income ratio	Operating expenses compared to operating income.
Counterparty	In any financial contract, the person or institution entering the contract on the opposite side of the transaction is called a counterparty.
Covered bonds	Debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Bank issues covered bonds as part of its funding activities.
Credit conversion factors	The portion of an off balance sheet commitment drawn in the event of a future default. The conversion factor is expressed as a percentage. The conversion factor is used to calculate the exposure at default (EAD).

Terminology	Definition
Credit default swap	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 rating agency.
Credit risk	Credit risk is 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 its failure to perform as agreed.
Credit trading vehicle (CTV)	An investment vehicle similar to a SIV (see SIVs).
Customer deposits	Money deposited by all individuals and companies that are not credit institutions. Such funds are recorded as liabilities in the Bank's balance sheet under Customer accounts or Financial liabilities designated at fair value.
Delinquency	A customer in arrears is also said to be in a state of delinquency. When a customer is in arrears, his entire outstanding balance is said to be delinquent, meaning that delinquent balances are the total outstanding loans on which payments are overdue (see 'Arrears').
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.
Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period.
Expected loss	A measure of anticipated loss for exposures captured under an internal ratings based credit risk approach. The expected loss amount is the exposure from a potential default of a counterparty or dilution over a one year period to the amount outstanding at default.
Exposure at Default (EAD)	A Basel II parameter used in internal ratings based approaches to estimate the amount outstanding at the time of default.
External audit	The independent review of the financial statements of the company, by an external firm.
External credit rating	A financial indicator of risk, assigned by credit rating agencies, to potential investors in the Bank.
Financial instruments	Any document with monetary value. Examples include cash and cash equivalents, but also securities such as bonds and stocks which have value and may be traded in exchange for money.
Financial Services Authority (FSA)	An independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000, which regulates the financial services industry in the best interests of its stakeholders. It is a company limited by guarantee and financed by the financial services industry.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FSA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Floating Rate Notes (FRNs)	Investments with a variable interest rate. The adjustments to the interest rate are usually made every six months and are tied (or 'float') to a certain money market index.
Hedging	Hedging is a technique used by the Bank to offset risks on one instrument by purchasing a second instrument that is expected to perform in the opposite way.
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.
Individually/collectively assessed for impairment	Impairment is measured individually for assets that are individually significant with risk, and collectively where a portfolio comprises assets with a homogenous risk and where appropriate statistical techniques are available.
Institute of International Finance (IIF)	A global association of financial institutions which provides industry guidelines on areas such as liquidity management.
Internal audit	The examination of the company's records and reports by its employees. Internal audits are usually intended to prevent fraud and to ensure compliance with board directives and management policies.
Internal Capital Adequacy Assessment Process (ICAAP)	The Bank's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events.
Internal rating grade (IRG)	The grading of credit risk resulting from the internal ratings based approach (IRB).

Glossary continued
For the year ended 31 December 2010

Terminology	Definition
Investment grade	A debt security, treasury bill or similar instrument with a credit rating measured by external agencies of AAA to BBB.
IRB (Internal ratings based approach)	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 FSA permission.
LIBOR (London Interbank Offer Rate)	The interest rate participating banks offer to other banks for loans on the London market.
Lifetime expected loss	The losses that the Bank expects to incur over the lifetime of portfolios of mortgage assets which were acquired on merger with Britannia Building Society. This is different from expected loss (see definition above) which is based on assets expected to default in the next 12 months.
Limited Liability Partnership (LLP)	An LLP provides each of its individual partners protection against personal liability for certain partnership liabilities.
Liquidity risk	Liquidity risk arises from the timing of cash flows generated from the Bank's assets and liabilities. It is defined as the Board approved survival period under stress scenarios. The Bank undertakes various stress tests on a weekly basis.
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)).
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.
Malus	A facility whereby the Remuneration Committee may reduce the amount of any deferred bonus payable in the event that any of the underpins to the incentive plans are not met or where business and/or individual performance otherwise requires.
Mandatory reserve deposits	Mandatory reserve deposits are deposited with the Bank of England and are not available for use in the Bank's day to day operations. They are non-interest bearing and are not included in cash and cash equivalents.
Medium term notes (MTN)	Flexible medium term corporate debt instruments, continuously offered by the Bank, to investors, through a dealer. Investors can choose from differing maturities, ranging from nine months to 30 years.
Member	A person who has a share investment or a mortgage loan with the Bank.
Merger	Any combination of two or more business enterprises into a single enterprise. In the Bank, this specifically refers to the merger of the Bank with Britannia Building Society on 1 August 2009. See Transfer of engagements definition below.
Mortgage backed securities	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.
Net interest income	The difference between interest received on assets and interest paid on liabilities after taking into account the effect of derivatives.
Net present value (NPV)	The present value of the expected future cash in and out flows on an asset or liability.
Off balance sheet	An FSA term that describes the regulatory treatment of certain of the Bank's SPEs.
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.
Optimum & Platform segment	This is the specialist mortgage team dealing with intermediary lending.
Over the counter (OTC)	Contracts that are traded (and privately negotiated) directly between two parties, without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange traded products, they can be tailored to fit specific needs.
Past due	When a counterparty has failed to make a payment when contractually due.
Preference shares	Preferred shares of the Bank that have first claim to a fixed non-cumulative preferential dividend on the capital for the time being paid up. The dividends take priority over dividends to any other class of share in the capital of the Bank.
Prime	Prime mortgages are mainstream residential loans, which typically have a higher credit quality and fit standard underwriting processes. As such, they are likely to have a good credit history, and pass a standard affordability assessment at the point of origination.

Terminology	Definition
Probability of default (PD)	The likelihood that a loan will not be repaid and will fall into default. PD may be calculated for each customer who has a loan (normally applicable to wholesale customers) or for a portfolio of customers with similar attributes (normally applicable to retail customers). To calculate PD, the Bank assesses the credit quality of borrowers and other counterparties and assigns them an internal risk rating.
Renegotiated loans	A permanent change to the terms and conditions of the customer's mortgage contract.
Repo/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.
Retail	The segment that comprises customer focused products and services for individuals, sole traders and small partnerships. This includes mortgages, credit cards, consumer loans, current accounts and savings products.
Risk management committee (RMC)	This committee is responsible for review and challenge of the adequacy of capital for all risks (including operational risk), and for technical risk management activities and portfolio exposures across CFS.
Risk weighted amount	Risk weightings are established in accordance with Basel II as implemented by the FSA. Risk weighted amounts are the carrying value of the Bank's assets, adjusted by the risk weightings, to reflect the degrees of risk they represent.
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.
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.
Significant items	Items which are material by both size and nature (ie outside of the normal operating activities of the Bank) are treated as significant items and disclosed separately on the face of the income statement.
Special purpose entities (SPEs)	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	Lending in which 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.
Standard Variable Rate (SVR)	A variable and basic rate of interest charged on a mortgage. This may change in reaction to market conditions resulting in monthly repayments going up or down.
Structured investments (SIVs)	Special purpose entities which invest in diversified portfolios of interest earning assets, generally funded through issues of commercial paper, medium term notes and other senior debt to take advantage of the spread differentials between the assets in the SIV and the funding cost.
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 interest 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	The Co-operative Bank as a stand alone entity.
the Board	The Board of Directors. They manage the Bank's business performance in line with its purpose, givens, vision and values.
The Co-operative Group	The ultimate holding company.
the Group	The Co-operative Bank consolidated with its subsidiaries.

Glossary continued
For the year ended 31 December 2010

Terminology	Definition
Tier one	A regulatory measure of financial (capital) strength. Tier one is divided into core tier one and other tier one capital. Core tier one capital comprises general reserves from retained profits. The book values of goodwill and intangible assets are deducted from core tier one 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 one capital.
Tier one ratio	Tier one capital divided by risk weighted assets.
Tier two	Tier two 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.
Transfer of engagements	On 1 August 2009, Britannia Building Society merged with The Co-operative Bank plc by a transfer of engagements between the building society and the bank under the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007. See Merger definition above.
Treasury	The treasury department's responsibilities usually include capital management, risk management, strategic planning and investor relations.
Unsecured lending	Lending for which there is no collateral for the loan.
Value at risk (VaR)	An estimate of the potential loss which might arise from market movements under normal market conditions, if the current positions were to be held unchanged for one business day, measured to a defined confidence level. The Bank uses a confidence level of 95%.
Wholesale segment	The segment that carries out asset and liability management across the Bank's balance sheet including trading activities.
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.

Notes

Notes

Design by Radley Yeldar

Printed at APS Group, an ISO 14001 and
FSC certified company.

We like our communications to have an impact on you –
but not on the environment, which is why this is printed using
vegetable oil-based inks on 80% recycled paper, with the
remaining 20% produced from Forest Stewardship Council
certified sources. The paper is made in a totally
chlorine-free process.

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PART (D)

AUDITED INTERIM FINANCIAL STATEMENTS OF THE COMPANY FOR THE PERIOD ENDING 30 JUNE 2013

For the Audited Interim Financial Statements of the Company for the period ending 30 June 2013 please see pages 279 to 396 of the Bank T2 Notes Prospectus.

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION.

THIS DOCUMENT COMPRISES AN EXPLANATORY STATEMENT IN COMPLIANCE WITH SECTION 897 OF THE COMPANIES ACT 2006 (the **Explanatory Statement**). It is being sent to persons who are believed to be Scheme Creditors at the date of this Explanatory Statement. If you have assigned, sold, or otherwise transferred, or assign, sell or otherwise transfer, your interests as a Scheme Creditor before the Record Date you must forward this Explanatory Statement and the accompanying documents at once to the person or persons to whom you have assigned, sold or otherwise transferred, or assign, sell or otherwise transfer, your interests as a Scheme Creditor.

If you are in any doubt as to the contents of this Explanatory Statement or the documents that accompany it or what action you should take, you are recommended to seek your own independent financial, legal and tax advice immediately from your financial, legal and/or tax adviser who, if you are taking advice in the United Kingdom, is authorised pursuant to the Financial Services and Markets Act 2000 (**FSMA**) or by an appropriate regulatory body, or from another appropriately authorised independent adviser if you are in a territory outside the United Kingdom.

This Explanatory Statement is accompanied by an Account Holder Letter. It is important that you read the Account Holder Letter carefully for information about the Scheme and that you complete and return it in accordance with the instructions contained in it.

Further copies of this Explanatory Statement can be obtained by contacting the Information Agent at via email to co-op@lucid-is.com or telephone on + 44 20 7704 0880.

Application has been made to the Financial Conduct Authority under Part VI of the Financial Services and Markets Act 2000 (the **UK Listing Authority)** for the Bank T2 Notes referred to in this Explanatory Statement to be admitted to the Official List of the UK Listing Authority and to the London Stock Exchange plc. (the **London Stock Exchange**) for the Bank T2 Notes to be admitted to trading on the London Stock Exchange's regulated market. The London Stock Exchange's regulated market is a regulated market for the purposes of the Markets in Financial Instruments Directive (Directive 2004/39/EC).

A document comprising a prospectus relating to the Company has been prepared in accordance with Article 5.4 of Directive 2003/71/EC as amended (which includes the amendments made by Directive 2010/73/EU to the extent that such amendments have been implemented in a relevant Member State of the European Economic Area) (the **Prospectus Directive**), and a copy of that prospectus (referred to in this Explanatory Statement as the Bank T2 Notes Prospectus) is appended to this Explanatory Statement at Appendix 9 (*Bank T2 Notes Prospectus*).

EXPLANATORY STATEMENT IN RELATION TO A SCHEME OF ARRANGEMENT

under Part 26 of the Companies Act 2006

between

THE CO-OPERATIVE BANK P.L.C.

and the

Scheme Creditors

(as defined in this Explanatory Statement)

DATE: 18 November 2013 (as amended on 4 December 2013)

VOLUME 2 OF 2

IMPORTANT NOTICE

Scheme Creditors' attention is drawn to the Important Notice on pages 5-9 of this Explanatory Statement and to the Important Securities Law Notice on pages 10-12 of this Explanatory Statement which are incorporated into Volume 2 of this Explanatory Statement by reference.

INDEX

VOLUME 1

Preliminary Sections

1. Important Notice.....5

2. Letter from the Chairman of the Company 13

3. Expected timetable of Principal Events,.....16

4. Are you a Scheme Creditor or a person with an interest in the Dated Notes?.....18

5. Summary of actions to be taken by Scheme Creditors and any person with an interest in the Dated Notes 21

PART A

6. Background to and Reasons for the Recapitalisation Plan 28

PART B

7. Overview of the Scheme 36

PART C

8. Overview of the Liability Management Exercise.....64

PART D

9. Risk Factors.....77

PART E

10. Information on the Company and Additional information relating to the Scheme 84

PART F

11. Taxation.....93

PART G

12. The Scheme 97

Appendices

1. Definitions and Interpretation....163

2. Instructions and Guidance for Scheme Creditors and any Person with an Interest in the Dated Notes....178

3. Form of Account Holder Letter....198

4. Notice of Scheme Meeting....227

5. Notice of Director Nomination Resolution....230

6. Illustrative Additional New Ordinary Shares Allocation Model....232

7. Resolution Analysis....234

8. Financial Statements....242

   (A) Audited Financial Statements of the Company for the Financial Year Ending 31 December 2012....242

   (B) Audited Financial Statements of the Company for the Financial Year Ending 31 December 2011....391

   (C) Audited Financial Statements of the Company for the Financial Year Ending 31 December 2010....528

   (D) Audited Interim Financial Statements of the Company for the Period Ending 30 June 2013....665

VOLUME 2

9. Bank T2 Notes Prospectus....670

   (A) Prospectus dated 4 November 2013....671

   (B) Supplementary Prospectus dated 4 December 2013....1372

APPENDIX 9

BANK T2 NOTES PROSPECTUS

PART (A)

PROSPECTUS DATED 4 NOVEMBER 2013

PROSPECTUS dated 4 November 2013

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in doubt as to the action you should take in connection with this document or the proposals contained in it, you are recommended to seek your own personal financial advice immediately from your stockbroker, bank manager, solicitor, accountant or other independent financial adviser authorised under the Financial Services and Markets Act 2000, if you are taking advice in the United Kingdom, or from another appropriately authorised independent financial adviser if you are taking advice in a jurisdiction outside the United Kingdom.

The co-operative bank

The Co-operative Bank p.l.c.

(incorporated with limited liability in England with registered number 00990937)

11 per cent. Subordinated Notes due 2023

Issue price: 100 per cent.

The 11 per cent. Subordinated Notes due 2023 (the **Notes** or the **Bank T2 Notes**) will, subject to successful completion of the Liability Management Exercise (as defined below), be issued by The Co-operative Bank p.l.c. (the **Bank** or the **Issuer**). Interest on the Notes will be payable quarterly in arrear up to the maturity (or earlier redemption) of the Notes. The conditions of the Notes (the **Conditions**) are set out in Appendix B (*Conditions of the Notes*) to this Prospectus.

Unless previously redeemed or purchased and cancelled, the Issuer will redeem the Notes on the tenth anniversary of their date of issue (the **Maturity Date**). The Issuer may, at its option but subject to certain conditions as described under Condition 6.6, redeem all, but not some only, of the Notes at any time prior to the Maturity Date at an amount equal to 101 per cent. of their principal amount plus accrued interest in the event of certain tax changes as described under Condition 6.2 or if the Notes cease to be eligible for recognition as regulatory capital of the Issuer due to a change in law or regulation as described under Condition 6.3.

The Notes are being offered in connection with a liability management exercise being conducted by the Issuer and Co-operative Group Limited (**Co-operative Group**) in respect of the Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (the **2016 Notes**), the 5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942) (the **2019 Notes**), the 9.25% Subordinated Notes due 28 April 2021 (ISIN: XS0620315902) (the **April 2021 Notes**), the Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984) (the **November 2021 Notes**), the 7.875% Subordinated Notes due 19 December 2022 (ISIN: XS0864253868) (the **2022 Notes**), the 5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183) (the **2024 Notes**), the 5.875% Subordinated Notes due 2033 (ISIN: XS0145065602) (the **2033 Notes**) (together the **Dated Notes**), the 5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) (the **5.5555% Bonds**) and other capital securities issued by the Bank (the **Liability Management Exercise** or **LME**) as announced on 4 November 2013 and as more fully described in this Prospectus. The Notes will be issued only upon successful completion (as further described in Section 6 (*Details of the Liability Management Exercise*)) of the Liability Management Exercise. The final principal amount of Notes to be issued (if any) will be announced by the Issuer via the Regulatory News Service operated by the London Stock Exchange.

Application has been made to the Financial Conduct Authority under Part VI of the Financial Services and Markets Act 2000 (the **UK Listing Authority**) for the Notes to be admitted to the Official List of the UK Listing Authority and to the London Stock Exchange plc (the **London Stock Exchange**) for the Notes to be admitted to trading on the London Stock Exchange's regulated market. The London Stock Exchange's regulated market is a regulated market for the purposes of the Markets in Financial Instruments Directive (Directive 2004/39/EC).

The Issuer is rated BB- (long-term) and B (short-term) by Fitch Ratings Ltd. (**Fitch**) and Caa1 (long-term) and NP (short-term) by Moody's Investors Service Limited (**Moody's**). Fitch and Moody's are established in the European Union and are registered under Regulation (EC) No 1060/2009 (as amended) (the **CRA Regulation**). As such Fitch and Moody's are included in the list of credit rating agencies published by the European Securities and Markets Authority on its website (at *http://www.esma.europa.eu/page/List-registered-and-certified-CRAs*) in accordance with the CRA Regulation. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

The denomination of each Note will be £10. The Notes will be issued in both certificated and uncertificated form on the date of issue of the Notes (the **Issue Date**). Investors may hold interests in the Notes either (i) in certificated form outside of Euroclear UK & Ireland Limited (formerly known as CRESTCo Limited) (**CREST**), Euroclear Bank SA/NV (**Euroclear**) and Clearstream Banking, *société anonyme* (**Clearstream, Luxembourg**), (ii) in uncertificated form in CREST, or (iii) in uncertificated form with Euroclear or Clearstream, Luxembourg through CREST.

An investment in the Notes involves certain risks. Prospective investors should have regard to the factors described under the heading "*Risk Factors*" commencing on page 40.

Dealer Managers

HSBC **UBS INVESTMENT BANK**

IMPORTANT NOTICES

About this document

This Prospectus comprises a prospectus for the purposes of Article 5.4 of Directive 2003/71/EC as amended (which includes the amendments made by Directive 2010/73/EU to the extent that such amendments have been implemented in a relevant Member State of the European Economic Area) (the **Prospectus Directive**).

This Prospectus contains important information about the Issuer, the terms of the Notes and details of the Liability Management Exercise pursuant to which the Notes will be issued. This Prospectus also describes certain risks relevant to the Issuer and its businesses, risks relating to the Liability Management Exercise and risks relating to an investment in the Notes.

You should read and understand fully the contents of this Prospectus, including the Appendices and the information incorporated by reference herein, before making any decision whether or not to participate in the Liability Management Exercise.

The Issuer accepts responsibility for the information contained in this Prospectus. To the best of the knowledge of the Issuer (having taken all reasonable care to ensure that such is the case) the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

Where information has been sourced from a third party, this information has been accurately reproduced and as far as the Issuer is aware and is able to ascertain from information published by that third party, no facts have been omitted which would render the reproduced information inaccurate or misleading. The source of third party information is identified where used.

Neither UBS Limited or HSBC Bank plc, in their capacity as dealer managers in respect of the Notes (the **Dealer Managers**), nor Law Debenture Trustees Limited in its capacity as a trustee in respect of the Notes (the **Trustee**) have independently verified the information contained in this Prospectus. Accordingly, no representation, warranty or undertaking, expressed or implied, is made and no responsibility is accepted by the Dealer Managers or the Trustee as to the accuracy and completeness of the information contained or incorporated in this Prospectus.

This Prospectus does not constitute or form part of any offer or invitation to sell or issue, or any solicitation of any offer to exchange, purchase or subscribe for, any securities other than the securities to which it relates or any offer or invitation to sell or issue, or any solicitation of any offer to purchase or subscribe for, such securities by any person in any circumstances in which such offer or solicitation is unlawful.

None of the Dealer Managers, the Trustee or Computershare Investor Services PLC or Equiniti Limited (the **Registrars**) are able to, and they do not, express any opinion on the merits of the Liability Management Exercise or any component part of the Liability Management Exercise, or make any recommendation or offer any advice regarding whether or not a holder of existing securities of the Bank should participate in the Liability Management Exercise. Each holder must carefully review the applicable documents in connection with the Liability Management Exercise and come to a decision, either on its own or with the assistance of its professional advisers, whether or not it wishes to participate in the Liability Management Exercise.

Use of defined terms in this Prospectus

Certain terms or phrases in this Prospectus are defined in bold formatting and subsequent references to that term are designated with initial capital letters. The meanings of these terms (or an indication of where in this Prospectus the meanings can be found) are set out in Appendix A (*Defined Terms*) to this Prospectus.

Information incorporated by reference in this Prospectus

This Prospectus, including the Appendices, must be read together with all information which is deemed to be incorporated in this Prospectus by reference (see Section 18 (*Information Incorporated by Reference*)).

The Notes are subordinated capital securities of the Bank and are not protected by the Financial Services Compensation Scheme

The Notes will, upon issue, form part of the regulatory capital of the Bank. Banks are required to hold regulatory capital to absorb losses (before depositors and other senior creditors suffer losses) during periods of financial stress. As a provider of capital to the Bank, an investor in the Notes should be prepared to suffer

losses on its investment if, in particular, the Bank and/or the financial sector generally approaches or enters into a period of financial stress. Such losses could be manifested in a number of ways, including (without limitation) that the market price of the Notes may fall significantly, the United Kingdom authorities could take action under the Banking Act 2009 (or similar future legislation), or the Bank could enter into an insolvent winding-up, with the result that investors in the Notes could lose all or substantially all of their initial investment in the Notes.

The Notes are not protected by the Financial Services Compensation Scheme (the **FSCS**). As a result, if the Bank does go out of business or becomes insolvent, or if the United Kingdom authorities take action under the Banking Act 2009 (or similar future legislation) to preserve or restore the viability of the Bank, the FSCS will not pay compensation to an investor. Accordingly, in such circumstances, an investor in the Notes may lose some, or the entire amount of, its investment in the Notes.

How to participate in the Liability Management Exercise

Investors are referred to the Consent and Exchange Offer Memorandum (the **Offer Memorandum**) set out in Appendix C (*Consent and Exchange Offer Memorandum*) to this Prospectus for a description of the Liability Management Exercise and how to participate in the Liability Management Exercise.

Participation in the Liability Management Exercise is the only manner in which Notes can be obtained upon issue.

If an investor is unsure as to the meaning or effect of any of the information contained or incorporated by reference in this Prospectus, or as to any action it should take, it should seek independent advice from its financial, legal and/or other advisers as it considers appropriate.

Interpretation

There are a number of references in this Prospectus to Existing Securities (as defined herein) being "offered for exchange", "exchanged" and similar expressions. Where these expressions are used in the context of holders of Preference Shares or 13% Bonds who elect the Instalment Repayment Notes option (as further described in this Prospectus), such expressions are used for investors' convenience only in understanding what is being proposed, and must not be treated as a technical legal description of the mechanism through which holders would receive any Instalment Repayment Notes. As set out in this Prospectus, holders who opt for Instalment Repayment Notes will actually be selling their Preference Shares or 13% Bonds to Co-operative Group in return for cash consideration which will be payable in twelve equal instalments over twelve years up to (and including) 2025 and it is these instalment payments which will be represented by the Instalment Repayment Notes.

Queries

Questions regarding the terms of the Liability Management Exercise

Questions about the terms of the Liability Management Exercise can be directed to the Dealer Managers at the following contact details:

HSBC Bank plc 8 Canada Square London E14 5HQ United Kingdom Telephone: +44 20 7992 6237 Attention: Liability Management Group Email: coop.exchange@hsbcib.com	**UBS Limited** 1 Finsbury Avenue London EC2M 2PP United Kingdom Telephone: +44 20 7567 0525 Attention: Liability Management Group Email: mark-t.watkins@ubs.com/ mahmoud.abdelaal@ubs.com

Questions regarding participation mechanics in respect of the Liability Management Exercise

Questions of a practical nature regarding how to participate in the Liability Management Exercise should be directed to the Exchange Agent and Information Agent at the following contact details:

Lucid Issuer Services Limited 436 Essex Road London N1 3QP United Kingdom Telephone: 0800 279 7346 (if calling from outside the UK: +44 20 7704 0880) Fax: +44 20 7067 9098 Attention: Sunjeeve Patel / David Shilson / Yves Theis Email: co-op@lucid-is.com

In addition, holders of the Preference Shares may contact Computershare as registrar for the Preference Shares, and holders of the 13% Bonds and 5.5555% Bonds may contact Equiniti as registrar for those bonds, at the following contact details:

Preference Shares	*13% Bonds and 5.5555% Bonds*
Computershare Investor Services PLC Corporate Actions Projects Bristol BS99 6AH United Kingdom Telephone: 0800 694 0470 (if calling from outside the UK: +44 0117 902 7672)	**Equiniti Limited** Corporate Actions Aspect House Spencer Road Lancing West Sussex BN99 6DA United Kingdom Telephone: 0800 169 7006 (if calling from outside the UK: +44 121 415 0260)
Lines are open from 8.30 a.m. to 5.30 p.m. (London time) Monday to Friday (except UK public holidays). Calls from UK landlines will not be chargeable. Calls from outside the UK will be charged at the applicable international rate. Different charges may apply to calls from mobile telephones and calls may be recorded and randomly monitored for security and training purposes. Please note that the telephone operators cannot provide advice on the merits of the Liability Management Exercise or any part of it, nor can they give financial, tax, investment or legal advice.	

TABLE OF CONTENTS

Section		Page
1.	Summary	6
2.	Risk Factors	40
3.	Information about the Notes	98
4.	Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise	104
5.	Expected Timetable of the Liability Management Exercise	122
6.	Details of the Liability Management Exercise	127
7.	How to Participate in the Liability Management Exercise	143
8.	Description of the Bank	145
9.	Directors, Senior Management, Employees and Corporate Governance	186
10.	Capitalisation and Indebtedness	196
11.	Selected Financial Information	198
12.	Operating and Financial Review	202
13.	Capital Adequacy	232
14.	Risk Management	244
15.	Segmental Financial and Other Information	265
16.	Financial Information	278
17.	Supervision and Regulation	397
18.	Information Incorporated by Reference	409
19.	Taxation	411
20.	Additional Information	417
21.	Important Legal Information	471

Appendix		Page
A.	Defined Terms	A-1
B.	Conditions of the Notes	B-1
C.	Consent and Exchange Offer Memorandum	C-1

1
SUMMARY

The following is a summary of information relating to the Bank and the Notes.

SUMMARY OF THE NOTES

Summaries are made up of disclosure requirements known as "Elements". These elements are numbered in Sections A-E (A.1 – E.7).

This summary contains all the Elements required to be included in a summary for this type of security and issuer. Because some Elements are not required to be addressed, there may be gaps in the numbering sequence of the Elements.

Even though an Element may be required to be inserted in the summary because of the type of security and issuer, it is possible that no relevant information can be given regarding the Element. In this case a short description of the Element is included in the summary with the mention of "not applicable".

Section A – Introduction and warnings		
Element	**Title**	
A.1	**Warning**	This summary should be read as an introduction to the Prospectus. Any decision to invest in the securities should be based on consideration of the Prospectus as a whole by the investor. Where a claim relating to the information contained in the Prospectus is brought before a court, the plaintiff investor might, under the national legislation of the Member States, have to bear the costs of translating the Prospectus before the legal proceedings are initiated. Civil liability attaches only to those persons who have tabled the summary including any translation thereof, but only if the summary is misleading, inaccurate or inconsistent when read together with the other parts of the Prospectus or it does not provide, when read together with the other parts of the Prospectus, key information in order to aid investors when considering whether to invest in such securities.
A.2	**Consent for Financial Intermediaries**	Not Applicable. The Bank has not consented to the use of the Prospectus for any subsequent resale or final placement of securities by financial intermediaries.

Section B – Issuer		
Element	**Title**	
B.1	**Legal and commercial name of the Issuer**	The Co-operative Bank p.l.c. (the **Bank**)
B.2	**Domicile/legal form/ legislation/country of incorporation**	The Bank is a public limited company, incorporated and domiciled in the UK with its registered office situated in England and Wales. The Bank operates under the Companies Act 2006 and is registered by the UK Prudential Regulation Authority (the **PRA**) and the UK Financial Conduct Authority (the **FCA**). The Bank's Firm Reference Number is 121885.

B.4b	**A description of any known trends affecting the Issuer and the industry in which the Issuer operates**	***The Bank*** The Bank is currently facing a number of financial pressures which, following a review of the financial position of the Bank, led the boards of the Bank and Co-operative Group Limited (**Co-operative Group**) to announce on 17 June 2013 that the Bank required an additional £1.5 billion of common equity tier 1 capital, as assessed by the PRA. To meet the capital shortfall, on 4 November 2013 Co-operative Group and the Bank announced details of their comprehensive recapitalisation plan (the **Recapitalisation Plan**) to strengthen the Bank's capital base, which is expected to result in an increase in the common equity tier 1 capital of the Bank of £1.5 billion by the end of 2014. The capital shortfall is a result of continuing losses incurred by the Bank predominantly driven by impairment charges to the carrying value of the Bank's loans, in particular corporate loans acquired as part of the merger with Britannia Building Society (**Britannia**) in 2009. Impairment charges for the six months ended 30 June 2013 were £496.0 million. The Bank also has a high cost base relative to its revenue when compared with its peers. The Bank has an ageing IT platform that has suffered from under-investment in recent years and has failed to integrate Britannia into the Bank's operations, resulting in significant cost duplications in front, middle and back office functions and a significant overlap in the branch network. In addition, the Bank's revenues are impacted by it not having achieved sufficient penetration of its current account customer base and historically pricing certain of its products on terms more generous to customers than the market. In response, the Bank has recently strengthened its management team and has adopted a comprehensive new business strategy that is targeted at addressing the issues identified above, reducing the overall risk profile of the Bank and restoring the Bank to health. Whilst the Bank has already taken a number of actions to try to address the challenges it faces, it is clear that it is in the early stages of turning itself around and that the legacy issues identified above will continue to have an impact on the Bank for some time.
B.5	**Description of Co-operative Group and the Issuer's position within Co-operative Group**	Co-operative Group is the UK's largest mutual business, owned by over 7 million consumer members. It is the UK's fifth biggest food retailer, a leading farmer and a major financial services provider. Among its other businesses are a funeral services provider, a pharmacy chain and a legal services provider. The Bank is currently a subsidiary of Co-operative Banking Group Limited (**Banking Group**) which is itself a subsidiary of Co-operative Group. Co-operative Group is the ultimate holding entity of Banking Group and its subsidiaries.

B.8	**Selected key pro forma financial information**	The unaudited pro forma balance sheet as at 30 June 2013 has been prepared to show the pro forma impact of the liability management exercise being conducted by the Bank and Co-operative Group (the **Liability Management Exercise**), on assets, liabilities, equity and certain capital and leverage ratios, as if it had taken place as at 30 June 2013. It has been prepared for illustrative purposes only in accordance with Annex II of the Prospectus Directive (Directive 2003/71/EC as amended) and should be read in conjunction with the notes set out below. Because of its nature, it addresses a hypothetical situation and therefore does not represent the Bank's actual financial position as at 30 June 2013, nor is it indicative of the results that may or may not be expected to be achieved in the future. The successful completion of the Liability Management Exercise is expected to be earnings enhancing as a result of interest savings on Existing Securities (as defined below) surrendered in the Liability Management Exercise, net of coupon payments on New Securities issued in the Liability Management Exercise.

Balance sheet as at 30 June 2013

		Adjustments			
	As at 30 June 2013[1]	*Liability Management Exercise*[2]	*Additional New Ordinary Share Offer*[3]	*Expenses of the Exchange Offers*[4]	*Unaudited pro forma*
			(£ millions)		
Cash and balances at central banks	5,402.1	–	125.0	(43.0)	5,484.1
Other assets	41,230.2	–	–	–	41,230.2
Total assets	46,632.3	–	125.0	(43.0)	46,714.3
Liabilities					
Other borrowed funds	1,248.1	(1,042.1)	–	–	206.0
Other liabilities	44,369.5	–	–	–	44,369.5
Total liabilities	45,617.6	(1,042.1)	–	–	44,575.5
Total equity	1,014.7	1,042.1	125.0	(43.0)	2,138.8
Total liabilities and equity	46,632.3	–	125.0	(43.0)	46,714.3

Notes:

(1) The accounting policies adopted in preparing the pro forma balance sheet as at 30 June 2013 are consistent with the accounting policies adopted in preparing the Interim Financial Information. No account has been taken of actual changes in the trading or financial position of the Bank since 30 June 2013.

(2) The Liability Management Exercise is assumed to generate £1,042.1 million of capital on the basis of full participation in the Liability Management Exercise.

(3) £125.0 million of New Ordinary Shares will be issued as a result of the Additional New Ordinary Shares Offer.

(4) The expenses of the Liability Management Exercise to be borne by the Bank are estimated at approximately £51.0 million (inclusive of VAT), of which approximately £8.0 million was recorded in the six months ended 30 June 2013. The remaining balance of approximately £43.0 million will be paid by the Bank out of cash resources. A portion of these expenses may be allocated to the Bank Tier 2 Notes rather than wholly against total equity. This allocation has not yet been determined.

(5) No adjustment has been made to reflect the legally binding and irrevocable commitment, provided to Bank by Banking Group on 4 November 2013, conditional only upon the successful completion of the Liability Management Exercise, to contribute up to £333.0 million of capital to the Bank during 2014.

B.9	**Profit forecast or estimate**	On 29 August 2013, the Bank published its interim results for the six months ended 30 June 2013. The interim results contained the following statement: *"Clearly there are lessons to be learned from the last few years but it is vital that the new management team focuses on navigating the short-term issues and building the strategy that is targeted at returning the business to health in the future. We have already taken a number of actions but it is clear that we are in the early stages of turning the Bank around. Indeed, we do not expect to be profitable for some years and legacy issues will continue to have an impact on the Bank for some time."* The statement above regarding profitability represents a profit forecast under the prospectus rules published by the FCA under Part VI of the Financial Services and Markets Act 2000, as amended (the **Prospectus Rules**). The Directors have considered the above statement and continue to believe that it is valid based on the assumptions below as the Bank will not be profitable in 2013 and 2014 and can give no assurance that the Bank will generate a profit for some years thereafter. **Basis of preparation and principal assumptions** This profit forecast is based on the interim results for the six months ended 30 June 2013, the unaudited management accounts for the eight months ended 31 August 2013, management's forecast for the remaining four months ending 31 December 2013 and management's latest available projections for the financial years ending 31 December 2013 and 2014. The principal assumptions on which the profit forecast is based comprise: (a) assumptions that are within management's control including: • deleveraging of non-core business will be underwritten in such a manner that the anticipated future losses from deleveraging do not materially exceed the capital released from the reduction in risk-weighted assets; and • there will be no material variation to the assumed level of cost reductions and to the assumption that the cost-to-income ratio for the core business, of not less than 60 per cent., is only achieved in the longer term. (b) assumptions that are not within management's control including: • there will be no material change in legislation or regulatory capital and liquidity requirements impacting the Bank's operations; • there will be no material change in the accounting standards applicable to the Bank; • there will be no material change in interest rates affecting the Bank from those currently applicable to the Bank;

		• there will be no material improvement in the economic and general trading environment currently prevailing in the UK; and • there will be no material change to the competitive environment which impacts on consumer preferences. The profit forecast has been properly compiled on the basis of the stated assumptions and using accounting policies which are in accordance with International Financial Reporting Standards and consistent with those used by the Bank in the six months ended 30 June 2013 and which will be applicable for the financial years ending 31 December 2013 and 2014.
B.10	**Audit report qualifications**	The Accountant's Report on the Bank's audited Interim Financial Information for the six months ended 30 June 2013 of KPMG Audit Plc contains an "emphasis of matter" statement relating to going concern. In the opinion of KPMG Audit Plc, the risks associated with the successful execution of the Recapitalisation Plan, the main cornerstone of which is the Liability Management Exercise, indicate the existence of a material uncertainty which may cause significant doubt on the Bank's ability to continue as a going concern. There are no qualifications in the audit reports for the other periods covered by the historical financial information.
B.12	**Selected historical key financial information/significant change/no material adverse change**	The following table sets out the consolidated income statement of the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013 and 2012.

	Financial year ended 31 December			*Six months ended 30 June*	*(Unaudited)*
	2012	*2011*	*2010*	*2013*	*2012*
		(£millions)		*(£millions)*	
Income	771.2	817.6	821.8	355.8	385.1
Operating costs – steady state	(568.2)	(548.2)	(555.5)	(303.1)	(282.8)
Operating costs – strategic initiatives	(14.8)	(13.4)	(26.0)	(14.3)	(9.2)
	188.2	256.0	240.3	38.4	93.1
Impairment losses	(468.7)	(114.9)	(95.8)	(496.0)	(91.9)
Operating result	(280.5)	141.1	144.5	(457.6)	1.2
Significant items	(85.1)	(53.3)	(55.5)	(34.6)	(39.3)
Intangible asset impairment	(150.0)	–	–	(148.4)	–
Customer redress (including PPI)	(149.7)	(90.0)	(4.3)	(163.0)	(40.0)
Share of post-tax profits from joint venture	1.2	0.2	0.7	0.3	0.6
Financial Services Compensation Scheme levies	(24.8)	(14.5)	(11.5)	0.1	(0.8)
Fair value amortisation	15.2	86.3	(14.2)	(8.2)	19.7
Profit (loss) before taxation and distributions	(673.7)	69.8	59.7	(811.4)	(58.6)
Profit-based payments to members of Co-operative Group	–	(15.6)	(10.8)	–	–
Profit (loss) before taxation	(673.7)	54.2	48.9	(811.4)	(58.6)

The following table sets out the consolidated balance sheet of the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013.

	As at 30 June 2013	*As at 31 December*		
		*2012**	*2011*	*2010*
	(£ millions)	*(£ millions)*		
Assets				
Loans and advances to customers	32,932.9	33,693.7	34,132.3	35,144.1
Cash and balances at central banks	5,402.1	5,433.0	6,696.6	1,735.6
Loans and advances to banks	1,737.5	1,904.1	2,006.5	2,394.1
Investment securities	5,082.6	6,889.8	4,571.0	4,903.1
Derivative financial instruments	804.3	818.8	975.8	975.6
Other assets	672.9	834.0	573.4	428.8
Total assets	46,632.3	49,573.4	48,955.6	45,581.3

	As at 30 June 2013	*As at 31 December*		
		*2012**	*2011*	*2010*
	(£ millions)	*(£ millions)*		
Liabilities				
Amounts owed to customers	34,922.3	36,772.5	36,420.4	34,114.7
Wholesale liabilities	3,517.8	3,612.0	3,302.7	2,938.6
Debt securities in issue	4,610.0	4,713.7	4,164.8	4,212.2
Derivative financial instruments	662.7	967.6	1,087.9	702.4
Other liabilities	656.7	398.8	447.9	564.9
Other borrowed funds	1,248.1	1,258.6	1,258.8	975.4
Total liabilities	45,617.6	47,723.2	46,682.5	43,508.2
Total equity	1,014.7	1,850.2	2,273.1	2,073.1
Total liabilities and equity	46,632.3	49,573.4	48,955.6	45,581.3

Note:

* On 29 August 2013, the Bank published its interim financial report for 2013. The 2012 balance sheet comparatives contained in the interim financial report were represented to reflect that certain deferred tax liabilities cannot be offset against the deferred tax assets. As a result, the 'Other assets', 'Total assets', 'Other liabilities', 'Total liabilities' and 'Total liabilities and equity' each increased by £121.4 million.

The following table sets out the consolidated cash flow statement of the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013 and 2012.

	Financial year ended 31 December			*Six months ended 30 June*	
	2012	*2011*	*2010*	*2013*	*2012*
	(£millions)			*(£millions)*	
Net cash flows from operating activities	805.2	3,470.2	(1,333.5)	(1,978.9)	(1,654.5)
Net cash flows from investing activities	(2,344.7)	831.9	2,220.6	1,842.2	(194.2)
Net cash flows from financing activities	(34.7)	183.1	128.8	(47.2)	(51.2)
(Decrease) increase in cash and cash equivalents	(1,574.2)	4,485.2	1,015.9	(183.9)	(1,899.9)
Cash and cash equivalents at the beginning of the period	7,888.4	3,403.2	2,387.3	6,314.2	7,888.4
Cash and cash equivalents at the end of the period	6,314.2	7,888.4	3,403.2	6,130.3	5,988.5

The following table sets out selected consolidated financial information which is unaudited but which has been derived from the Bank's consolidated financial statements for the financial years ended 31 December 2012, 2011 and 2010, and the Bank's

interim financial information for the six months ended 30 June 2013 and 2012.

	Financial year ended 31 December			*Six months ended 30 June*	
	2012	*2011*	*2010*	*2013*	*2012*
	(percentages)			*(percentages)*	
Core Tier 1 ratio	8.8	9.6	9.6	4.9	9.6
Loans to deposit ratio	91.6	93.9	102.5	94.3	100.5

Set out below is a description of significant changes to the Bank's financial condition and operating results during each of the periods covered in the tables above. The Bank has experienced challenging market conditions in each of the financial years ended 31 December 2010 (**FY 2010**), 31 December 2011 (**FY 2011**) and 31 December 2012 **(FY 2012**), with the UK economy failing to recover at the speed expected.

The Bank incurred losses of £673.7 million in FY 2012, compared with a profit-before-tax of £54.2 million earned in FY 2011. These losses reflect the continuing economic downturn and prolonged low interest rates which have put pressure on the Bank's margins. In addition, and in line with the rest of the banking industry, the Bank saw an increase in the volume of Payment Protection Insurance (**PPI**) complaints in FY 2012 which resulted in an increased provision for PPI. Significant items of £85.1 million were also incurred in FY 2012, notably more than in FY 2011 (£53.3 million) and FY 2010 (£55.5 million): of these significant items costs, a significant amount was incurred in relation to the bid for the Lloyds Banking Group branches, with the remainder primarily associated with investment in the Bank's transformation and integration programmes. While the non-core business (being those business activities no longer congruent with the Bank's strategy) generated an operating loss in FY 2012, the core business delivered an operating profit, reflecting the strategy and risk appetite of the Bank.

Credit impairments in FY 2012 of £468.7 million were £353.8 million higher than the £114.9 million recorded in FY 2011. This increase relates principally to credit impairment on non-core assets following a reassessment of the carrying value of the customer loan portfolios of the Bank in light of the continued and persistent weakness in the economy.

In FY 2012, total income was £771.2 million, down from £817.6 million in FY 2011, a reduction of £46.4 million. This reduction reflects the cost of retained and incremental funding raised during FY 2012 in challenging market conditions and arose principally in the non-core business.

In FY 2011, profit-before-tax was £54.2 million, an increase of £5.3 million over the £48.9 million recorded in FY 2010. Strategic initiative operating costs decreased by £12.6 million between FY 2010 and FY 2011 following significant strategic investment in the Bank's business in FY 2010. Income in FY 2011 was broadly stable at £817.6 million following the generation of £821.8 million of income in FY 2010.

		The Bank incurred significant losses of £811.4 million for the six months ended 30 June 2013, compared to losses of £58.6 million for the six months ended 30 June 2012. These losses have arisen primarily from significant additional impairment charges, intangible asset impairment and customer redress (including PPI) provisions. The Bank has announced a regulatory capital shortfall of £1.5 billion which it plans to address through the implementation of the Recapitalisation Plan comprising the Liability Management Exercise and a contribution from Banking Group (supported by Co-operative Group). The Bank's impairment charge on loans and advances for the six months ended 30 June 2013 was £496.0 million, up from £91.9 million for the six months ended 30 June 2012. These credit impairments, made up of £165.5 million in the core business and £330.5 million in the non-core business, are the reason for the level of operating loss for the six months ended 30 June 2013. The increase in the overall credit impairment charge is due to various factors, including the Bank's strategy of targeting non-core assets for run down and exit, improvements in the Bank's credit risk management approach and impairments incurred in the ordinary course of business due to changes in customer circumstances. In addition, the losses incurred in the six months ended 30 June 2013 were also driven by a number of significant items including a £148.4 million write-down of IT assets, £163.0 million of additional customer redress provisions and £10 million of costs incurred in connection with the aborted bid for the Lloyds Banking Group branch network. Save as set out in "*Recent events impacting the Issuer's solvency*" below (other than the first paragraph) there has been no significant change in the financial or trading position of the Bank or its subsidiaries since 30 June 2013, the date to which the last historical audited consolidated financial information of the Bank was prepared. Save as set out in "*Recent events impacting the Issuer's solvency*" below (other than the first paragraph) there has been no material adverse change in the prospects of the Bank or its subsidiaries since 30 June 2013.
B.13	**Recent events impacting the Issuer's solvency**	The Accountant's Report to the Bank's audited Interim Financial Information for the six months ended 30 June 2013 of KPMG Audit Plc contains an "emphasis of matter" statement relating to going concern. In their opinion, the risks associated with the successful execution of the Recapitalisation Plan, the main cornerstone of which is the Liability Management Exercise, indicate the existence of a material uncertainty which may cause significant doubt on the Bank's ability to continue as a going concern. The Bank believes that the failure of the Liability Management Exercise will result in the Bank ceasing to be a going concern. ***Current trading*** Consistent with the Bank's unaudited interim results for the period ended 30 June 2013, which were announced on 29 August

		2013, the short term outlook for the Bank continues to be challenging. Monthly revenue and cost trends since 30 June 2013 have remained consistent with those observed in the first half of the year. The average monthly level of impairment charges in July and August has fallen as compared to average monthly levels for the first half of the year. In the period from 30 June 2013 to 30 September 2013, £0.6 billion of Non-core Assets (consisting of Non-core Business loans) were deleveraged, through a combination of asset sales, run-off and managed repayments, net of new drawdowns and the Bank raised £1.5 billion of secured wholesale funding. As at 30 September 2013, the encumbrance ratio was 29.8 per cent. The Bank's capital position has not materially changed since 30 June 2013 and the Bank remains dependent on the successful completion of the Liability Management Exercise.
B.14	**Dependence upon other entities in Co-operative Group**	The Bank is dependent on Co-operative Group for the provision of certain administrative services (such as finance, marketing, human resources, some risk functions and, in particular, IT) although the extent of this reliance is expected to be reduced following completion of the Liability Management Exercise as services are likely to be repatriated to the Bank. These arrangements may need to be renegotiated as a result of the successful implementation of the Liability Management Exercise. In addition the Bank is dependent on the strength of the wider Co-operative brand and its reputation with customers and potential customers of the Bank.
B.15	**A description of the Issuer's principal activities**	The Bank's core business (which as at 30 June 2013 had total segment assets of £30,021.8 million) includes the core retail and corporate banking businesses, treasury and certain other businesses. The core retail banking business product offering consists of a range of current accounts and money transmission services, lending and savings products, to individuals, households and certain small businesses in the UK, while the core corporate banking business targets small- and medium-sized businesses. The Bank's strategy is to become a retail and commercial bank focused on retail and small- and medium-sized enterprises and franchise businesses in the UK, built around the Bank's existing brand and franchise strength. The Bank had total assets of £46,632.3 million as at 30 June 2013 (£49,694.8 million as at 31 December 2012). These assets include non-core business asset classes which are not consistent with the Bank's business strategy, are being targeted for run-down or exit, and include non-performing commercial and residential real estate exposures, including non-prime residential mortgages (both income verified and self-certified), buy-to-let and other non-conforming mortgages.

		The Bank has approximately 4.7 million customers, and operates through a network of branches, call centres, ATMs, the internet and digital channels.
B.16	**Controlling shareholders**	The Bank is currently a wholly-owned subsidiary of Banking Group. Co-operative Group is the ultimate holding entity of Banking Group and its subsidiaries. Successful completion of the Liability Management Exercise will involve the issue by the Bank of ordinary shares to a number of existing investors in the Bank, being the holders of the Bank's existing lower tier 2 securities. Upon successful completion of the Liability Management Exercise, Co-operative Group will continue to own (through Banking Group) 30 per cent. of the issued shares of the Bank with the remaining 70 per cent. of the issued shares of the Bank being held by holders of the Bank's existing lower tier 2 securities. The Bank does not anticipate that, following completion of the Liability Management Exercise, any of the holders of the Bank's Dated Notes shall acquire a controlling interest in the Bank simply by participating in the Liability Management Exercise.
B.17	**Solicited credit ratings**	The Bank is rated BB– (long-term) and B (short-term) by Fitch Ratings Ltd. (**Fitch**) and Caal (long-term) and NP (short-term) by Moody's Investors Service Limited (**Moody's**). The Notes will not be rated.

Section C – Securities		
Element	**Title**	
C.1	**Description of Notes**	11 per cent. Subordinated Notes due 2023 (the **Notes**). The International Securities Identification Number (**ISIN**) for the Notes is: GB00BFXW0853.
C.2	**Currency**	British pounds Sterling.
C.5	**Transferability**	Not Applicable. There are no restrictions on the free transferability of the Notes provided that no Noteholder may require the transfer of a Note to be registered during the period of 15 days ending on the due date for any payment of principal or interest on that Note.
C.8	**A description of rights attached to the Notes including ranking and limitations to those rights**	The Notes are issued upon terms and conditions (the **Conditions**) which set out the obligations of the Bank and the rights of the Noteholders. ***Status of the Notes*** The Notes will be unsecured and, in accordance with the paragraph below describing rights on a winding-up of the Bank, subordinated obligations of the Bank and will rank equally without any preference among themselves. ***Rights on a winding-up of the Bank*** On a winding-up of the Bank, the Trustee (on behalf of the Noteholders) will have a claim for the principal amount of the Notes together with accrued and unpaid interest which will rank

		at least equally with all claims of holders of all other subordinated obligations of the Bank which constitute tier 2 capital of the Bank (or are expressed to rank equally with such instruments). That claim will, however, be subordinated to the claims of depositors and other unsubordinated creditors of the Bank. Accordingly, the Noteholders will only recover any amounts under their claims if there are assets remaining once senior-ranking creditors have been paid in full. If the Bank's assets are sufficient to repay senior creditors in full, but are insufficient to repay fully the Noteholders and other creditors whose claims rank alongside the Noteholders' claims, then the Noteholders will lose some of their investment in the Notes. ***Rights of enforcement upon default*** The Notes will contain the following events of default: (a) non-payment of principal when due in respect of any of the Notes for a period of seven days; (b) non-payment of interest when due in respect of any of the Notes for a period of fifteen days; or (c) the winding-up of the Bank. In the event of a payment default, Law Debenture Trustees Limited as trustee for the Noteholders (the **Trustee**) may elect to institute proceedings for the winding-up of the Bank. The Trustee may also prove in a winding-up of the Bank on behalf of the Noteholders. If directed in writing by the holders of at least one-fifth in nominal amount of the Notes then outstanding or by an Extraordinary Resolution of the Noteholders, the Trustee shall be obliged to institute such proceedings and/or prove in a winding-up, provided it is indemnified and/or secured and/or pre-funded to its satisfaction (which means it receives assurance that it will receive the funds or be entitled or able to receive the funds to cover any costs that the Trustee incurs). Noteholders will be unable to take the above enforcement action directly unless the Trustee has become bound to act and fails to do so. Further, no other remedy (including any right of set-off in respect of any amounts owed to the Bank by a Noteholder) is available to the Trustee or the Noteholders. Accordingly, the Noteholders' rights of enforcement available are limited to the above. ***Taxation*** All payments in respect of Notes will be made without withholding or deduction for or on account of taxes imposed by the United Kingdom or any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law. In the event that any such deduction is made, the Bank will, save in certain limited circumstances, be required to pay additional amounts to cover the amounts so deducted.

		Meetings of Noteholders The Conditions contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions will permit defined majorities of the holders present and voting at the relevant meeting to bind all Noteholders, including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority. The powers afforded to majorities to bind minorities are significant, and could result in material changes to the terms of the Notes, including potentially reducing the amounts of interest and/or principal payable by the Bank, changing the maturity of the Notes, including extending the time to maturity of the Notes, the timing of payments of interest and/or principal in respect of the Notes, mandatory substitution of the Notes with other securities and, in the extreme, the complete abrogation (i.e. annulment) of all rights of the holders under the Notes. ***Governing law*** English law.
C.9	**Interest, redemption, yield and representative**	***Interest*** Interest will accrue from (and including) the date of issue of the Notes at a fixed rate of 11 per cent. per year and will be payable quarterly in arrear every three-month anniversary of the issue date up to and including the date of redemption of the Notes. ***Redemption*** Unless redeemed or purchased and cancelled earlier, the Bank will be required to repay the Notes on the tenth anniversary of the issue date at their principal amount. The Bank will also have the option (subject to PRA approval) to repay the Notes before their final maturity date if there is a change in law or regulation which results in certain adverse tax consequences for the Bank or in the Notes ceasing to be eligible to qualify as regulatory capital of the Bank at an amount equal to 101 per cent. of their principal amount. ***Indication of yield*** The Notes will be issued at 100 per cent. of their principal amount and will pay a fixed rate of interest of 11 per cent. per year to maturity. Accordingly, the yield to an investor who initially subscribes the Notes and holds them to maturity will be 11 per cent. per annum. The yield above is stated as at the issue date on the basis of the issue price and is not an indication of future yield. ***Representative of the Noteholders*** Law Debenture Trustees Limited will be trustee (the **Trustee**) for the Noteholders. As well as taking enforcement action on behalf of the Noteholders as described above, the Trustee may (without the consent of the Noteholders) agree to certain formal, technical or minor modifications to the Notes, to any modification to correct a manifest error or which, in the opinion of the Trustee, is not materially prejudicial to the interests of the Noteholders

		and to waivers of breaches or proposed breaches under the Notes which it considers not to be materially prejudicial to the interests of the Noteholders.
C.10	**Derivative component in the interest payment**	Not Applicable. The Notes will not have a derivative component in the interest provisions.
C.11	**Listing/admission to trading**	Application has been made to the UK Listing Authority for the Notes to be admitted to the Official List and to the London Stock Exchange for the Notes to be admitted to trading on the London Stock Exchange's regulated market upon issue.

Section D – Risks		
Element	**Title**	
D.2	**Key risks specific to the Issuer**	***Risks relating to the Liability Management Exercise*** • Following a review of the capital position of the Bank and discussions with the PRA, it was determined and announced on 17 June 2013 that the Bank requires additional aggregate common equity tier 1 capital of £1.5 billion. Co-operative Group and the Bank have developed the Recapitalisation Plan which is intended to address this capital shortfall. The Recapitalisation Plan includes, amongst other things, the implementation of the Liability Management Exercise. At least £1 billion of this capital requirement is intended to be contributed pursuant to the Liability Management Exercise in 2013. Conditional on completion of the Liability Management Exercise, £333 million of the capital requirement is intended to be contributed by Banking Group during 2014 of which £170 million is to be contributed by 30 June 2014 (with £70 million of this contribution to be paid before 31 January 2014) and the remaining £163 million by 31 December 2014. The remainder of the common equity tier 1 capital is intended to be generated pursuant to an offer to subscribe for 62,500,000 additional New Ordinary Shares for an aggregate consideration equal to £125 million to Holders of the Dated Notes in accordance with the Scheme (as defined below) and the capital created through interest savings on the Existing Securities exchanged pursuant to in the Liability Management Exercise. Given that the success of the Liability Management Exercise is dependent on the participation of holders of Existing Securities, there is a risk that holders of the Existing Securities will fail to participate in the Liability Management Exercise in sufficient numbers such that the Liability Management Exercise fails. The Liability Management Exercise will only successfully complete if the entire principal amount of all Existing Securities is exchanged or sold pursuant to the Liability Management Exercise. In addition, there is the risk that, notwithstanding the fact that the PRA reconfirmed its assessment on 29 August 2013 and on 21 October 2013 that the Bank needed to generate an additional £1.5 billion in common equity tier 1 capital, the PRA concludes that the aggregate £1.5 billion of common equity tier 1 capital to be

		contributed pursuant to the Recapitalisation Plan is inadequate, which may result in either the Bank deciding not to proceed with the Liability Management Exercise or holders of the existing securities electing not to participate in the Liability Management Exercise. Whilst in the event that the Liability Management Exercise is not successfully implemented, with the result that the Bank would fail to raise sufficient common equity tier 1 capital by 31 December 2013, the Bank would take immediate action to try to address the Bank's capital shortfall, the Bank believes that, in such circumstances, the failure of the Liability Management Exercise would result in the Bank becoming subject to a resolution procedure under the Banking Act 2009 (**Banking Act**). In the event that the authorities exercise their powers under the Banking Act or there is market speculation regarding the occurrence of any such event, it is highly probable that the Bank would be materially adversely affected, and the market price of existing securities (if they remain outstanding in such circumstances) would be materially adversely affected. The Bank considers that there are fundamental uncertainties as to whether the Bank could be successfully resolved such that the Bank remains a going concern without the active participation of Co-operative Group and a substantial amount of additional capital. The Bank believes that if the Bank were to be resolved and go into an insolvency proceeding as a result of that resolution, Holders of existing securities would receive no recovery in respect of their existing securities. As a result, the Bank believes that the outcome of a successful Liability Management Exercise is a substantially more favourable outcome to Holders of any class of existing securities than a resolution of the Bank. • The Bank is exposed to the risk that litigation seeking to challenge the implementation of the Liability Management Exercise could materially impact or prevent the success of the Liability Management Exercise or result in all or part of the Liability Management Exercise being declared unlawful or invalid retrospectively. The success of any such arguments or claims or delay to the implementation of the Liability Management Exercise arising out of any such arguments or claims could result in the failure of the Liability Management Exercise or, if such claims were successful following the implementation of the Liability Management Exercise, could result in the Bank no longer meeting the PRA's requirement that the Bank raise an additional £1.5 billion common equity tier 1 capital. • As a result of the Bank's capital position and its dependency on the success of the Liability Management Exercise, along with other matters and uncertainties, the audit report in respect of the Bank's Interim Financial Information contains an "emphasis of matter" statement to the effect that there is material uncertainty which casts significant doubt on the ability of the Bank to continue as a

		going concern. Therefore the Bank believes that the failure of the Liability Management Exercise will result in the Bank ceasing to be a going concern. ***Risks relating to the Bank and its business*** The Bank is directly and indirectly subject to inherent risks arising from general economic conditions in the UK and other economies and the state of the global financial markets both generally and as they specifically affect financial institutions. Weakness or deterioration in general economic conditions or political instability in the UK or other economies could have a material adverse effect on the Bank's operations, financial condition and prospects. • ***Risks associated with implementation of the Bank's strategy:*** The difficult situation currently faced by the Bank is unprecedented for the Bank. To improve its financial and operational performance and capital position the Bank has recently adopted a new four to five year business plan. The Bank's newly adopted strategy was developed in a relatively short time-frame, has yet to be implemented and its performance and effectiveness is not yet proven. It is possible that the Bank's strategy may not sufficiently address the Bank's problems or deliver the expected benefits. In addition, the successful implementation 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. The Bank also does not have a track record of successfully implementing large-scale changes. In addition, notwithstanding the recent strengthening of the board and senior management team, including the appointment of Richard Pym as Chairman of the board and Niall Booker as Chief Executive Officer (amongst others), a number of further appointments are still required. Following completion of the Liability Management Exercise, the Bank intends to appoint a finance director to the Bank's board and to appoint a new Chief Operating Officer with business transformation experience. Grahame McGirr is currently both head of Co-operative Asset Management and Chief Risk Officer; following completion of the Liability Management Exercise the expectation is that a new Chief Risk Officer will be appointed allowing Grahame McGirr to focus solely on Co-operative Asset Management. In addition, Rodney Bulmer, the current Deputy Chief Executive Officer of the Bank and the Executive Director responsible for the Bank's core business has given notice to terminate his contract and is expected to leave the Bank in March 2014. A replacement will need to be found for Rodney Bulmer. The failure to recruit, or a delay in recruiting, suitable members of the senior management team or the loss of one or more members of senior management without finding suitable replacements may delay or impact on the ability of the

		Bank to successfully implement its strategy, notwithstanding the appointment of additional non-executive directors following completion of the Liability Management Exercise. The Bank is also reliant on the commitment and ability of persons employed by or seconded to the Bank to deliver the strategy and effectively and appropriately implement and support the numerous changes required by the strategy at the same time that significant changes, cost reductions and redundancies are being implemented. As a result, there can be no assurance that the Bank will, over the longer term, be able to successfully implement all or parts of its strategy or implement it when expected or targeted. • In addition, the implementation of the Bank's strategy has a number of specific risks: • The Bank's strategy includes leveraging the Bank's strong and differentiated brand and leading levels of customer satisfaction. The implementation of significant cost reductions, branch closures, redundancies and the reorientation of the Bank's distribution network may have a negative impact on the Bank's brand and levels of customer satisfaction which may, in turn, result in customer attrition. The Bank may also be unsuccessful in achieving the required shift in customer behaviour towards self-service and digital banking such that the Bank will fail to meet its cost saving objectives. Actions taken by the Bank in the implementation of its strategy may inadvertently be, or may be perceived, to be contrary to the principles of the co-operative movement which could negatively impact on the Bank's brand and its relationship with Co-operative Group. • The Bank's strategy also includes improving revenue in its core business in the medium-term through improved pricing of its products, appropriate re-pricing of existing products towards market rates, growing primary account customers in the Bank's key market segments, cross-selling products and growing the volume of higher margin unsecured lending. The Bank's ability to improve revenue in its core business is dependent upon a number of factors, including prevailing macroeconomic conditions (including the level of interest rates), the Bank's relative position versus its competitors and the ability of persons working for the Bank to appropriately cross sell products. • There is also a risk that the recent credit rating downgrades, the Bank's capital shortfall and/or the Bank's disappointing financial results for the six months ended 30 June 2013, continuing press reporting and public scrutiny of the same and of the Recapitalisation Plan and/or actions by the holders of

		the Bank's Existing Securities may, individually or cumulatively, over the longer term have a negative impact on the Bank's brand and reputation. • The Bank's high cost-to-income ratio continues to impact on its profitability and its capital position, and reducing its cost base remains a priority for the Bank. This cost reduction will be delivered through a number of management actions and there is no guarantee that these actions will achieve the intended cost benefits and will be successful or that they will otherwise be delivered on time or when expected. In addition, the reorientation of the Bank's distribution model and its cost reduction programme may negatively impact the Bank's customer service, which may result in customer attrition. • The Bank needs and intends to significantly improve and re-engineer its existing IT platform. This re-engineering of its IT platform is significant, both in terms of scale and cost, and involves a number of risks. • The inability of the Bank to deleverage its non-core assets in a controlled and capital efficient manner may have a negative impact on the Bank's operating results and financial position (in particular, its net interest margin) and its regulatory capital position. In addition, any greater than expected costs or delays in deleveraging the non-core assets may divert funding from and adversely impact the longer term development and growth of the core business. • A failure or delay in implementing the Bank's strategy or a failure by the Bank to achieve its targets may adversely affect the Bank's business, results of operation, financial position and/or prospects and, in the longer term, its ability to comply with its regulatory capital requirements. • ***Risks associated with implementation of the Bank's non-core business strategy:*** A failure by the Bank to deleverage its non-core assets in a controlled manner in accordance with its strategy may (for example, through greater than currently expected losses from the run-off or sale of non-core assets) negatively impact on the Bank's operating results and financial position (in particular, its net interest margin) and, in the longer term, its ability to comply with its regulatory capital requirements. The failure of the non-core business to deleverage its assets in a controlled manner may also hinder or restrict the longer term development and growth of the core business' business, and divert management attention from the core business. For example, it may restrict the ability of the core business to grow its existing loan portfolios or to expand its growth of other products, such as unsecured lending. In addition,

		notwithstanding the significant impairments already made to the non-core assets, the non-core business also has significant additional impairment risk given the underlying assets, which includes Optimum, a book of predominantly interest-only intermediary and acquired mortgage book assets (as at 30 June 2013, £7.3 billion). Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in the non-core assets suffering from more than expected impairments which would adversely impact on the Bank's operating results and financial position (in particular, its net interest margin) and, in the longer term, its ability to comply with its regulatory capital requirements. The non-core business' corporate asset book is also relatively concentrated, with the result that a small number of borrowers account for a large proportion of the total loans outstanding. A significant impairment of any of these borrowers would result in a disproportionate impact on the Bank's operating results and financial position. • ***Risks associated with the 2014 Commitment:*** The commitment of Banking Group to contribute £333 million of common equity tier 1 capital during 2014 (the **2014 Commitment**), in addition to being conditional upon the successful completion of the Liability Management Exercise, is subject to the ability of Banking Group to fund the commitment (supported by Co-operative Group), which is dependent on certain actions which are partially outside the control of Banking Group. In the event that Banking Group is unable to meet its obligations under the 2014 Commitment and is also unable to draw down on its support from Co-operative Group, Banking Group will be in breach of its obligations under the 2014 Commitment with the consequence that the Bank may have insufficient common equity tier 1 capital by 2014 to meet the PRA's requirements. • ***Risks associated with the Bank's requirement to maintain adequate regulatory capital, and with future changes to its regulatory capital requirements:*** The Bank is required to maintain adequate regulatory capital and capital ratios at all times. The Bank may require further capital and liquidity to meet new international capital and liquidity requirements (such reforms being commonly referred to as Basel III) as implemented in the EU through the introduction of the Prudential Requirements Regulation (the **PRR**) and a further iteration of the Capital Requirements Directive (the **PRD** and together with the PRR, **CRD IV**) beyond the level that the Bank has currently forecast and taken account of as part of the development of the Recapitalisation Plan and/or the implementation of (i) ring-fencing in the UK as currently proposed in the Financial Services (Banking Reform) Bill (the **Banking Reform Bill**) and (ii) the minimum requirement for eligible liabilities under the provisions of the European Commission's legislative

		proposal for a directive providing for the establishment of an EU-wide framework for the recovery and resolution of credit institutions and investment firms (the **RRD**) could also potentially impact the capital position of the Bank and require additional regulatory capital to be raised by the Bank. The actual impact of CRD IV on the Bank's capital requirements is also dependent on the European Banking Authority's technical standards, a large number of which are yet to be finalised. Based on its current understanding of how CRD IV will be implemented in the UK, the Bank believes it will, following the completion of the Recapitalisation Plan, be in compliance with the requirements of CRD IV upon their implementation. However, the risk that the final content of these technical standards may differ materially from current expectations cannot be excluded. There is also a risk of the introduction by the PRA of higher regulatory capital requirements on major UK banks. These risks that the final content of these technical standards may differ from the Bank's current expectations and/or that the PRA introduces higher regulatory capital requirements on the Bank than currently anticipated are not currently quantifiable and so have not been accounted for by the Bank. As a result, the Bank may become subject to regulatory capital requirements not currently anticipated or provided for. In addition, the regulatory position of the Bank may, in the future, be adversely affected by a currently unanticipated adverse economic and market environment and/or increasing interest rates in the UK or elsewhere, which may: (i) result in a deterioration in the quality of the Bank's assets; (ii) adversely impact the Bank's access to funding and capital, and (iii) negatively impact on unemployment, house prices and other factors, each of which may lead to lower than anticipated profits and higher than anticipated impairments. • The Bank is not compliant with its Individual Capital Guidance (**ICG**), although the Bank does meet its Pillar 1 requirements. The Bank has discussed, and agreed, with the PRA the Bank's recently adopted four to five year business plan which contemplates that the Bank will meet its ICG by the end of the plan period. The Bank's business plan envisages that the Bank will raise approximately £400 million by way of additional tier 2 capital during the business plan period. • Effective management of the Bank's capital is critical to its ability to operate and grow its business and to pursue its strategy. Any change that limits the Bank's ability to manage effectively its balance sheet and capital resources could have a material adverse impact on its business, financial condition, results of operations, liquidity and/or prospects. In the event that the impact of any of the new Basel III regulatory capital and liquidity requirements is greater than is currently anticipated by management, and if the Bank, as a consequence, were to suffer a shortage of

		regulatory capital, the Bank would expect to enter into discussions with the PRA and consider what actions to take in light of such circumstances, taking into account the regulatory capital position and requirements of the Bank at that time. Any such discussions with the PRA could take some time before agreement is reached. Any such actions, or any delay in implementing such actions or in agreeing them with the PRA, may have a material adverse effect on the Bank and its business. Possible actions might include accelerating the non-core business's asset disposal plan. Failure by the Bank to maintain adequate regulatory capital could lead to an inability of the Bank to support its business operations and implement its strategy, meet regulatory requirements, implement its investment plans, raise (in the medium term) further capital, make distributions, and could result in further changes to its credit ratings. Such consequences could, in turn, have a material adverse effect on the Bank's business, operating results, financial condition and prospects. A regulatory capital shortfall may result in the Bank being subject to a resolution procedure under the Banking Act. • ***Liquidity risk:*** The Bank's business is subject to inherent risks concerning liquidity, particularly if the availability of traditional sources of funding such as retail and corporate deposits and, to a lesser extent, unsecured wholesale funding (these being the principal sources of the Bank's funding) become limited and/or more expensive. This may result in an inability to operate in the ordinary course, and/or a failure to meet liquidity requirements, and/or may adversely impact the Bank's business and/or the implementation of its strategy. Given that the Bank's main source of funds is deposits, the Bank faces the risk of not being able to replace funds when they are withdrawn or, should a significant number of depositors seek to withdraw their funds, of not being able to meet its obligations to fund such withdrawals, repay lenders in accordance with its financing arrangements or fulfil commitments to lend. However, notwithstanding the steps that the Bank has taken to maintain its levels of total liquidity, given the reliance by the Bank on its customer deposits to provide funding for the Bank, any severe decline in customer confidence in the Bank could increase the amount of deposit withdrawals in a short space of time or over a sustained period. Given the relative size of the Bank's deposit base as compared with its other sources of funding, the Bank is particularly exposed to any serious loss of confidence by its depositors. Should the Bank experience an unusually high level of withdrawals which exceed the Bank's ability to manage through the application of its liquidity controls and contingency planning, this may have an adverse effect on the Bank's day-to-day operations, maintain the Bank's planned lending which may have an adverse effect on the Bank's business, results and financial position and could, in extreme circumstances, prevent the Bank from meeting its financial

		obligations as they fall due, meeting its regulatory minimum liquidity requirements or fulfilling its commitments to lend. In such circumstances, the Bank may be subject to a resolution procedure under the Banking Act. The credit rating downgrade experienced by the Bank has: (i) 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; (ii) negatively impacted the Bank's ability to access short-term unsecured wholesale funding; and (iii) increased the Bank's collateral requirements used in the clearing systems. In addition, the total amount of the Bank's corporate deposits also fell by approximately £1.4 billion in the first half of 2013, probably caused by the credit rating downgrade. To a lesser extent, the Bank's regulatory capital shortfall, its disappointing results for the six months ended 30 June 2013, and the continued press attention and speculation to which the Bank is subject have also affected the Bank's funding profile and the cost to the Bank of raising new funding. This continued impact on access to funding and increased cost of funding may, over the longer term, have adverse effects on the Bank's business, financial performance or future prospects and/or adversely affect the Bank's ability to achieve its strategic objectives. • In addition, whilst the Bank's retail deposit base has remained broadly stable (in appropriate circumstances, the Bank has managed its retail offering to mitigate against the risk of depositors withdrawing funds), a failure by the Bank to achieve its strategy, a deterioration in the Bank's operating results or financial position, or the continued press attention and speculation to which the Bank is subject may in extreme circumstances result in a severe decline in customer confidence which could result in the withdrawal of retail funds. • ***Credit risk:*** The Bank is directly and indirectly subject to inherent risks arising from general economic conditions in the UK and other economies and the state of the global financial markets both generally and as they specifically affect financial institutions. These risks have been enhanced by the period of significant turbulence and uncertainty affecting the global economy and the global financial system, and the Eurozone in particular (including the risk of a break-up of the single European currency). 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 significantly lower revenues and/or greater than expected losses which could have a material adverse effect on the Bank's operations, financial condition and prospects. • ***Changes in laws and regulations and regulatory risk:*** The Bank is subject to wide-ranging legal and regulatory

		(including liquidity and capital) requirements and supervision. There is a risk that changes to the legal and regulatory environment may result in additional compliance costs (including the raising of further capital and/or liquidity) and diversion of management time and resources, which may adversely affect the Bank's business, strategy and prospects. In addition, failure to comply with such requirements may result in investigations, disciplinary action, fines, reputational damage and the revocation of the Bank's licences, permissions or authorisations which could have a material adverse effect on the Bank's operations, financial condition and prospects. Known future changes in legislation include the new capital regime commonly known as Basel III which will be implemented in the UK pursuant to CRD IV (as described above) and which will be effective from 1 January 2014. • ***Risk of litigation against the Bank:*** The Bank faces the risk that the past, current or future actions of the Bank (including in respect of the implementation of the Recapitalisation Plan, and the Liability Management Exercise of which it is a part) may result in litigation. The Bank is currently co-operating with enquiries received from the Conduct Committee of the Financial Reporting Council relating to the Bank's disclosures in its 2012 annual report and the accounts of the Bank's regulatory capital position, amongst other matters, and the FCA with respect to the Bank's compliance with the FCA's Disclosure and Transparency Rules. In addition, on 12 July 2013, Co-operative Group and the Bank announced the launch of an independent review, to be chaired by Sir Christopher Kelly, into the events that led to the recent announcement of the Recapitalisation Plan to address the Bank's £1.5 billion capital shortfall, the decision to merge the Bank with Britannia in 2009 and the proposed acquisition of the Lloyds TSB branches (the **Kelly Review**). The Kelly Review will include an analysis of strategic decision-making, management structures, culture, governance and accounting practices and aspects of the role of the Bank's auditors. The intention is to present the findings of the Kelly Review to Co-operative Group's members at its annual general meeting in May 2014. The Bank may face additional investigations or proceedings arising out of the Kelly Review. Any of these risks, should they materialise, could have an adverse impact on the Bank's operations, financial results, condition and prospects, and the confidence of the Bank's customers in the Bank, as well as taking a significant amount of management time and resources away from the implementation of the Bank's strategy. • ***Conduct risk:*** The Bank is exposed to risks relating to the mis-selling of financial products, acting in breach of legal or regulatory principles or requirements and giving negligent advice. Any failure to manage these risks

		adequately could lead to significant liabilities and/or reputational damage. In addition, the Bank faces both financial and reputational risk where legal or regulatory proceedings are brought against it or members of its industry generally, or where complaints are made against it or members of the industry generally to the Financial Ombudsman Service or another relevant body. Sustained conduct reputational damage could affect the Bank's operations, financial condition and prospects. • ***Pensions:*** The main Co-operative Group pension scheme is The Co-operative Pension Scheme (Pace) (**Pace**), in which the Bank participates. At present there is an actuarial deficit in Pace: the most recent actuarial report indicated that there was a funding deficit of £715 million as at 5 April 2013. Contributions towards the deficit are agreed between the Co-operative Group and the scheme trustee following the advice of the independent scheme actuary. However, Co-operative Group has undertaken to agree with the Bank its proportion of the employer contributions in Pace (if not agreed, the matter will be referred to an independent third party). CFSMS is the employer in relation to the Britannia Scheme and charges the Bank for any payments due to the scheme in respect of members employed by CFSMS and working for the Bank. In addition, the Bank has provided guarantees in respect of the Britannia Scheme under which the Bank may become liable to contribute towards that scheme. However, Co-operative Group has undertaken to procure that if CFSMS is not controlled by the Bank, CFSMS will not take or omit to take any action without the Bank's prior agreement if the result would be to increase the Bank's liabilities or contributions in respect of the Britannia Scheme. The most recent actuarial report indicated that the funding deficit in the Britannia Scheme as at 5 April 2013 was £61 million. There are risks associated with the pension schemes due to the value of the asset portfolios and returns from them being less than expected and because there may be greater than expected increases in the estimated value of the schemes' liabilities. In addition, Pace is a non-segregated, hybrid pension scheme in which several Co-operative Group companies participate, including the Bank. On an on-going basis, each employer is responsible for funding a proportion of the Pace liabilities. In addition, an exit debt is payable where an employer exits Pace and this liability is a material risk for the Bank if it exits Pace following the LME. However Co-operative Group has undertaken not to exercise its powers without the Bank's prior written approval except (i) where the Bank is in breach of the rules of Pace, (ii) where required by law or (iii) where all other employers cease participation at the same time so that a liability of this type does not arise. There are other circumstances in which funding from an employer may be required for liabilities relating to members' service with another employer. In particular, where other employers in Co-operative Group have ceased

		to participate in the pension scheme without satisfying their liabilities (for example due to insolvency) the Bank's share of the deficit could include liabilities relating to those other employers, up to the level of the entire buy-out deficit in the scheme. These additional liabilities could have an adverse impact on the Bank's operations, financial condition and prospects. • ***Information technology:*** The Bank needs and intends to progressively re-engineer its existing IT platform. This re-engineering of its IT platform is significant, both in terms of scale and cost, and involves a number of risks. Any failure in systems as a result of not mitigating the IT risks, or in the period prior to such remediation being completed, could adversely affect the Bank's ability to conduct its business and lead to regulatory focus on the Bank, which may impact on the Bank's operations, financial condition and prospects. The Bank is also, and will continue to be, dependent on the use of third-party IT, software, data and service providers, including Co-operative Group. A failure on the part of either Co-operative Group or a third party to provide the agreed services could have an adverse impact on the Bank's operations, financial condition and prospects.
D.3	**Key risks regarding the Notes**	• ***The Notes are not protected by the Financial Services Compensation Scheme (FSCS):*** Unlike a bank deposit, the Notes will not be protected by the FSCS. As a result, if the Bank does go out of business or becomes insolvent, or if the United Kingdom authorities take action under the Banking Act (or similar future legislation) to preserve or restore the viability of the Bank, the FSCS will not pay compensation to an investor. Accordingly, in such circumstances, an investor in the Notes may lose some, or the entire amount, of its investment in the Notes. • ***The Notes are subordinated obligations of the Bank:*** The Notes will constitute unsecured and subordinated obligations of the Bank. On a winding-up or dissolution of the Bank, claims in respect of the Notes would rank behind the claims of all depositors and other unsubordinated creditors of the Bank. In a winding-up, the assets of the Bank would be applied first in satisfying all senior ranking claims in full, and payments would be made to holders of the Notes, proportionately with payments made to holders of any other equally ranking instruments (if any), only if and to the extent that there were any assets remaining after satisfaction in full of all such senior ranking claims. • ***The Notes may become subject to provisions enabling the UK authorities to convert the Notes to equity or write-down or write-off the principal amount of the Notes, and/or the UK authorities may exercise existing powers under the Banking Act:*** There are current proposals both in the European Union (through the RRD) and in the United Kingdom (such proposals were announced by HM Treasury on 1 October 2013) which, if implemented in the United

		Kingdom, will enable the UK authorities to convert an instrument issued by the bank from one form or class to another (for example, a debt instrument into equity), to write down or write off instruments such as the Notes in certain circumstances relating to preserving or restoring the stability of the financial systems in the UK, the protection and enhancement of public confidence in the stability of the banking systems of the UK and/or the protection of depositors. If implemented in the United Kingdom, the use of any such powers could result in Noteholders losing some, or potentially all, of their investment in the Notes, even if the Bank does not become insolvent. In addition, the UK authorities already have considerable powers under the Banking Act to resolve a bank which is failing (or likely to fail) the threshold conditions for its authorisation to conduct banking business. These powers include, but are not limited to, the power to modify or annul the effect of an instrument or to convert securities from one form or class to another through the making of a share transfer instrument or order in respect of a bank. If the United Kingdom authorities take action under the Banking Act, Noteholders may also lose some or potentially all of their investment in the Notes. • ***Rights of enforcement in respect of the Notes are limited:*** The only events of default under the terms of the Notes are failure to pay interest or principal when due and the winding-up of the Bank. Further, the Noteholders will have limited rights to enforce default, and will only have direct rights of enforcement in the event that the Trustee representing the Noteholders fails to act having become bound to do so. • ***The conditions of the Notes contain provisions which may permit their modification without the consent of all investors:*** The terms of the Notes provide for the calling of meetings of Noteholders at which, subject to certain requirements regarding the conduct of the meeting, a specified majority of the holders present and voting may approve amendments to the terms of the Notes in a manner which will bind all holders (whether or not present at the meeting and/or voting in favour) and such amendments could have a material adverse effect on the Notes and/or the rights of Noteholders under the Notes. • ***There can be no assurance that a secondary market in the Notes will develop:*** The Notes may have no established trading market when issued, and one may never develop. If a market does develop, it may not be very liquid. The market price of Notes can go down as well as up, and Noteholders may be unable to sell their Notes, or may only be able to sell them at a loss.

Section E – Offer		
Element	**Title**	
E.2b	**Reasons for the Offer and use of proceeds when different from making profit and/or hedging certain risks**	The offer of the Notes forms part of the Liability Management Exercise, which is being conducted in order to raise at least £1 billion of common equity tier 1 capital for the Bank as part of its wider Recapitalisation Plan to generate £1.5 billion of common equity tier 1 capital. The Recapitalisation Plan is being implemented to ensure that the Bank has sufficient common equity tier 1 capital to meet its regulatory obligations, to minimise the risk of being resolved under the Banking Act and to ensure it can continue as a going concern. Common equity tier 1 capital is a form of capital which banks and other financial institutions are required to maintain to help absorb losses. As a direct result of the recent global financial crisis, the PRA, in line with banking regulators around the world, is requiring UK banks to bolster their capital resources so that the banks, and the UK banking system generally, is better able to withstand future losses and financial shocks. As the Notes are being offered in connection with an exchange for the Dated Notes of the Bank and 5.5555% Bonds of the Bank, the issue of the Notes will not generate cash proceeds. However, the Notes are being offered in exchange for the Dated Notes of the Bank and the 5.5555% Bonds of the Bank at a discount to the Bank's book value for those securities, which will generate common equity tier 1 capital to the extent that the liability is reduced to less than such book value.
E.3	**Terms and conditions of the offer**	The offer of the Notes (also referred to in this section as the **Bank T2 Notes**) is part of the Liability Management Exercise. The Notes will be issued at the issue price (which is 100% of the principal amount of the Notes) only upon successful completion of the Liability Management Exercise, and no Notes will be issued if the Liability Management Exercise does not successfully complete. If the Liability Management Exercise is successful and settles on 18 December 2013, the maximum principal amount of Notes which may be issued is expected to be £206,000,000. The final principal amount of Notes to be issued (if any) will be announced by the Bank via the Regulatory News Service (**RNS**) operated by the London Stock Exchange, which announcement is currently expected to be made on or around 12 December 2013 or, in the event that any meeting pursuant to the Proposals (as defined below) is adjourned, is currently expected to be made on or around 30 December 2013. ***Introduction*** The Liability Management Exercise is being conducted in respect of the Preference Shares, the 13% Bonds, the 5.5555% Bonds and the Dated Notes (each as defined below) (together, the **Existing Securities**).

		Holders who are eligible to participate in the Exchange Offers for the Preference Shares, 13% Bonds and 5.5555% Bonds in accordance with applicable securities laws are referred to below as **Eligible Holders**. The Liability Management Exercise consists of the Exchange Offers, the Proposals and the Scheme described below. The **Exchange Offers** consist of: • an invitation to Eligible Holders of the Bank's outstanding 9.25 per cent. Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516) (the **Preference Shares**) and 13 per cent. Perpetual Subordinated Bonds (ISIN: GB00B3VH4201) (the **13% Bonds**) to either: (a) offer to exchange their Preference Shares and 13% Bonds for new 11 per cent. Final Repayment Subordinated Notes due 2025 (the **Final Repayment Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group; or (b) offer to sell their Preference Shares and 13% Bonds to Co-operative Group for cash consideration payable in twelve equal instalments over twelve years and represented by new Instalment Repayment Subordinated Notes (the **Instalment Repayment Notes** and, together with the Final Repayment Notes, the **Group Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group; and • an invitation to Eligible Holders of the Bank's outstanding 5.5555 per cent. Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) (the **5.5555% Bonds**) to offer to exchange their 5.5555% Bonds for Bank T2 Notes. The **Proposals** consist of the convening of meetings of the holders of the Preference Shares, 13% Bonds and 5.5555% Bonds to vote on resolutions which, if passed, will, amongst other things (i) enable the Bank to mandatorily effect the exchange (or transfer to Co-operative Group), of any remaining Preference Shares, 13% Bonds and 5.5555% Bonds (as applicable) on the same economic terms as the terms of the relevant Exchange Offer(s) and (ii) result in holders agreeing to certain waivers and releases in favour of the Bank, Co-operative Group, their respective directors and certain other persons. In addition, the holders of the Preference Shares will be asked to vote on a resolution which, if passed, will enable the Bank to purchase and cancel any share capital of the Bank (which would include Preference Shares) from time-to-time without any further consent of such holders being needed. It is a term of the Exchange Offers that any holder who offers to exchange (or sell to Co-operative Group) its Preference Shares, 13% Bonds or 5.5555% Bonds in the Exchange Offers will also vote in favour of the resolutions proposed at the relevant meeting. If such resolutions are passed and implemented by the Bank they will

		bind all holders of the relevant Existing Securities, including those who did not vote in favour of the Proposals. The **Scheme** is a scheme of arrangement under Part 26 of the Companies Act 2006. Pursuant to the Scheme, the holders of seven series of lower tier 2 subordinated bonds of the Bank (the **Dated Notes**) will vote on proposals which, if approved by the requisite statutory majorities and sanctioned by the court and if the Settlement Condition is satisfied, will result in all of the Dated Notes (and accrued but unpaid interest on the Dated Notes up to a specified record date) being exchanged for a combination of Bank T2 Notes and new ordinary shares in the Bank (**New Ordinary Shares**). The holders of the Dated Notes will also be entitled to elect to subscribe for 62,500,000 additional New Ordinary Shares for an aggregate consideration equal to £125 million, pursuant to, and on the terms of, the Scheme and, to the extent any such additional New Ordinary Shares are not subscribed, certain holders of Dated Notes have agreed to purchase them. ***Conditionality of the Liability Management Exercise*** The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities is exchanged or sold pursuant to the Liability Management Exercise. The last date on which the Liability Management Exercise may successfully complete is 31 December 2013. In order for the entire principal amount of all Existing Securities to be exchanged or sold pursuant to the Liability Management Exercise (i) each of the Proposals in respect of the Preference Shares, 13% Bonds and 5.5555% Bonds must be approved by the Holders thereof at meetings convened for the purposes of voting on such Proposals (and, in the case of the Preference Shares, a resolution in similar terms must also be approved at a general meeting of the shareholders of the Bank) and the Proposals must be capable of being implemented in accordance with their terms, and (ii) the Scheme must be approved by the requisite majority of the Holders of the Dated Notes at the Scheme meeting and sanctioned by the Court, an office copy of the sanction order must be delivered to the Registrar of Companies at Companies House and the Scheme must become unconditional in accordance with its terms (subject only to satisfaction of the Settlement Condition) (together referred to as the **Settlement Condition**). ***Offer period*** The offer period for the Liability Management Exercise is expected to commence on 4 November 2013 and end at 4.30 p.m. (London time) on 6 December 2013 (or such later date and time to which the Bank and Co-operative Group may extend the offer period by publication of a supplement to the Prospectus). However, in order to incentivise holders of the Preference Shares, 13% Bonds and 5.5555% Bonds to participate in the Liability Management Exercise early, if the Early Participation Threshold is achieved by 4.30 p.m. (London time) on 29 November 2013

		(the **Early Participation Deadline**), all such holders will (if the Liability Management Exercise settles) receive more Bank T2 Notes or Group Notes on the exchange (or sale) of their Preference Shares, 13% Bonds and 5.5555% Bonds than if the Early Participation Threshold is not achieved by the Early Participation Deadline. The **Early Participation Threshold** will be achieved by the Early Participation Deadline only if, by that time, at least 75 per cent. of the aggregate nominal amount outstanding of each of the Preference Shares, the 13% Bonds and the 5.5555% Bonds has been validly offered for exchange (or sale) and/or otherwise validly voted in favour of the Proposals (and not revoked). Settlement of the Liability Management Exercise (the date on which, if the Settlement Condition is satisfied, Existing Securities will be exchanged or sold) is currently expected to be on 18 December 2013. The Bank and Co-Operative Group are entitled to amend the timetable at their discretion (subject where relevant to the approval of the Court in relation to the Scheme), and will announce any amendments by publication of a supplement to the Prospectus. ***Offer Terms*** *Preference Shares* Eligible Holders of Preference Shares are being invited either: • to offer to transfer their Preference Shares to Co-operative Group in exchange for Final Repayment Notes. Holders electing this option will receive, per £1,000 in nominal amount of Preference Shares exchanged, (i) £601 in principal amount of Final Repayment Notes if the Early Participation Threshold is achieved by the Early Participation Deadline; or (ii) £551 in principal amount of Final Repayment Notes if the Early Participation Threshold is not achieved by the Early Participation Deadline (in each case subject to rounding); or • to offer to sell their Preference Shares to Co-operative Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025 and which will be represented by Instalment Repayment Notes. Holders electing this option will receive, per £1,000 in nominal amount of Preference Shares sold to Co-operative Group, (i) £1,110 in principal amount of Instalment Repayment Notes if the Early Participation Threshold is achieved by the Early Participation Deadline; or (ii) £1,060 in principal amount of Instalment Repayment Notes if the Early Participation Threshold is not achieved by the Early Participation Deadline (in each case subject to rounding). Such holders will also receive a cash amount equal to accrued but unpaid dividends on their Preference Shares from 30 November 2013, up to the Settlement Date.

		The next instalment of the Preference Share dividend is, under the terms of the Preference Shares, scheduled to be paid on 30 November 2013 (which is during the offer period for the Liability Management Exercise). Under the terms of the Preference Shares, the Bank will not be permitted to pay the dividend in cash, but will instead be required to allot additional Preference Shares to each holder in lieu of cash payment (**Additional Preference Shares**). The Bank expects to allot such Additional Preference Shares on 29 November 2013 (since 30 November is a Saturday). However, if the Liability Management Exercise successfully completes, then upon transfer to Co-operative Group of those Additional Preference Shares, the relevant holders will not receive Final Repayment Notes or Instalment Repayment Notes in respect thereof but rather will receive an amount in cash (in pounds sterling) equal to the cash dividend which the Bank would have paid on 29 November 2013 had it been able to do so under the terms of the Preference Shares. *The references above to an exchange (or sale) of £1,000 in nominal amount of Preference Shares are for illustrative purposes only. Holders of Preference Shares will be able to offer to exchange (or sell) Preference Shares in any whole multiple of £1, subject to a minimum of £2 if such holder elects the Final Repayment Notes option. There is no minimum offer amount for the Instalment Repayment Notes option.* *13% Bonds* Eligible Holders of 13% Bonds are being invited either: • to offer to transfer their 13% Bonds to Co-operative Group in exchange for Final Repayment Notes. Holders electing this option will receive, per £1,000 in nominal amount of 13% Bonds exchanged, (i) £844 in principal amount of Final Repayment Notes if the Early Participation Threshold is achieved by the Early Participation Deadline; or (ii) £794 in principal amount of Final Repayment Notes if the Early Participation Threshold is not achieved by the Early Participation Deadline (in each case subject to rounding); or • to offer to sell their 13% Bonds to Co-operative Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025 and which will be represented by Instalment Repayment Notes. Holders electing this option will receive, per £1,000 in nominal amount of 13% Bonds sold to Co-operative Group, (i) £1,560 in principal amount of Instalment Repayment Notes if the Early Participation Threshold is achieved by the Early Participation Deadline; or (ii) £1,510 in principal amount of Instalment Repayment Notes if the Early Participation Threshold is not achieved by the Early Participation Deadline (in each case subject to rounding).

		Such holders will also receive a cash amount equal to accrued but unpaid interest on their 13% Bonds from 31 July 2013 up to the Settlement Date. Upon successful completion of the Liability Management Exercise the Bank will also pay to all holders of the 13% Bonds the deferred interest payment originally scheduled for 31 July 2013. *The specified denomination of each 13% Bond is £1,000. Accordingly, 13% Bonds must be offered for exchange (or sale) in principal amounts equal to £1,000 or a whole multiple of £1,000.* *5.5555% Bonds* Eligible Holders of the 5.5555% Bonds will be invited to offer to exchange their 5.5555% Bonds for Bank T2 Notes at the following exchange ratios: • if the Early Participation Threshold is achieved by the Early Participation Deadline, £530 in principal amount of Bank T2 Notes for every £1,000 in principal amount of 5.5555% Bonds exchanged; or • if the Early Participation Threshold is not achieved by the Early Participation Deadline, £480 in principal amount of Bank T2 Notes for every £1,000 in principal amount of 5.5555% Bonds exchanged. Such holders will also receive a cash amount equal to accrued but unpaid interest on their 5.5555% Bonds from (and including) 14 December 2013 to (but excluding) the Settlement Date. The next scheduled interest payment date for the 5.5555% Bonds is 14 December 2013. The Bank intends to defer that interest payment (which it is entitled to do under the terms of the 5.5555% Bonds). If the Liability Management Exercise subsequently successfully completes, the Bank will (in addition to the accrued interest referred to in the paragraph above) pay the deferred interest payment originally scheduled for 14 December 2013. *The specified denomination of each 5.5555% Bond is £1,000. Accordingly, 5.5555% Bonds must be offered for exchange in principal amounts equal to £1,000 or a whole multiple of £1,000.* *Dated Notes* Holders of the Dated Notes will, if the Scheme is sanctioned and implemented, be entitled to receive Bank T2 Notes and New Ordinary Shares in exchange for their Scheme Claim at approximately the following exchange ratio: • £102.63 in principal amount of Bank T2 Notes and 115 New Ordinary Shares for every £1,000 of its Scheme Claim. A holder's claim in the Scheme (its **Scheme Claim**) will be equal to the sum of (i) the aggregate principal amount outstanding of such holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme

		Record Date; provided that a Holder's Scheme Claim in respect of any Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (which are denominated in euro) shall be the sterling equivalent of such sum, calculated on the basis of an exchange rate of £0.85644 per €1.00. The Scheme will provide that any interest that accrues or falls due for payment after the Scheme Record Date will be irrevocably cancelled. The Scheme Record Date (the **Scheme Record Date**) is currently expected to be 10 December 2013. The principal amount of Bank T2 Notes and the number of New Ordinary Shares which such holder will receive will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline. The holders of the Dated Notes will also be entitled to elect to subscribe for 62,500,000 additional New Ordinary Shares for an aggregate consideration of £125 million pursuant to, and on the terms of, the Scheme. ***Delivery of Bank T2 Notes, Group Notes and New Ordinary Shares*** The Bank T2 Notes, Group Notes and New Ordinary Shares will be capable of being held and traded (i) in uncertificated form in CREST; (ii) in uncertificated form in Euroclear and Clearstream, Luxembourg (via CREST); and (iii) in certificated form outside the clearing systems. Eligible Holders of Preference Shares, 13% Bonds and 5.5555% Bonds and holders of Dated Notes who offer to exchange or sell their securities in Euroclear, Clearstream, Luxembourg or CREST will (subject as provided under "*Holding Period in respect of Dated Notes*" below) receive interests in their new Bank T2 Notes, Group Notes and/or New Ordinary Shares (as the case may be) in the same securities account as that in which they currently hold their Preference Shares, 13% Bonds, 5.5555% Bonds or Dated Notes (as applicable). Where holders currently hold Preference Shares, 13% Bonds or 5.5555% Bonds in certificated form outside Euroclear, Clearstream, Luxembourg and CREST, any Bank T2 Notes and Group Notes (as applicable) to be delivered to them will be delivered in certificated form outside Euroclear, Clearstream, Luxembourg and CREST. ***Holding Period in respect of Dated Notes*** If any holder of Dated Notes fails to comply with certain procedures in connection with the Scheme, the Bank T2 Notes and New Ordinary Shares to which such holder would become entitled pursuant to the Scheme will be transferred to Lucid Issuer Services Limited in its capacity as holding period trustee (the **Holding Period Trustee**).

		The relevant Bank T2 Notes and New Ordinary Shares will be held on trust by the Holding Period Trustee pending: (a) confirmation for or on behalf of the relevant holder of the Dated Notes that it or its Designated Recipient is eligible to receive the Bank T2 Notes and New Ordinary Shares, at which time the Holding Period Trustee will transfer the relevant Bank T2 Notes and New Ordinary Shares to the relevant holder of the Dated Notes or its Designated Recipient; (b) confirmation for or on behalf of the relevant holder of the Dated Notes that it is not eligible to receive the Bank T2 Notes and the New Ordinary Shares, at which time the relevant Bank T2 Notes and New Ordinary Shares will be sold by or on behalf of the Holding Period Trustee and the net proceeds of such sale (after deduction of all applicable taxes and expenses) will be distributed to the relevant holder of the Dated Notes; and (c) the date falling 36 months following the Scheme Settlement Date, at which time the Holding Period Trustee will sell or procure the sale of the Bank T2 Notes and New Ordinary Shares not already distributed or sold as described in paragraphs (a) and (b) above and the net proceeds of such sale (after deduction of all applicable taxes and expenses) will be distributed to the Bank. **Designated Recipient** means a person nominated by a holder of Dated Notes to receive the New Ordinary Shares and Bank T2 Notes which such holder is entitled to receive pursuant to the terms of the Scheme.
E.4	**Material Interests to the Offer, including conflicting Interests**	The Bank is as, at the date of this Prospectus, a subsidiary of Banking Group. Following completion of the Liability Management Exercise, Banking Group is expected to have a 30 per cent. holding in the Bank's ordinary shares. As a result, Banking Group and, indirectly, Co-operative Group, are expected to continue to be able to exercise influence over matters requiring shareholder approval. HSBC Bank plc (**HSBC**) has been appointed as a dealer manager and adviser to the Bank, and UBS Limited (**UBS**) has been appointed as a dealer manager, to facilitate the Liability Management Exercise. HSBC will be paid fees and expenses by the Bank in connection with the Liability Management Exercise. Each of UBS and HSBC and their respective affiliates may also have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform other services for, the Bank and its affiliates in the ordinary course of business.
E.7	**Estimated expenses charged to the investor by the Issuer**	Not applicable. There are no expenses to be charged to the investor (being the Existing Holders) by the Bank.

2

RISK FACTORS

The following section contains a description of certain factors which the Bank believes may affect its ability to fulfil its obligations under the Notes.

The factors include risks relating to the Bank's business and financial condition, the specific features of the Notes and how they will be held by investors, and risks relating to the markets generally which could impact the market price of Notes.

In addition, the following section describes certain risks associated with the Liability Management Exercise, including risks which relate to the possible consequences for holders of Existing Securities in the event that the Liability Management Exercise is not successfully implemented.

RISK FACTORS

*Holders and other prospective investors should carefully consider the factors and risks associated with the Liability Management Exercise, any investment (whether by way of the Scheme or otherwise) in the Notes, the Bank's business and the financial services industry in the United Kingdom (the **UK**) in which the Bank operates, together with all the other information contained in this document and all of the information incorporated by reference into this document, including, in particular, the risks and uncertainties described below. Holders and other prospective investors should note that the risks relating to the Liability Management Exercise, the Bank, the financial services industry in the UK and the Notes summarised in the section of this Prospectus headed "Summary" are risks that the Bank believes to be the most essential to an assessment by a Holder of whether to consider an investment in the Notes. However, as the risks which the Bank faces relate to events and depend on circumstances that may or may not occur in the future, Holders should consider not only the information on key risks summarised in the section of this Prospectus headed "Summary" but also, among other things, the risks and uncertainties described below.*

This section describes the risk factors which are considered by the Bank to be material to the Bank and the decision to participate in the Liability Management Exercise or otherwise decide to make an investment in the Notes. However, these risk factors should not be regarded as a complete and exhaustive statement or explanation of all potential risks and uncertainties which Holders may face when making a decision with respect to participation in any part of the Liability Management Exercise (including making a decision in respect of the Scheme or otherwise) or any other investment in respect of Notes and should be used as guidance only. There may be other risks and uncertainties which are currently not known to the Bank or which the Bank currently does not consider to be material. Should any of the risks described below, or any other risks or uncertainties, occur this could, individually or cumulatively, have a material adverse effect on the Bank's business, results of operation, financial condition or prospects which in turn would be likely to cause the price of the Notes to decline and, as a result, a Holder could lose some or all of its investment. Holders should consider carefully whether or not to participate in any part of the Liability Management Exercise such that they will acquire Notes (including making a decision in respect of the Scheme or otherwise) is suitable for them in the light of the information contained in this Prospectus and their personal circumstances. The risk factors, amongst other things, consider the implications for Holders in the event that the Liability Management Exercise fails, which would occur if sufficient numbers of Holders decided not to participate in the Liability Management Exercise, such that not all of the Existing Securities would be able to be exchanged (or purchased) by the Bank or Co-operative Group pursuant to the Liability Management Exercise.

This section of the Prospectus is divided into three main sections – "Risks Relating to the Liability Management Exercise", "Risks Relating to the Bank and its Business" and "Risks Relating to the Notes".

RISKS RELATING TO THE LIABILITY MANAGEMENT EXERCISE

The implementation of the Liability Management Exercise is subject to a number of significant risks. Should the Liability Management Exercise not be implemented, the Bank is likely to be the subject of a resolution procedure under the Banking Act 2009. In such circumstances, Holders of Existing Securities could potentially have no recovery at all in respect of their investment in the Existing Securities.

Background to the Liability Management Exercise

On 17 June 2013, following the conclusion of the Bank's review of its capital position and discussions with the PRA, it was stated in the June Announcement that the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion, of which at least £1 billion is expected to be contributed pursuant to the Liability Management Exercise in 2013 and, conditional on completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is to be contributed by Banking Group in 2014 pursuant to the 2014 Commitment of which £170 million must be satisfied at the latest by 30 June 2014 (with £70 million of this contribution to be paid by 31 January 2014) and the remaining £163 million by 31 December 2014.

On 17 June 2013, the PRA made the following statement:

"The PRA's current assessment is that the Co-operative Bank needs to generate an additional £1.5 billion in Common Equity Tier One capital in order to absorb potential losses over coming years. We will hold the Co-operative Group to the delivery of its plans. In relation to the Co-operative Bank this action will deliver the Financial Policy Committee's recommendation to the PRA in March regarding the capital position of the banking system."

On 29 August 2013, the PRA reconfirmed its assessment of the Bank's capital shortfall of £1.5 billion of Common Equity Tier 1 Capital following the announcement of the Bank's interim results for the six month period ended 30 June 2013. The PRA also reconfirmed that this requirement remained unchanged following the announcement by the Bank on 21 October 2013 of an expectation of an increase in its overall provisions of approximately £103 million relating to customer redress. The Liability Management Exercise is intended to generate at least £1 billion of the required £1.5 billion of Common Equity Tier 1 Capital by the end of 2013. Successful completion of the Liability Management Exercise is conditional upon the entire principal amount of all Existing Securities being exchanged or sold pursuant to the Liability Management Exercise.

The contributions that a successful Liability Management Exercise would provide by the end of 2013 would increase the Bank's Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9 per cent. but above the regulatory minimum requirement" by the end of 2013, including after taking into account the impact of the impairment charges of £496.0 million incurred for the six month period ended 30 June 2013 and potential impairment charges for the remainder of the Bank's financial year ending 31 December 2013.

The Liability Management Exercise is expected to generate at least £1 billion of the £1.5 billion of Common Equity Tier 1 Capital required by the Bank. The Liability Management Exercise will generate Common Equity Tier 1 Capital in two ways:

- first, to the extent that the Bank exchanges Dated Notes for New Ordinary Shares and issues Additional New Ordinary Shares pursuant to the Scheme, the amount of such New Ordinary Shares and Additional New Ordinary Shares issued will constitute Common Equity Tier 1 Capital; and
- second, to the extent that Existing Securities are exchanged or issued for New Securities at a discount to the Bank's book value of those Existing Securities (i.e. by imposing a discount on the Existing Securities through the Liability Management Exercise), Common Equity Tier 1 Capital will also be generated as a consequence of that discount (on the basis that the Bank will reduce a liability for less than the book value of that liability in the Bank's accounts).

See the Offer Memorandum, which is appended to and forms part of this Prospectus, for full terms of the Liability Management Exercise, including a description of the Existing Securities which are the subject of the Liability Management Exercise.

Overview of principal risks to the implementation of the Liability Management Exercise

The principal risks to the successful implementation of the Liability Management Exercise are:

- The failure of Holders to participate in the Liability Management Exercise in sufficient numbers such that the Liability Management Exercise fails.
- Any of the HM Treasury, the Bank of England, the FCA and/or the PRA (the **Authorities**) concluding that the aggregate £1.5 billion of Common Equity Tier 1 Capital to be contributed pursuant to the Recapitalisation Plan is inadequate to meet the Bank's regulatory capital requirements and that, as a result, further steps are required to be taken by the Bank to generate additional Common Equity Tier 1 Capital or additional total capital. Should the Authorities reach such a conclusion, the Bank may decide not to proceed with the Liability Management Exercise and/or Holders may elect not to participate in the Liability Management Exercise, with the consequence that the Liability Management Exercise is not successfully implemented.
- The Bank and/or the Co-operative Group becoming involved in disputes and legal proceedings in respect of the Liability Management Exercise. Such disputes or proceedings could be brought or

raised during the implementation of the Liability Management Exercise following publication of this Prospectus with the objective of preventing the implementation of all or part of the Liability Management Exercise and/or could be brought after the Liability Management Exercise has been implemented with the objective of seeking a declaration that all or part of the Liability Management Exercise was unlawful and invalid. Further information on the risk of litigation is contained in the risk factor titled "*Litigation seeking to challenge the implementation of the Liability Management Exercise or certain aspects of it could materially impact or prevent the successful implementation of the Liability Management Exercise or result in all or part of the Liability Management Exercise being declared to be unlawful and invalid retrospectively*."

In the event that the Liability Management Exercise is not successfully implemented, the Bank would fail to comply with the PRA's stated requirement that the Bank raise an additional £1 billion of Common Equity Tier 1 Capital by 31 December 2013. In addition, Banking Group's undertaking to contribute £333 million additional Common Equity Tier 1 Capital in 2014 would terminate as it is conditional upon the success of the Liability Management Exercise. Co-operative Group will not provide any capital contribution to meet the Bank's regulatory capital shortfall unless the Liability Management Exercise is successfully implemented (i.e. all Existing Securities are exchanged or sold pursuant to the Liability Management Exercise).

Consequences of a failure of the Liability Management Exercise

Whilst in the event of the Liability Management Exercise being unsuccessful the Bank would take immediate action to try to address the Bank's capital shortfall, including holding urgent discussions with the PRA, the Bank believes that, in such circumstances, the failure of the Liability Management Exercise would result in the Bank becoming subject to a resolution procedure under the Banking Act 2009 (the **Banking Act**). In the event that the Authorities exercise their powers under the Banking Act or there is market speculation regarding the occurrence of such an event, it is highly probable that the Bank would be materially adversely affected and the market price of Existing Securities would be materially adversely affected. The Bank considers that there are fundamental uncertainties as to whether the Bank could be successfully resolved such that the Bank remains a going concern without the active participation of Co-operative Group and a substantial amount of additional capital. The Bank believes that if the Bank were to be resolved and go into an insolvency proceeding as a result of that resolution, Holders of Existing Securities would receive no recovery in respect of their Existing Securities. As a result, the Bank believes that the outcome of a successful Liability Management Exercise is a substantially more favourable outcome to Holders of any class of Existing Securities than a resolution of the Bank. For further information on the consequences for Holders of a resolution of the Bank see "*Part C – Potential consequences of Holders failing to support the Liability Management Exercise*" in Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*).

Failure of Holders to participate in the Liability Management Exercise

The Liability Management Exercise will only be successfully completed if (and is therefore conditional upon) the entire principal amount of all Existing Securities is exchanged pursuant to the Liability Management Exercise. If this condition is not satisfied, the Liability Management Exercise will not be implemented and, furthermore, Banking Group will not be required to contribute £333 million of Common Equity Tier 1 Capital in 2014.

Part of the Liability Management Exercise will be conducted by way of the Scheme in respect of the Dated Notes. The Bank intends to propose that Holders of the Dated Notes should vote on the Scheme as a single class of creditors. In order to approve the Scheme, a majority in number of Holders of the Dated Notes, representing at least 75 per cent. in value of the Holders of the Dated Notes present in person or by proxy and voting at the Scheme Meeting, will need to approve the Scheme. Even if the Scheme is approved at the Scheme Meeting, it is possible for a person with an interest in the Scheme (whether a Holder or otherwise) to object to the Scheme and to attend or be represented at the Court hearing to sanction the Scheme in order to make representations that the Scheme should not be approved and to appeal against the granting of the Court order sanctioning the Scheme. Therefore, it is possible that objections will be made at or before the Court hearing or that an appeal will be made against the granting of the order by the Court and that any such

objections or appeal will delay or possibly prevent the implementation of the transactions contemplated by the Scheme.

In order for the Scheme to become effective under English law, it must receive the sanction of the Court and the Court order must be lodged with the Registrar of Companies. The Court will not sanction the Scheme unless it is satisfied that the class of Holders of the Dated Notes (as creditors in respect of the Scheme) has been properly constituted and, as a matter of discretion, the Court considers that it is proper to sanction the Scheme. There can be no assurance that the Court will sanction the Scheme. If the Court does not sanction the Scheme, or approves it subject to conditions or amendments which (i) the Bank and other relevant parties deem unacceptable or (ii) would have (directly or indirectly) a material adverse effect on the interests of any Holders and such conditions or amendments are not approved by the Holders, the Scheme will not become effective and the transactions contemplated by the Scheme will not be implemented.

In connection with the Scheme, Holders of Dated Notes are entitled to elect to subscribe for Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer, and it is a condition of the Scheme that, in connection with the Additional New Ordinary Shares Offer, an amount equal to or greater than £125,000,000 is placed in an escrow account. Should such sum not be placed in the escrow account, then a condition to the Scheme will not be satisfied and the Scheme will not become effective. In connection therewith, the Bank has entered into an agreement (the **Purchase Agreement**) with certain Holders of the Dated Notes to subscribe for Additional New Ordinary Shares not taken up by other Holders of the Dated Notes (should the amount which Holders of the Dated Notes elect to subscribe for be less than £125 million). The Purchase Agreement is subject to certain conditions precedent described in paragraph number 20.9 "*Purchase Agreement*" in Section 20 (*Additional Information*).

Should Holders of Dated Securities not participate in the Additional New Ordinary Shares Offer (or, having elected to participate, not transfer funds to the escrow account) such that the total amount placed in escrow is less than £125,000,000, and should, in such circumstances, the conditions to the Purchase Agreement not be satisfied (or, at the election of the Holders, such conditions not be waived) such that such Holders of Dated Notes are not required to subscribe for the Additional New Ordinary Shares not taken up, then the above mentioned condition is likely not to be satisfied and that the Scheme will not become effective.

If the Scheme is approved by the requisite majorities of the Holders of Dated Notes and sanctioned by the Court and implemented, all outstanding Dated Notes (including Dated Notes held by Holders who did not vote in favour of the Scheme) will be exchanged for a combination of New Ordinary Shares and Bank T2 Notes. If, however, the Scheme is not approved, sanctioned and implemented, none of the Dated Notes will be exchanged in the Liability Management Exercise and the Liability Management Exercise will fail. The implementation of the Scheme is conditional upon the Settlement Condition having been satisfied.

The remaining part of the Liability Management Exercise is being conducted by way of the Exchange Offers in respect of the Bank's Preference Shares, 13% Bonds and 5.5555% Bonds (as each are defined in Section 6 (*Details of the Liability Management Exercise*) and the Proposals.

Eligible Holders of Preference Shares and 13% Bonds are being invited to either:

(a) offer to exchange their Preference Shares and 13% Bonds for new 11 per cent. Final Repayment Subordinated Notes due 2025 (the **Final Repayment Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group; or

(b) offer to sell their Preference Shares and 13% Bonds to Co-operative Group for cash consideration which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by new Instalment Repayment Subordinated Notes (the **Instalment Repayment Notes** and, together with the Final Repayment Notes, the **Group Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group,

as described in Section 6 (*Details of the Liability Management Exercise*).

Eligible Holders of the 5.5555% Bonds are being invited to offer to exchange their 5.5555% Bonds for new lower tier 2 11 per cent. Subordinated Notes due 2023 to be issued by the Bank (the **Bank T2 Notes**) as described in Section 6 (*Details of the Liability Management Exercise*).

In conjunction with the Exchange Offers, the Bank is also convening separate meetings of the Holders of the Preference Shares, the 13% Bonds and the 5.5555% Bonds, respectively, in order for the relevant Holders to vote on resolutions which, if successful, would enable the Bank to mandatorily effect the exchange or transfer to Co-operative Group of all securities of the relevant series which are not exchanged or sold in the Exchange Offers, on the same economic terms as those upon which securities of the relevant series are exchanged or sold in the Exchange Offers. The resolution at each meeting will be passed if the relevant meeting is quorate and if the Holders of at least three quarters of the relevant securities present and voting vote in favour of the resolution. Details of the requisite quorum for each meeting can be found in Appendix C (*Consent and Exchange Offer Memorandum*).

The Liability Management Exercise will only successfully complete if the entire principal amount of all Existing Securities is exchanged pursuant to the Liability Management Exercise.

In order for that to happen, all of the following must occur:

(i) the Proposal in respect of the Preference Shares must be (A) approved by the Holders of the Preference Shares at the meeting convened for such Holders to vote on such Proposal (and a resolution in similar terms must also be approved at a general meeting of the shareholders of the Bank) and (B) capable of being implemented in accordance with the terms of that Proposal;

(ii) the Proposal in respect of the 13% Bonds must be (A) approved by the Holders of the 13% Bonds at the meeting convened for such Holders to vote on such Proposal and (B) capable of being implemented in accordance with the terms of that Proposal;

(iii) the Proposal in respect of the 5.5555% Bonds must be approved by (A) the Holders of the 5.5555% Bonds at the meeting convened for such Holders to vote on such Proposal and (B) capable of being implemented in accordance with the terms of that Proposal; and

(iv) (A) the Scheme must be approved by the requisite majority of the holders of the Dated Notes at the Scheme Meeting and sanctioned by the Court; (B) an office copy of the sanction order must be delivered to the Registrar of Companies at Companies House; and (C) the Scheme must become unconditional in accordance with its terms.

The Authorities concluding that the aggregate £1.5 billion of Common Equity Tier 1 Capital to be contributed pursuant to the Recapitalisation Plan is inadequate to meet the Bank's regulatory capital requirements.

Since January 2013 and up to the date of this Prospectus, the Bank has been in close and continual contact with the Bank of England, the FCA and the PRA and has discussed in detail with the Bank of England, the FCA and the PRA the Recapitalisation Plan and the Bank's capital and financial position. On 17 June 2013, the PRA announced, following detailed discussions with the Bank and Co-operative Group, that it was the PRA's assessment that the Bank needed to generate an additional £1.5 billion in Common Equity Tier 1 Capital. The PRA reconfirmed its assessment, on 29 August 2013, following the announcement by the Bank of its interim results for the six-month period ended 30 June 2013 and taking into account the Bank's losses for such period. In addition, the PRA reconfirmed that the additional Common Equity Tier 1 Capital requirement of £1.5 billion remained unchanged following the announcement by the Bank on 21 October 2013 of an expectation of an increase in its overall provisions of approximately £103 million relating to customer redress.

Notwithstanding these detailed discussions between the Bank and the Bank of England, the FCA and the PRA and the announcements by the PRA on 29 August 2013 confirming its assessment that £1.5 billion in Common Equity Tier 1 Capital is sufficient, there remains a risk, whether due to changes in circumstances or otherwise, that the Authorities decide that the Bank is required to generate more than £1.5 billion of Common Equity Tier 1 Capital. Should the Authorities reach such a conclusion, the Bank may decide not to proceed with the Liability Management Exercise and/or Holders may elect not to participate in the Liability Management Exercise, with the consequence that the Liability Management Exercise is not successfully implemented.

Resolution procedure under the Banking Act 2009

Should the Liability Management Exercise not be successful the Directors consider it likely that the Bank will be subject to a resolution procedure under the Banking Act (see *"Part C – Potential consequences of Holders failing to support the Liability Management Exercise"* in Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*)).

The Banking Act empowers the Authorities, where a bank is failing (or likely to fail) the threshold conditions (which relate to conducting its business in a prudent manner, which is assessed by reference to its financial and non-financial resources and structural arrangements) for its authorisation to conduct banking business, to impose the special resolution regime (the **SRR**) on relevant entities. The SRR consists of three stabilisation options, a bank insolvency procedure and a bank administration procedure, which may be commenced by the Authorities. The three stabilisation options could, for example, include the taking of the Bank into temporary public ownership, or the sale of some or all of the Bank's assets to a private sector purchaser or bridge bank, which may involve the residual part of the Bank being run off as a "bad bank".

The stabilisation options available to the Authorities are described in paragraph 2.6 titled "*Recovery and resolution regime*" in Section 17 (*Supervision and Regulation*).

In addition, the Authorities have the power under the Banking Act to require the exchange of Existing Securities into equity for so long as the Existing Securities remain outstanding.

Given the discretionary nature of the powers available to the Resolution Authorities under the Banking Act, the Bank is unable to predict with certainty the precise outcome for Holders if the Liability Management Exercise is not successfully implemented during 2013. The Bank has no other source available to it to raise the required additional capital. As stated in the Bank's Interim Financial Information, if the Liability Management Exercise is not successfully implemented the Bank will cease to be a going concern and, as a result, is likely to fail to satisfy its threshold conditions for authorisation (within the meaning of Section 55B of FSMA) and the relevant Authorities may then exercise a stabilisation power under the Banking Act. These threshold conditions include a requirement that the PRA is satisfied that the Bank, in particular, has appropriate financial and non-financial resources, including that the Bank has made appropriate provisions for its liabilities. In addition, the Resolution Authorities may also exercise powers to resolve the Bank even where it remains a going concern.

If the Liability Management Exercise is not successfully implemented on or before 31 December 2013, the Bank therefore considers that the PRA would have a basis for determining: that the Bank is failing, or is likely to fail, to satisfy its threshold conditions; that the power of the Resolution Authorities to exercise stabilisation powers under the Banking Act had arisen, and that the Bank would be subject to a resolution procedure under the Banking Act. The Bank therefore believes that there are only two realistic outcomes for the Bank, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Bank becoming subject to a resolution procedure under the Banking Act.

In the event that the Resolution Authorities exercise their powers under the Banking Act or there is market speculation regarding the occurrence of any such event, it is highly probable that the Bank would be materially adversely affected, and the market price of Existing Securities would be materially adversely affected. The Bank considers that there are fundamental uncertainties as to whether the Bank could be successfully resolved such that the Bank remains a going concern without the active participation of Co-operative Group and a substantial amount of additional capital. The Bank believes that if the Bank were to be resolved and go into an insolvency proceeding as a result of that resolution, the Holders of Existing Securities would receive no recovery. Part C of Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*) sets out a description of the hypothetical position that Holders would be likely to face if the Bank were to be resolved. As a result, the Bank believes that implementation of the Liability Management Exercise is substantially more beneficial to Holders of all classes of Existing Securities than a resolution of the Bank.

Litigation seeking to challenge the implementation of the Liability Management Exercise or certain aspects of it could materially impact or prevent the successful implementation of the Liability Management Exercise or result in all or part of the Liability Management Exercise being declared to be unlawful and invalid retrospectively.

Litigation seeking to challenge the implementation of the Liability Management Exercise

Whilst the exact nature of any disputes and legal proceedings in connection with the Liability Management Exercise, and the likelihood of their occurrence or their outcome, cannot be predicted in advance with any certainty, the Bank is aware that previous liability management exercises by other institutions have demonstrated that, in such situations, there are people who may seek to bring claims or raise arguments in Court. Therefore it is possible that Holders may seek to bring claims or raise arguments in Court with the objective of preventing or delaying the implementation of all or part of the Liability Management Exercise.

In particular, it is possible that Holders may advance arguments seeking to persuade the Court not to: (i) approve the composition of the voting class for the purposes of the Scheme Meeting; and/or (ii) sanction the Scheme. Holders may also bring claims seeking to challenge the lawfulness of the Exchange Offers in respect of the Preference Shares, the 13% Bonds and/or the 5.5555% Bonds, and/or the related Proposals in respect of those securities. The success of any such arguments or claims or delay to the implementation of the Liability Management Exercise arising out of any such arguments or claims (including where any such claims are without merit) could result in the failure of the Liability Management Exercise.

Claims determined after the implementation of the Liability Management Exercise

It is possible that claims challenging the elements of legality of the Liability Management Exercise, or certain aspects of that exercise, may be brought after the Liability Management Exercise has been implemented. Other claims brought before such implementation may not be determined until after such implementation.

However, the success of such claims could result in all or part of the Liability Management Exercise being declared to be unlawful and invalid retrospectively. The consequences of such a finding would largely depend on the scope of the claims and the legal basis of the finding, but it could conceivably result in the Bank no longer meeting the PRA's requirement that the Bank raise an additional £1.5 billion Common Equity Tier 1 Capital. It is not clear, in such circumstances, what steps the PRA would take, but the Bank would take immediate action to try to address the Bank's capital shortfall, including holding urgent discussions with the PRA. See also the risk factor titled "*Consequences of a failure of the Liability Management Exercise*".

Other potential consequences of proceedings

The Bank may incur significant expense in connection with any such proceedings (whether seeking to challenge the implementation of the Liability Management Exercise or determined after the implementation of the Liability Management Exercise), even if such proceedings are ultimately concluded in favour of the Bank. Any one or more proceedings could also expose the Bank to substantial monetary damage, other penalties and injunctive relief and/or a negative effect on the Bank's reputation, any of which could have an adverse impact on the Bank's operations, financial condition and prospects. An adverse decision in any one matter could lead to further claims against the Bank.

The failure of the Liability Management Exercise is likely to result in the Bank ceasing to be a going concern.

As a result of the Bank's capital position and its dependency on the success of the Liability Management Exercise, along with other matters and uncertainties set forth in note 2 to the Interim Financial Information, the notes to the Bank's Interim Financial Information indicate that, and the audit report in respect of the Bank's Interim Financial Information contain an "emphasis of matter" statement to the effect that, there is a material uncertainty which may cast significant doubt on the Bank's ability to continue as a going concern.

If the Liability Management Exercise is not successfully completed on or before 31 December 2013, and in the absence of alternative support, the Bank believes that the Bank will be unable to continue as a going

concern. Were the Bank to be unable to continue as a going concern, it is likely that the Resolution Authorities would exercise their powers under the Banking Act to resolve the Bank. See the risk factor titled "*The implementation of the Liability Management Exercise is subject to a number of significant risks. Should the Liability Management Exercise not be implemented, the Bank is likely to be the subject of a resolution procedure under the Banking Act 2009. In such circumstances, Holders of Existing Securities could potentially have no recovery at all in respect of their investment in Existing Securities.*"

The Liability Management Exercise will, if successfully implemented, result in all Existing Securities being exchanged or sold pursuant to the Liability Management Exercise, even those held by Holders who do not voluntarily participate

It is a term of the Liability Management Exercise that it will only be implemented if all Existing Securities will be exchanged or sold pursuant to the Liability Management Exercise.

Holders of Dated Notes should be aware that if the Scheme is approved at the Scheme Meeting and sanctioned by the Court, all Dated Notes (including those held by Holders who vote against the Scheme or who take no action in connection with the Scheme) will (if the Liability Management Exercise settles) be mandatorily exchanged for a combination of New Ordinary Shares and Bank T2 Notes in accordance with the terms of the Scheme.

Holders of Preference Shares should be aware that, even if they do not offer to exchange (or sell to Co-operative Group) their Preference Shares in the relevant Exchange Offer, if the resolution proposed at the meeting convened for Holders of the Preference Shares is passed and implemented, the Bank will (if the Liability Management Exercise is settled) mandatorily effect the exchange (or sale to Co-operative Group) of all Preference Shares (including those held by Holders of Preference Shares who vote against the resolution or who take no action in connection with the Liability Management Exercise) for Group Notes on the same economic terms as those on which Preference Shares are exchanged (or sold) in the Exchange Offer. In that regard, Holders should also be aware that any such Holder who offers to exchange (or sell) its Preference Shares in the Exchange Offer will also instruct a proxy to exercise the votes attached to those Preference Shares in favour of the resolution at the meeting.

Holders of 13% Bonds should be aware that, even if they do not offer to exchange (or sell to Co-operative Group) their 13% Bonds in the relevant Exchange Offer, if the resolution proposed at the meeting convened for Holders of the 13% Bonds is passed and implemented, the Bank will (if the Liability Management Exercise settles) mandatorily effect the exchange (or sale to Co-operative Group) of all 13% Bonds (including those held by Holders of 13% Bonds who vote against the resolution or who take no action in connection with the Liability Management Exercise) for Group Notes on the same economic terms as those on which 13% Bonds are exchanged (or sold) in the Exchange Offer. In that regard, Holders of 13% Bonds should also be aware that any such Holder who offers to exchange (or sell) its 13% Bonds in the Exchange Offer will also instruct a proxy to exercise the votes attached to those 13% Bonds in favour of the resolution at the meeting.

Holders of 5.5555% Bonds should be aware that, even if they do not offer to exchange their 5.5555% Bonds in the relevant Exchange Offer, if the resolution proposed at the meeting convened for Holders of the 5.5555% Bonds is passed and implemented, the Bank will (if the Liability Management Exercise settles) mandatorily effect the exchange all 5.5555% Bonds (including those held by Holders of 5.5555% Bonds who vote against the resolution or who take no action in connection with the Liability Management Exercise) for Bank T2 Notes on the same economic terms as those on which 5.5555% Bonds are exchanged in the Exchange Offer. In that regard, Holders of 5.5555% Bonds should also be aware that any such Holder who offers to exchange its 5.5555% Bonds in the Exchange Offer will also instruct a proxy to exercise the votes attached to those 5.5555% Bonds in favour of the resolution at the meeting.

Exchange Instructions are irrevocable except in certain limited circumstances.

It is a term of the Exchange Offers that Exchange Instructions are irrevocable from the time of their submission, except that Holders will be entitled to revoke their Exchange Instructions during a period of two days following the publication of any supplement to this Prospectus and/or the Group Notes Prospectus.

The participation by Holders in the Liability Management Exercise will result in the blocking of their Existing Securities such that they will be unable to transfer those Existing Securities pending settlement or termination of the Liability Management Exercise.

By offering to exchange or sell Existing Securities in the Exchange Offers or voting on the Proposals or entering into certain arrangements with respect to the Scheme, Holders of Existing Securities will be required to take steps to immobilise their Existing Securities (by blocking them in a relevant securities account or surrendering their certificates to the relevant Registrar). Except where, in respect of Holders of Preference Shares, 5.5555% Bonds or 13% Bonds only, the Holder revokes its Exchange Instruction in the limited circumstances in which revocation will be permitted, each Holder will not be able to transfer such Existing Securities until the Liability Management Exercise is successfully completed (in which case those Existing Securities will be transferred to the Bank or Co-operative Group, as applicable or as it directs) or terminated (in which case the Existing Securities will no longer be immobilised and can be transferred by such Holder). Holders should take into account these restrictions on the transfer of their Existing Securities before deciding whether or not to participate in the Liability Management Exercise.

The nominal amount of New Securities to be delivered in exchange for Existing Securities will generally be lower than the nominal amount of the Existing Securities, and there are important differences between the Existing Securities and the New Securities.

The Existing Securities exchanged or sold in the Liability Management Exercise will be exchanged or sold at an effective discount, such that if a Holder's Existing Securities are exchanged or sold for New Securities in the Liability Management Exercise (whether through voluntary participation by such Holder or as a result of the Bank mandatorily exchanging Existing Securities through the Scheme or the Proposals), the nominal amount of the New Securities delivered to such Holder will generally be lower than the nominal amount of its Existing Securities exchanged or sold. Whilst holders of the 13% Bonds and the Preference Shares who elect to receive Instalments Repayment Notes will receive a nominal amount of Instalment Repayment Notes which is initially higher than that of their 13% Bonds or Preference Shares, such Instalments Repayment Notes will not bear interest, and will, in real terms, amount to an effective discount to their 13% Bonds or Preference Shares. In addition, the terms of the New Securities will be different from the Existing Securities in certain material respects. The consequences of the discount and the different terms of the New Securities may include that the Holder's income from its investment will decrease and the tax consequences of the investment may change.

With respect to Preference Shares, 13% Bonds and 5.5555% Bonds, certain differences between those securities and the New Securities for which they may be exchanged or sold are set out in Parts 6, 7 and 8 of Section C of the Offer Memorandum, which is appended to and forms part of this Prospectus.

Holders of Preference Shares, 13% Bonds and 5.5555% Bonds should note, in particular:

- the difference between the annual income payable on their Existing Securities and the amounts which they will receive each year as a result of holding the Group Notes or (in the case of the 5.5555% Bonds) the Bank T2 Notes. For the avoidance of doubt, no interest shall be payable on the Instalment Repayment Notes;
- the difference between the tax treatment of Existing Securities and New Securities (particularly where Preference Shares are exchanged for Final Repayment Notes);
- the differences between the payment obligations of the Bank under the Existing Securities (including the ability of the Bank to defer interest on the 13% Bonds and the 5.5555% Bonds and that the Bank may, in certain circumstances, deliver additional Preference Shares instead of paying a cash dividend in certain circumstances) and the payment obligations of the Bank and Co-operative Group, respectively, on the Bank T2 Notes and Group Notes which will be mandatory);
- that the Bank T2 Notes and Group Notes will not be perpetual, but rather the Bank and Co-operative Group, respectively, will be required to repay those Bank T2 Notes and Group Notes; and
- that the date of such repayment will be ten years after issue in the case of the Bank T2 Notes and twelve years after issue in the case of the Final Repayment Notes whereas the Instalment Repayment

Notes will repay principal in twelve equal instalments over twelve years rather than in one payment at the end of those twelve years.

Holders of the Dated Notes should note that part of the consideration for exchange of their Dated Notes will be delivered in the form of New Ordinary Shares. Holders of New Ordinary Shares will be the first creditors of the Bank to suffer losses (i.e. potentially lose all of their investment) in a winding-up of the Bank. The Bank will not expect to be able to pay dividends on such New Ordinary Shares in the near-term, as more fully described in paragraph 9 titled "*Dividend Policy*" in Section 8 (*Description of the Bank*). The Ordinary Shares will not, as of their date of issue, be listed or admitted to trading on any stock exchange.

These differences described above are not the only differences between the Existing Securities and the New Securities, and Holders should ensure that they carefully review the terms of their Existing Securities and the New Securities which they may receive in the Liability Management Exercise and that they fully understand the differences (including the tax consequencies thereof).

The tax treatment of Existing Securities may be different to the tax treatment of the New Securities. The tax treatment of Holders of Preference Shares or 13% Bonds opting to exchange their Preference Shares or 13% Bonds for Final Repayment Notes will be different to the tax treatment of such Holders opting to sell their Preference Shares or 13% Bonds for a cash amount paid in instalments (represented by Instalment Repayment Notes). Holders are advised to consult their own professional advisers regarding the differences for them in the tax treatment.

Failure to comply with the procedures of the Liability Management Exercise may result in Holders being unable to attend or vote at the Scheme Meeting, exchange or sell their Existing Securities or attend or vote at the meetings convened for the Holders of the Preference Shares, the 13% Bonds and the 5.5555% Bonds.

Holders of Existing Securities are responsible for complying with all of the procedures for participating in the Liability Management Exercise, which are set out in the Offer Memorandum appended to this Prospectus as Appendix C (*Consent and Exchange Offer Memorandum*) and, in the case of the Dated Notes, the Explanatory Statement and the other Scheme documents. Failure to do so may result in Holders being unable to receive New Securities in exchange for their Existing Securities or, as the case may be, attend or vote at the meetings convened for the Holders of the Preference Shares, the 13% Bonds and the 5.5555% Bonds or, in the case of the Dated Notes, attend or vote at the Scheme Meeting.

The price obtained on a sale of New Securities pursuant to the trust arrangements may be less than their price on issue

If any Holder of Dated Notes fails to comply with certain procedures in connection with the Scheme, the Bank T2 Notes and New Ordinary Shares for which such Holder's Dated Notes will be exchanged if the Scheme is sanctioned and implemented to which such Holder becomes entitled pursuant to the Scheme will be transferred to Lucid Issuer Services Limited as holding period trustee (the **Holding Period Trustee**). Such Bank T2 Notes and New Ordinary Shares will be held on trust by the Holding Period Trustee pending:

(a) confirmation for or on behalf of the relevant Holder that it or its Designated Recipient is eligible to receive the Bank T2 Notes and New Ordinary Shares, at which time the Holding Period Trustee will transfer the relevant Bank T2 Notes and New Ordinary Shares to that Holder or its Designated Recipient;

(b) confirmation for or on behalf of the relevant Holder that it is not eligible to receive the Bank T2 Notes and New Ordinary Shares, at which time the relevant Bank T2 Notes and New Ordinary Shares will be sold by or on behalf of the Holding Period Trustee and the net proceeds of such sale (after deduction of all applicable fees and expenses) will be distributed to that Holder; or

(c) the date falling 36 months following the Scheme Settlement Date, at which time the Holding Period Trustee will sell or procure the sale of the Bank T2 Notes and New Ordinary Shares not already distributed or sold as described in paragraphs (a) and (b) above and the net proceeds of such sale (after deduction of all applicable taxes and expenses) will be distributed to the Bank.

In the event that the Holding Period Trustee or selling agent (as applicable) sells any New Securities in the market as described above, the price obtained will be less than their current market price after deduction of costs and expenses, may be less than the price at which they were issued and may also be less than the holder's own valuation of such New Securities.

Sales of New Securities pursuant to the trust arrangements may affect the value of other New Securities

Any sales by the Holding Period Trustee or selling agent (as applicable) in the circumstances described in the risk factor "*The price obtained on a sale of New Securities pursuant to the trust arrangements may be less than their price on issue*" set out above may have an adverse effect on the market price of other New Securities issued pursuant to the Liability Management Exercise and which are not sold pursuant to the trust arrangements. In particular, certain holders of Dated Notes may not be permitted to hold unlisted ordinary shares of any company (including the Bank) which may mean a large number of New Ordinary Shares may be sold pursuant to the arrangements described above. Any such sales of any New Securities (particularly if a large number of New Securities are sold by the Holding Period Trustee or selling agent) may adversely affect the value of such other New Securities.

Holders may face penalties or the unwinding of transactions unless they comply with the offer terms and Offer Restrictions.

There are certain offer restrictions (called **Offer Restrictions**) imposed on the Liability Management Exercise and, in addition Holders will be deemed to make a number of acknowledgements, representations, warranties and undertakings on submission of an Exchange Instruction. Failure to comply with such Offer Restrictions or any such acknowledgements, representations, warranties and undertakings could result in, among other things, the unwinding of trades and/or heavy penalties.

RISKS RELATING TO THE BANK AND ITS BUSINESS

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

The difficult situation currently faced by the Bank is unprecedented for the Bank. The Bank has recently adopted a new four to five year business plan and begun to implement a range of measures aimed at improving its financial and operational performance and capital position. This includes the Recapitalisation Plan, separating its Non-core Business from its Core Business, refocusing the Core Business onto its core relationship retail and SME banking customers, overseeing a controlled run-off and exit of its Non-core Assets over the medium term, as well as embarking on a significant cost reduction programme across the Bank. In connection therewith, the Bank is beginning to implement steps designed to upgrade and enhance many of its operational processes and IT systems for the Core Business. Further information on the Bank's strategy is contained in Section 8 (*Description of the Bank*).

The Bank's newly adopted strategy was developed in a relatively short timeframe, has yet to be implemented and its performance and effectiveness is not yet proven. It is therefore possible that the Bank's strategy may not sufficiently address the Bank's problems or deliver the expected benefits to the Bank. The successful implementation of the Bank's strategy requires the simultaneous execution of a number of complex and overlapping changes (including the finalisation of the separation arrangements between the Bank and Co-operative Group, significant cost reductions, a substantial re-engineering of its IT platform, the reorientation of its distribution network, improving revenue in its business in the medium-term, the streamlining of its product offering, and the managing of its Non-core Assets in a manner intended to achieve optimal economic outcomes, after taking into consideration capital requirements, liquidity provisions, the nature of the assets and the underlying trends of value of such assets) in a manner that does not negatively impact on the Bank's brand, reputation, customer satisfaction or its relationship with, and ability to retain, its employees. The Bank also has a poor historic track record of successfully implementing large-scale changes.

In delivering its strategy, the Bank will be reliant on the collective skill, experience and commitment of its Directors, senior management team, and persons working for the Bank. The board has been strengthened

through the appointment of Richard Pym as Chairman of the board and Niall Booker as Chief Executive Officer and the Bank intends further to strengthen the Board. The senior management team has also recently been strengthened through the appointment of Robert Rickert as Chief Operating Officer and Julie Harding as HR Director. The Directors and senior managers therefore have a relatively limited track record of working for the Bank and working together. Notwithstanding these appointments, a number of further appointments are still required. In particular, following completion of the Liability Management Exercise, the Bank intends to appoint a finance director to the Bank's board. Grahame McGirr is currently both head of Co-operative Asset Management (**CoAM**) and CRO; following completion of the Liability Management Exercise the expectation is that a new CRO will be appointed allowing Grahame McGirr to focus solely on CoAM. In addition, Rodney Bulmer, the current Deputy Chief Executive Officer of the Bank and the Executive Director responsible for the Bank's Core Business has given notice to terminate his contract and is expected to leave the Bank in March 2014. A replacement will need to be found for Rodney Bulmer. The failure to recruit or delay in recruiting suitable members of the senior management team, the loss of one or more executive Directors or members of senior management without finding suitable replacements or any adverse perception resulting from the change to the Bank's ownership structure following the successful completion of the Recapitalisation Plan may delay or impact on the ability of the Bank to successfully implement its strategy.

The delivery of the strategy is also dependent on the commitment and ability of persons working for the Bank to effectively and appropriately implement and support the numerous changes required by the strategy at the same time that cost reductions and redundancies are being implemented. The successful implementation of the strategy will necessitate changes to a more performance-based culture, with clear accountability and with commercially driven decision making whilst retaining the co-operative principles that help differentiate the Bank. At the same time, in areas where the Bank lacks or does not have sufficient number of skilled persons, the Bank is reliant on being able to attract and recruit such persons and to do so within the timescales envisaged by the Bank. A failure by the Bank to change its culture, a failure by persons working for the Bank to advocate or implement the changes required by the strategy, a deterioration in employee engagement, the loss of skilled and experienced employees, or a failure to attract and retain skilled employees or to do so within the timescales envisaged may negatively impact on the Bank's business, operating results, financial position and prospects. The ability of the Bank to recruit skilled and experienced employees is currently negatively impacted by uncertainty as to whether the Liability Management Exercise will be successfully implemented. A failure to successfully implement the Liability Management Exercise will have a significant negative impact on the Bank's ability to attract and recruit such employees. See the risk factor titled "*The Bank is dependent on its Directors, senior management team and skilled personnel and the loss of one or more Directors or members of senior management or the loss of or failure to recruit and retain skilled personnel may have an adverse effect on the Bank's business, financial position and prospects and its ability to achieve its strategy*" below for further details.

There can be no assurance that the Bank will be able to successfully implement all or part of its strategy or implement it when expected or targeted. The Bank may experience unexpected costs or cost increases, delays and other execution problems in implementing its strategy; in particular, any significant delay in or failure of the Bank to implement the required steps to separate from Co-operative Group as a result of the change in the Bank's shareholding structure, the Liability Management Exercise, or to re-engineer its existing IT platform may result in a significant delay in delivering planned cost savings and may impact on the Bank's ability to achieve its business strategy. Risks may also emerge from the separation of services currently provided by the Co-operative Group. There can also be no assurance that the Bank will be able to achieve its capital, financial or operational targets (including its targets for return on equity, cost-to-income ratio, Non-core Assets profitability and Common Equity Tier 1 Capital) or realise all or part of the benefits that it expects from its current plans or other future initiatives. A failure or delay in implementing the Bank's strategy or a failure by the Bank to achieve its targets may adversely affect the Bank's business, results of operation, financial position and/or prospects, its regulatory capital position and its ability to comply with its regulatory capital requirements.

The implementation of the Bank's strategy has the following specific risks:

- The Bank's strategy includes leveraging the Bank's strong and differentiated brand and leading levels of customer satisfaction. The implementation of significant cost reductions, branch closures, redundancies and the reorientation of the Bank's distribution network may have a negative impact on the Bank's brand and levels of customer satisfaction which may, in turn, result in customer attrition. The Bank may also be unsuccessful in achieving a shift in customer behaviour towards self-service and digital banking.
- The Liability Management Exercise and the arrangements entered into in connection therewith and/or actions taken by the Bank in the implementation of its strategy may inadvertently be, or may be perceived to be, contrary to the principles of the co-operative movement which could negatively impact on the Bank's brand and business, in particular it may result in a loss of customers.
- The Bank's strategy also includes improving revenue in its Core Business through improved pricing of its products, appropriate re-pricing of existing products towards market rates, growing primary account customers in the Bank's key market segments, cross-selling products and growing the volume of higher margin unsecured lending. The Bank's ability to improve revenue in its Core Business is dependent upon a number of factors, including prevailing macroeconomic conditions (including the level of interest rates), the Bank's relative position versus its competitors and the ability of persons working for the Bank to appropriately cross sell products (see the risk factor titled "*The Bank faces competition in all of the core markets in which it operates*" and "*The Bank's business and financial performance have been and may continue to be affected by general economic conditions in the UK, and adverse developments in the UK or global financial markets could cause the Bank's earnings and profitability to decline*").
- There is also a risk that the recent credit rating downgrades, the Bank's capital shortfall and/or the Bank's disappointing financial results for the six months ended 30 June 2013, continuing press reporting and public scrutiny of the same and of the Recapitalisation Plan and/or actions by the Holders of the Bank's Existing Securities may, individually or cumulatively, over the longer term have a negative impact on the Bank's brand and reputation or on the strength of the co-operative movement as a whole.
- The Bank's high cost-to-income ratio continues to impact on its profitability and its capital position, and reducing its cost base remains a priority for the Bank. This cost reduction will be delivered through (i) the simplification of the Bank's product offering, allowing for efficiency gains in the Bank's operations and IT functions; (ii) greater levels of self-service through the reorientation of the Bank's distribution model towards digital and other self-service channels; (iii) business process re-engineering (both IT and non-IT enabled) which will remove middle and back office costs; (iv) delayering of management; and (v) full integration of Britannia within the Bank. There is no guarantee that these actions will achieve the intended cost benefits and will be successful or that they will otherwise be delivered on time or when expected. In particular, the implementation of this cost reduction programme currently has no member of the senior management team who has been appointed to oversee and be accountable for the delivery of this plan. In addition, the reorientation of the Bank's distribution model and its cost reduction programme may negatively impact the Bank's customer service, which may result in customer attrition.
- The Bank needs to significantly improve, and the Bank intends to progressively re-engineer, its existing IT platform. This re-engineering of its IT platform is significant, both in terms of scale and cost, and involves a number of risks (see the risk factor titled "*The Bank's operations are highly dependent on the proper functioning of IT and communication systems. Any significant delay in or failure of the Bank to re-engineer its existing IT platform to meet the requirements of its business strategy may adversely affect the future operational and financial performance of the business*"). In addition, the Non-core Business and the Core Business also share the same IT platform. As the IT platform is remediated, digitalised and re-engineered in line with the Core Business' strategy, the systems may over time cease to be suitable for the activities of the Non-core Business and the Non-

core Business may, as a consequence, be negatively impacted and/or required to move to alternative IT systems.

- The inability of the Bank to deleverage its Non-core Assets in a controlled and capital efficient manner may have a negative impact on the Bank's operating results and financial position (in particular, its net interest margin) and its regulatory capital position. In addition, any greater than expected costs or delays in deleveraging the Non-core Assets may divert funding from and adversely impact the longer term development and growth of the Core Business (for further information see the risk factor titled "*The inability of the Bank to deleverage its Non-core Assets in a controlled and capital efficient manner may have a negative impact on the Bank's financial position and operating results and, its regulatory capital position and ability to comply with its regulatory capital requirements. Any greater than expected costs or delays in deleveraging the Non-core Assets may divert funding from and adversely impact the growth of the Core Business*").

The model used to create the Bank's four to five year plan was produced in a relatively short timescale. In addition, the model is reliant on manual inputs and controls, and inputs are from a wide range of sources. Whilst and notwithstanding that the Bank engaged independent advisers to assist it in developing its model and separate independent advisers to perform an external review of the model (consequential to which a number of changes to the model were made) and a number of checks have been carried out to confirm the accuracy of the data inputs, given the relatively short timescale in which the model was created and given the reliance on manual inputs and controls, there is a risk that there are weaknesses in the design of the model and there is a risk that data has been incorrectly input into the model.

The successful development and implementation of the Bank's strategy requires difficult, subjective and complex judgements, including forecasts of economic conditions. Furthermore, the successful implementation of the Bank's strategy is contingent upon a range of factors which are beyond the Bank's control, including market conditions, the general business environment, regulation (including currently unexpected regulatory change), the activities of its competitors and consumers and the legal and political environment.

The inability of the Bank to deleverage its Non-core Assets in a controlled and capital efficient manner may have a negative impact on the Bank's financial position and operating results and its regulatory capital position and ability to comply with its regulatory capital requirements. Any greater than expected costs or delays in deleveraging the Non-core Assets may divert funding from and adversely impact the growth of the Core Business.

The Bank's Non-core Assets consist of asset classes of the Bank which are not consistent with the Bank's Core Business strategy. As at 30 June 2013 the Non-core Business had total segment assets of £14.2 billion constituting 32.1 per cent. of the Bank's total segment assets. The Bank's Non-core Assets therefore constitute a significant part of the Bank's total assets.

A key part of the Bank's overall strategy is a controlled run-off and exit of the Non-core Assets in a manner that the anticipated future losses from such run-off and exit do not materially exceed the capital which is released from the reduction in RWAs, and which the Directors believe minimises adverse impact on the realisation of the Bank's Core Business strategy and the Bank's core customers. As part of this process, the Bank has reviewed its corporate loan book on an asset-by-asset basis, identified Non-core Assets for run-down and exit and changed the work-out approach on a significant number of such assets. The assets are managed taking into consideration their capital requirements, provisioning (both past and future), the nature of any security over the assets, returns, and the ability to improve economic outcomes by proactive management of the assets. Depending on the asset, this may involve the sale or refinancing of the asset or the holding of the asset until maturity. The Bank has also adjusted its credit risk management approach and the data upon which impairment assessments are made. These factors in part resulted in significant impairment charges of £496.0 million for the six month period ended 30 June 2013.

A failure by the Bank to deleverage its Non-core Assets in a controlled manner in accordance with its strategy may (for example, through greater than currently expected losses from the run-off or sale of Non-core Assets) negatively impact on the Bank's operating results and financial position (in particular, its net interest margin) and its regulatory capital position and ability to comply with its regulatory capital

requirements. The Bank may, for example, be unable to exit or run down its Non-core Assets as anticipated due to unfavourable market conditions, lack of appetite from buyers, or because sales take longer to execute than assumed. In addition, the Bank may be competing against other financial and other institutions also seeking to exit from their Non-core Assets, in particular given the continuing European-wide deleveraging of similar assets, which may impact on secondary market pricing and demand for its Non-core Assets, and the Bank may be required to compete on price and ease of execution. In addition, given the period over which the Bank will be running off and exiting from its Non-core Assets, the Bank is exposed to market conditions, including declines in commercial property values, and other macro-economic factors during this period. For further information see the risk factor titled see "*Worsening economic and market conditions could result in increased commercial property loan losses beyond what the Bank has already provided for, which could adversely impact the Bank's financial and operational performance*". The Bank may be required or may decide to exit on short notice and at unfavourable prices for liquidity, funding or other needs.

Notwithstanding the significant impairments already made to the Non-core Assets, the Non-core Business also has significant additional impairment risk given the underlying assets, which includes Optimum, a book of predominantly interest-only intermediary and acquired mortgage book assets (as at 30 June 2013, £7.3 billion). Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in the Non-core Assets suffering from more than expected impairments which would adversely impact on the Bank's operating results and financial position (in particular, its net interest margin) and its regulatory capital position and ability to comply with its regulatory capital requirements (for further information see the risk factor titled "*Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in increased residential mortgage and unsecured loan losses which would adversely impact the Bank's financial and operational performance*").

The Non-core Business' corporate asset book is relatively concentrated, with the result that a small number of borrowers account for a large proportion of the total loans outstanding. A significant impairment of any of these borrowers would result in a disproportionate impact on the Bank's operating results and financial position (for further information see the risk factor titled "*A number of the Non-core Asset classes have a small number of borrowers accounting for a large proportion of the total loans outstanding*").

The failure of the Non-core Business to deleverage its assets in a controlled manner in accordance with its strategy may hinder or restrict the longer term development and growth of the Core Business' business, and divert management attention from the Core Business. For example, it may restrict the ability of the Core Business to grow its existing loan portfolios or to expand its growth of other products, such as unsecured lending. In addition, the Non-core Business is partially funded by retail deposits from the Core Business. Any greater than expected expenses or operating costs or delays in the exiting and running down of the Non-core Assets may require additional funding from the Core Business (and which cannot reasonably be funded from elsewhere) which may divert funding from the Core Business to the Non-core Business and may adversely impact the development and growth of the Core Business.

The commitment by Banking Group to contribute £333 million of Common Equity Tier 1 Capital during 2014, in addition to being solely conditional upon the successful completion of the Liability Management Exercise, is subject to the ability of Banking Group and/or Co-operative Group to fund the commitment, which is dependent on certain actions, some of which are partially outside the control of Co-operative Group.

An important part of the Recapitalisation Plan is the contribution by Banking Group of £333 million of Common Equity Tier 1 Capital during 2014 (the **2014 Commitment**). On 4 November 2013 (being the date of the launch of the Recapitalisation Plan), Banking Group entered into a legally binding and irrevocable undertaking to pay (the **Undertaking to Pay**) in favour of the Bank in consideration for the issuance of 54,058,442 New Ordinary Shares immediately prior to the completion of the Liability Management Exercise (the **2014 Commitment Agreement**). Banking Group's obligations under the 2014 Commitment and the Undertaking to Pay are conditional only upon the successful completion of the Liability Management Exercise.

As announced on 17 June 2013, Banking Group intends to satisfy the 2014 Commitment and the Undertaking to Pay from the net proceeds of the sale by Banking Group of Co-operative Life Insurance and

Asset Management and the proposed sale of CIS General Insurance (the **Insurance Proceeds**). The Insurance Proceeds are currently anticipated to be sufficient to satisfy the Undertaking to Pay subject to these disposals realising the Insurance Proceeds in the expected timeframe. In the absence of the Insurance Proceeds (and the proceeds of the Intra-group Loan (as described further below)), Banking Group would be unable to satisfy its obligations under the Undertaking to Pay without seeking alternative sources of funding.

The sale of Co-operative Life Insurance and Asset Management to The Royal London Mutual Insurance Society Limited (**Royal London**) completed on 31 July 2013. The total consideration for the sale was £219.0 million, of which £39.0 million has already been paid to Banking Group. Payment of the remaining £180 million (as deferred consideration) is subject to the approval of the court under a transfer of the life insurance fund of Co-operative Life Insurance Society Ltd (now named RL (CIS) Ltd) into Royal London under Part VII of FSMA. There is no certainty as to timing or outcome of the court process and therefore no certainty as to when the deferred consideration may be received by Banking Group or if it will be received at all. The Bank also understands that Banking Group, together with the Co-operative Group, is currently in discussions with various interested parties to sell CIS General Insurance, but as at the date of this Prospectus, no legally binding agreement to sell CIS General Insurance has been entered into and any such agreement may, when entered into, be subject to various conditions precedent. In addition the trustee of Pace have a guarantee from CIS General Insurance for the liabilities of that scheme, which would need to be released as part of the sale process. It is therefore uncertain how much, if any, proceeds will be generated by Banking Group through a disposal of CIS General Insurance as a result of this requirement.

The PRA have stipulated that the 2014 Commitment must be satisfied in two tranches, with £170 million payable by 30 June 2014 and £163 million payable after 30 June 2014 but not later than 31 December 2014. In the 2014 Commitment Agreement, Banking Group has agreed to contribute the 2014 Commitment and satisfy the Undertaking to Pay in a number of tranches, with (i) £20 million payable by no later than 31 December 2013; (ii) £50 million by no later than 31 January 2014; (iii) £100 million by no later than 30 June 2014; and (iv) £163 million by no later than 31 December 2014. In addition, following receipt by Banking Group of the Co-operative Life Insurance and Asset Management Deferred Consideration or the net proceeds of the disposal of CIS General Insurance, Banking Group is required to apply such proceeds as soon as reasonably practicable following receipt of such proceeds in satisfaction of the Undertaking to Pay (in part or in full as the case may be).

To provide support to Banking Group's obligations under the Undertaking to Pay, the Bank and Banking Group have entered into an intra-group loan with Co-operative Group (the **Intra-group Loan**). The Intra-group Loan allows Banking Group to draw down sufficient amounts to satisfy the Undertaking to Pay taking into account Banking Group's existing cash resources and is intended to be unconditional before 2014 (and is only subject to a small number of customary conditions precedent – see the paragraph number 20.6 titled "*Intra-group Loan*" in Section 20 (*Additional Information*) for further details). Banking Group, under the terms of the Intra-group Loan is obliged to pay any amounts drawn down under that loan to the Bank in satisfaction of the Undertaking to Pay.

Given Banking Group's potential reliance on the Intra-group Loan to fund its obligations under the 2014 Commitment Agreement, Banking Group may, as a result, be dependent on the ability of Co-operative Group to satisfy, in turn, its obligations under the Intra-group Loan. Co-operative Group has informed the Bank that it has appropriate arrangements in place to fund any draw down under the Intra-group Loan to enable Banking Group to satisfy the discharge of its obligations under the Intra-group Loan from alternative resources in the event that the Insurance Proceeds are not sufficient to enable Banking Group to satisfy the amount of the 2014 Commitment or are otherwise not received in time to satisfy the PRA's required timing to satisfy the 2014 Commitment. Whilst Co-operative Group has an established track record of executing such transactions, they are by their nature dependent on purchasers and finance providers being willing to enter into such transactions which, in turn, are dependent on market conditions at the time of the transactions. As a result of such dependencies, it is possible that Banking Group may be unable to successfully draw down under the Intra-group Loan in the envisaged manner should this be required should the Co-operative Group have insufficient funds to comply with its funding obligations.

As a result, Banking Group may then, in turn, be in default of its obligations under the 2014 Commitment Agreement and Bank will be able to exercise certain rights under the 2014 Commitment Agreement and/or

to take legal action against Banking Group to recover any amounts owed. The Bank may fail to recover some or all of such amounts in such circumstances, which would adversely impact its regulatory capital position as the New Ordinary Shares which have been issued under the 2014 Commitment Agreement do not constitute Common Equity Tier 1 Capital until they Undertaking to Pay in respect of them has been satisfied. Should the Bank fail to raise £1.5 billion of additional Common Equity Tier 1 Capital by the end of 2014 the Bank will likely be in breach of the PRA requirement that the Bank raise an additional £1.5 billion of Common Equity Tier 1 Capital by the end of 2014 and similar consequences to those described in the risk factor entitled "*The implementation of the Liability Management Exercise is subject to a number of significant risks. Should the Liability Management Exercise not be implemented, the Bank is likely to be the subject of a resolution procedure under the Banking Act 2009. In such circumstances, Holders of Existing Securities could potentially have no recovery at all in respect of their investment in the Existing Securities*" above could apply.

See paragraph titled "*The Recapitalisation Plan*" in Section 12 *(Operating and Financial Review*) and paragraph 20.4 titled "*2014 Commitment Agreement*" in Section 20 (*Additional Information*) for more details of the 2014 Commitment.

The Bank's business, operating results, financial position and/or its ability to implement its strategy may be adversely impacted by it not maintaining adequate regulatory capital and by future changes to its regulatory capital requirements.

The Bank is required to maintain adequate regulatory capital and capital ratios at all times. The Bank will be required to meet new international capital and liquidity requirements (commonly referred to as **Basel III**) as implemented in the EU through the introduction of the Prudential Requirements Regulation (the **PRR**) and a further iteration of the Capital Requirements Directive (the **PRD**, and together with the PRR, **CRD IV**). The PRR will have direct effect in the UK with effect from 1 January 2014 and the PRA has consulted on the implementation of CRD IV in the UK, which must also be implemented by 1 January 2014; the results of that consultation are not yet public. These new EU capital requirements (and any additional UK requirements in excess of those required by CRD IV) will among other things require increased minimum levels of, and quality standards for, capital, increased risk weighting of assets, introduction of a minimum leverage ratio and additional capital buffers and new liquidity requirements. The Bank monitors its capital position under the forthcoming Basel III requirements and it believes, based on its current understanding of how such regulations will be implemented by the PRA in the UK and subject to implementation of the Recapitalisation Plan, that it will be compliant with the new Basel III capital requirements once they are implemented in the UK.

As the PRA's implementation of CRD IV in the areas in which Member States have discretion is not yet finalised, the impact on the Bank of certain of the new requirements is difficult to quantify. The PRA's rules (in exercising its discretion under CRD IV) and/or the requirements imposed as a result of finalisation of the European Banking Authority's (the **EBA**) technical standards could, therefore, have a negative impact on the Bank's capital and liquidity calculations and funding requirements and consequentially adversely affect its business or profitability beyond what is currently contemplated. It is not currently possible to predict with accuracy the final details of these reforms and the impact on the costs of capital.

The Regulatory Capital Framework

On 16 December 2010 and on 13 January 2011, the Basel Committee issued its final published guidance on a number of fundamental reforms to the regulatory capital framework (such reforms being commonly referred to as Basel III) (revised in June 2011), including new capital requirements, higher capital ratios, more stringent eligibility requirements for capital instruments, a new leverage ratio and liquidity requirements intended to reinforce capital standards and to establish minimum liquidity standards for financial institutions, including the Bank.

The Basel III reform package will be implemented in the European Economic Area (the **EEA**) through the PRR and the associated directive, the PRD, each of which was adopted by the European Parliament and the European Council on 26 June 2013. The PRR establishes a single set of harmonised prudential rules which will apply directly to all credit institutions in the EEA from 1 January 2014 with the PRD containing less prescriptive provisions which will need to be transposed into national law. Full implementation will begin

from 1 January 2014, with particular requirements being phased in over a period of time, to be fully effective by 2019.

Key elements of the CRD IV include the following:

- Regulatory capital requirements – higher minimum capital ratios and the introduction of conservation, countercyclical and systemic risk buffers (together, the **Capital Buffers**), which are expected to be phased in over the period January 2016 to January 2019. Once implemented, a bank will be restricted in making discretionary distributions where the Capital Buffer requirements are not met;
- Definition of capital – whilst all of the Bank's Dated Notes, Preference Shares and Perpetual Subordinated Bonds are intended to be retired as part of the Liability Management Exercise (if it is successful) any of the Bank's subordinated debt which is not retired following a failure of the Liability Management Exercise and which does not meet the new recognition criteria will cease to be recognised as capital over the period from 1 January 2014 to 1 January 2022. It is possible that the PRA may seek to decrease this time period. Over the period 2014-2018, changes and additions to capital deductions will also apply;
- Counterparty credit risk – an additional capital charge for representing the volatility of credit valuation adjustments applied to derivative positions will be imposed;
- Securitisation exposures – the new regulation will also lead to certain securitisation exposures being deducted 100 per cent. from Basel III Tier 1 Capital from 2014, as opposed to the current treatment of a 50 per cent. deduction from Core Tier 1 Capital and a 50 per cent. deduction from Tier 2;
- New liquidity metrics – two new liquidity ratios will be introduced. These are a short-term liquidity stress ratio, referred to as the liquidity non-performing loans average ratio, and a longer-term ratio, referred to as the net stable funding ratio. Both ratios are required to be maintained at levels in excess of 100 per cent, when fully implemented; and
- New leverage ratio – a new ratio, calculated by reference to Basel III Common Equity Tier 1 Capital after deductions divided by adjusted balance sheet exposure is required to be maintained at a level of at least 3 per cent. The PRR requires firms to disclose their leverage ratio from 2015. Calculation of the CRD IV leverage ratio remains subject to review by the EBA; following this review the European Commission is expected to develop a further legislative proposal for submission to the European Parliament and the European Council by the end of 2016. On the current timetable the CRD IV leverage ratio is not expected to be finally implemented until 2018. In the UK, the interim Financial Policy Committee (**FPC**) recommended that the regulator encourage UK banks to disclose their leverage ratios publicly; such disclosures began in 2013 in respect of the 2012 financial year end. It is currently expected that the requirement for a specific leverage ratio will be implemented on 1 January 2018. Because the leverage ratio requirement remains subject to EBA review, the impact of it remains unknown. The Bank expects to achieve a leverage ratio above the regulatory minimum by the end of 2014.

EBA technical standards yet to be finalised

The actual impact of CRD IV on the Bank's capital requirements is also dependent on the EBA's technical standards (to be issued by the EBA and other European supervisory authorities), a large number of which are yet to be finalised. Based on its current understanding of how the CRD IV will be implemented in the UK, the Bank believes it will be in compliance with the requirements upon their implementation. However, the risk that the final content of these technical standards may differ materially from current expectations cannot be excluded. In that case, the Bank may become subject to regulatory capital requirements not currently anticipated or provided for.

PRA implementation of CRD IV

The PRR and PRD contain a number of national discretions for the competent authorities of EU Member States which, depending on how those discretions are exercised in the UK by the PRA, could impact upon the Bank; in particular, the Bank's current forecasts of its capital position vis-à-vis its capital requirements

may need to be revised.

On 2 August 2013, the PRA published a consultation ("*Strengthening Capital Standards: Implementing CRD IV – CP5/13*") on the changes to the PRA rules to implement the new EU capital requirements. Under the PRA consultation, the PRA proposed that the definition of Common Equity Tier 1 Capital will require capital deductions and amendments to prudential filters to apply fully from 1 January 2014, rather than on a transitional basis as permitted by CRD IV. However, the disclosures on the Bank's capital resources in Section 13 (*Capital Adequacy*) are produced in-line with PRA requirements issued before the consultation on CRD IV and do not include these proposed amendments to the transitional period. The PRA has consulted on the proposals in CP5/13, and the consultation closed on 2 October 2013. The PRA intends to publish its policy statement containing the finalised rules in December 2013. As the PRA's rules are not in final form, it is not possible to assess with absolute certainty the impact of CRD IV on the Bank in areas where Member States have national discretion. If the PRA's final rules differ substantially from the current proposals, the Bank's capital position may differ from its current forecasts; the Bank does not presently expect such substantive changes, but it is a risk which cannot presently be excluded.

The key areas, from the Bank's perspective, in which Member States have discretion as to the details and/or timing of implementation include:

- **Capital Buffers** – the PRA has discretion as to the implementation date of the capital conservation buffer (a buffer comprised of Common Equity Tier 1 Capital and representing a percentage of risk weighted assets at group and solo level, intended to enable banks to absorb losses in stressed periods). The PRA currently proposes to begin phasing this buffer in from 1 January 2016. The quantum of the capital conservation buffer is also subject to the discretion of the home Member State. Member States may also impose additional capital buffers if it is considered that the Capital Buffers prescribed for in the PRD are insufficient to enable firms to meet their capital requirements under stress. Whilst the PRA has indicated its intention to utilise this discretion, it is yet to propose provisions in this respect. If the PRA were to require the Bank to hold a greater quantum of capital against its risk weighted assets than is prescribed for in the PRD (though within the discretions permitted to Member States), this may require the Bank to raise its capital beyond that required by the minimum harmonisation requirements of the PRD. Should it fail to hold the capital buffer required by the PRA, the Bank would be restricted in making discretionary distributions to holders of its securities.
- **Risk weighting for qualifying holdings outside the financial sector** – the PRD gives competent authorities of Member States discretion as to whether to apply a risk weight of 1250 per cent. to "qualifying holdings" outside of the financial sector which exceed certain thresholds (i.e. direct or indirect holdings of 10 per cent. or more of the capital or voting rights of an undertaking). The PRA has indicated its intention to elect not to prohibit firms from having qualifying holdings exceeding the relevant thresholds. As the PRA's rules are not yet finalised in this respect, the PRA's position may change.
- **Capital treatment of securitisations** – the decision as to whether significant risk transfer (**SRT**) has been achieved (and so whether the capital benefits that securitisations offer banks are available to a firm) and the ability of originators to use SRT, is subject to the discretion of the competent authorities of Member States. The SRT requirements seek to ensure that any reduction in capital as a result of a securitisation is matched by a commensurate transfer of risk to third parties. The PRA has indicated its intention to apply a high degree of scrutiny in its assessment of whether SRT has been achieved. Depending on the PRA's application of its discretions as to the capital treatment of securitisations, the Bank may need to revise the calculation of its capital position vis-à-vis its capital requirements (and its statements of current and historic capital position as calculated in accordance with Basel III) to ensure compliance with the PRA's rules.

FPC recommendations for possible additional capital

In March 2013, a meeting of the then interim FPC, a part of the Bank of England responsible for macro-prudential regulation, voted unanimously that the PRA should take steps to ensure that, by the end of 2013, major UK banks and building societies, including the Bank, hold capital resources equivalent to at least 7 per cent. of their risk-weighted assets assessed using the Basel III definition of equity capital but after:

(i) making deductions from currently-stated capital to reflect an assessment of expected future losses and a realistic assessment of future costs of conduct redress; and (ii) adjusting for a more prudent calculation of risk weights. The FPC noted that, relative to that benchmark, major UK banks and building societies in aggregate had a shortfall in capital of around £25 billion. The introduction by the PRA of any higher regulatory capital requirements in excess of the 7 per cent. referred to above on major UK banks could have an adverse impact on the Bank's operations, business, results, financial conditions and prospects. This risk is not currently quantifiable and so has not been accounted for by the Bank.

Consequences of changes to regulatory capital requirements or the Bank's current understanding of such requirements

Effective management of the Bank's capital is critical to its ability to operate and grow its business and to pursue its strategy. Any change that limits the Bank's ability to manage effectively its balance sheet and capital resources could have a material adverse impact on its business, financial condition, results of operations, liquidity and/or prospects.

In the event that the impact of any of the new Basel III regulatory capital and liquidity requirements is greater than is currently anticipated by management and the Bank were as a consequence to suffer a shortage of regulatory capital (assuming and notwithstanding the completion of the Recapitalisation Plan), the Bank would expect to enter into discussions with the PRA and consider what actions to take in light of such circumstances, taking into account the regulatory capital position and requirements of the Bank at that time. Any such discussions with the PRA could take some time before agreement is reached. Any such actions, or any delay in implementing such actions or in agreeing them with the PRA, may have a material adverse effect on the Bank and its business. Possible actions might include accelerating the Non-core Business's asset disposal plan. A regulatory capital shortfall resulting from any of the new Basel III regulatory capital and liquidity requirements may in extreme circumstances result in the Bank being subject to a resolution procedure under the Banking Act. See paragraph 2.6 titled "*Recovery and resolution regime*" in Section 17 (*Supervision and Regulation*) for further details of such resolution procedures.

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 1Requirements. The Bank has discussed, and agreed, with the PRA the Bank's recently adopted four to five year business plan which contemplates that the Bank will meet its ICG by the end of the plan period. The plan also envisages that the Bank will raise approximately £400 million by way of additional tier 2 capital during the plan period. Whether the Bank is able to meet its ICG during the period of the plan will depend on a number of factors, both within and outside the control of the Bank, including the Bank's ability to meet its newly adopted business plan and economic and market conditions generally in the UK. Whilst the PRA has agreed its plan with its ICG, the PRA has discretion to revisit the Bank's ICG and the Bank's non-compliance with its ICG. It is not possible to predict with any degree of certainty, if and therefore when, the PRA would revisit them and, if so, the nature or extent of any possible changes to the ICG. Should the Bank fail to meet its ICG or its plan to comply with its ICG, it is not possible to predict how the PRA would react. The PRA may, in any such circumstances, at its discretion elect to exercise one or more of its various powers over the Bank, which could include a variation of the Bank's permissions, restricting the Bank's business or, in conjunction with the other Authorities, imposing a resolution procedure on the Bank.

On 1 October 2013, the Bank of England published a discussion paper ("*A framework for stress testing the UK banking system*") setting out proposals for annual, concurrent stress tests of the UK banking system. The discussion paper follows the FPC recommendation in March 2013 that "looking to 2014 and beyond, the Bank of England and the PRA should develop proposals for regular stress testing of the UK banking system". The main purpose of the proposed stress-testing framework is to provide a quantitative, forward looking assessment of the capital adequacy of the UK banking system and individual institutions within it. The discussion paper states that the Bank of England expects that the stress-testing framework will use a suite of models to translate both common and bespoke scenarios into projections of bank profitability and capital ratios. The stress testing for 2014 will cover only the eight major UK banks. These banks (including the Bank) will be required to submit the results of the analysis to the PRA by 30 June 2014. The outcome of the analysis will be considered by the FPC and PRA during the fourth quarter of 2014, and will be used to inform remedial actions either at a system or individual bank level. It is not possible to predict with any certainty

what the output of the 2014 stress testing might be. As a result of such stress tests, the Bank may be required to hold more regulatory capital, or to take other steps to mitigate risks identified as part of the stress tests.

Failure by the Bank to maintain adequate regulatory capital could lead to an inability of the Bank to support its business operations and implement its strategy, meet regulatory requirements, implement its investment plans, raise (in the medium term) further capital, make distributions, and could result in further changes to its credit ratings. Such consequences could, in turn, have a material adverse effect on the Bank's business, operating results, financial condition and prospects.

The Bank operates in highly regulated industries and the Bank's business and results may be significantly affected by the laws and regulations applicable to it. In particular, the Bank may face legal and regulatory proceedings.

As a financial services firm, the Bank is subject to extensive and comprehensive regulation under the laws of the jurisdictions in which it does business. These laws and regulations significantly affect the way that the Bank does business, and can restrict the scope of its existing businesses and limit its ability to expand its product offerings, or can make its products and services more expensive for clients and customers. There has also been an increased focus on regulation and procedures for the protection of customers and clients of financial services firms. This has resulted, moreover, in increased willingness on the part of regulators to investigate past practices of financial services firms.

The Bank is exposed to many forms of risk relating to legal and regulatory proceedings, including that: (i) business may not be, or may not have been, conducted in accordance with applicable laws and financial and other penalties may result; (ii) contractual obligations may either not be enforceable as intended or may be enforced in a way adverse to the Bank; (iii) intellectual property may not be adequately protected and the Bank may use intellectual property which infringes, or is alleged to infringe, the rights of third parties; and (iv) liability for damages may be incurred to third parties harmed by the conduct of the Bank's business.

The Bank is currently involved in litigation (for further information see paragraph 21 titled "*Litigation and Arbitration*" in Section 20 (*Additional Information*)) and may in the future become involved in further litigation. The outcome of any legal proceedings is difficult to predict.

Following the publication by the Bank of its annual report and accounts for the financial year ended 31 December 2012 (the **2012 Accounts**), the Bank received enquiries from the FCA relating to the Bank's compliance with the Disclosure and Transparency Rules in respect of disclosures made by the Bank concerning its regulatory capital position. In addition, the Bank has received certain enquiries from the Conduct Committee of the Financial Reporting Council in respect of the 2012 Accounts. These enquiries relate to the disclosure in the 2012 annual report and accounts of the Bank's regulatory capital position. They also relate to the Bank's loan impairment, impairment of its investment in its replacement banking IT platform, and to fair value disclosures.

For example the 2012 Accounts included on page 80 of the statements that: (a) "Adequate capitalisation can be maintained at all times even under the most severe stress scenarios, including the revised FSA 'anchor' stress scenario"; and (b) "A capital buffer above Individual Capital Guidance (ICG) is being maintained to provide the ability to absorb capital shocks and ensure sufficient surplus capital is available at all times to cover the Bank's regulatory minimum requirements". The Board has reviewed the basis for these statements and has concluded that they are inaccurate and, should they be read in isolation, these statements could be misleading, but when taken in the context of the 2012 Accounts as a whole, including the disclosures on pages 18, 29 and 30 of the 2012 Accounts, a more balanced view can be formed. The Directors believe that the 2012 Accounts would not have been required to be reissued solely on the basis of the inaccuracy on page 80 referred to above. KPMG has confirmed agreement with the conclusion reached by the Board on this matter.

Given the preliminary nature of such enquiries the Bank is unable to make any definitive comment in relation to them and the Bank is cooperating with such enquiries. Given that the Bank is currently unable to assess whether or not it is likely that the enquiries may result in more formal investigations or proceedings and whether such or other investigations or proceedings may result in findings adverse to the Bank.

On 12 July 2013 Co-operative Group and the Bank announced the launch of an independent review, to be chaired by Sir Christopher Kelly, into the events that led to the recent announcement of the Recapitalisation Plan to address the Bank's £1.5 billion capital shortfall, the decision to merge the Bank with Britannia in 2009 and the proposed acquisition of the Verde Business (the **Kelly Review**). The Kelly Review will include an analysis of strategic decision-making, management structures, culture, governance and accounting practices and aspects of the role of the Bank's auditors. The intention is to present the findings of the Kelly Review to Co-operative Group's members at its annual general meeting in May 2014. The Bank may face additional enquiries or proceedings arising out of the Kelly Review. In addition, the House of Commons Treasury Committee is also currently conducting hearings in connection with its enquiry into the required divestment of the Verde Business and the collapse of the Bank's bid for the Verde Business.

The outcome of these enquiries or any other future legal, regulatory or other enquiries, investigations or proceedings, including any legal, regulatory or other enquiries, investigations or proceedings arising out of any other allegations made against the Bank, is difficult to predict. However, the Bank may incur significant expense in connection with any legal, regulatory or other enquiries, investigations or proceedings, which could expose the Bank to any of the following: substantial monetary damages and fines; other penalties and injunctive relief; potential for additional civil or private litigation; potential for criminal prosecution in certain circumstances; potential regulatory restrictions on the Bank's business; and/or a negative effect on the Bank's reputation. Any of these risks, should they materialise, could have an adverse impact on the Bank's operations, financial results, condition and prospects, and the confidence of the Bank's customers in the Bank, as well as taking a significant amount of management time and resources away from the implementation of the Bank's strategy.

The Bank's business is subject to inherent risks concerning liquidity, particularly if the availability of traditional sources of funding such as retail deposits becomes limited and/or becomes more expensive, and this may have an adverse effect on the Bank's business, profitability and its ability to meet its liabilities as they fall due.

The Bank is subject to liquidity risk as an inherent part of its business. Liquidity risk is the risk that an institution may not have sufficient funds at any time to make full payment in respect of liabilities falling due or can only do so at excessive cost. This may result in an inability to operate in the ordinary course, and/or a failure to meet liquidity or regulatory capital requirements, and/or may adversely impact the Bank's business and/or the implementation of its strategy.

The Bank raises the majority of its funding through accepting retail and corporate deposits. The Bank also maintains a range of funding programmes (including medium-term note, securitisation and covered bond programmes), targeting wholesale investors. The Bank's funding programmes are used for both short and medium-term funding, whilst its covered bond issues serve to satisfy longer-term funding requirements.

Depositors are a significant source of funding for the Bank and the maintenance and growth of the level of the Bank's lending activities depends in large part on the availability of deposit funding on appropriate terms. The Bank's deposits are split between retail and corporate deposits. As at 30 June 2013, the Bank's retail customer deposits totalled £28.1 billion and the Bank's corporate customer deposits totalled £4.7 billion, equal to 82.1 per cent. and 13.6 per cent., respectively, of the Bank's total customer funding as at that date. The Bank offers savings products which, generally, give rise to liabilities to repay depositors either "on demand" or on relatively short notice. The Bank's mortgage products, by contrast, are long-term assets repayable to the Bank over relatively long repayment terms. As a result, and given that the Bank's main source of funds is deposits, the Bank faces the risk of not being able to replace funds when they are withdrawn or, should a significant number of depositors seek to withdraw their funds, of not being able to meet its obligations to fund such withdrawals, repay lenders in accordance with its financing arrangements or fulfil commitments to lend.

The Bank 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 regular basis. The Bank's liquidity management framework is designed in line with the BIPRU regulations and industry guidelines. The Bank calculated its

total liquidity resources as at 30 June 2013 as £8,971.9 million compared with £8,657.7 million as at 31 December 2012.

The Bank uses a combination of asset pools to manage its liquidity, with "primary liquidity" (being assets that are eligible under BIPRU 12.7, being operational balances with central banks, gilts and central government and multilateral development bank bonds) which are used predominantly for short term cash flow movements, while "secondary liquidity" (being all other liquid assets (excluding non-buffer assets) 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 the Bank's liquidity has remained stable during the period ended 30 June 2013, supported by a large reduction in the Bank's non-buffer assets over this period. The Bank's secondary liquidity portfolio has been boosted by an increase in assets eligible for discounting at central banks. Overall, there has been a substantial reduction in non-buffer assets of the period (from £1,927.2 million as at 31 December 2012 to £188.2 million as at 30 June 2013). This reflected the change in the Bank's funding profile as a result of the Bank's rating downgrades and the sale of non-buffer assets which has been used to maintain sufficient levels of primary liquidity. The Bank's liquidity position is described in further detail in the paragraph titled "*Capital adequacy and liquidity requirements*" in Section 12 (*Operating and Financial Review*).

However, notwithstanding the steps that the Bank has taken to maintain its levels of total liquidity, given the reliance by the Bank on its customer deposits to provide funding for the Bank, any severe decline in customer confidence in the Bank could increase the amount of deposit withdrawals in a short space of time or over a sustained period. Given the relative size of the Bank's deposit base as compared with its other sources of funding, the Bank is particularly exposed to any serious loss of confidence by its depositors. Should the Bank experience an unusually high level of withdrawals which exceed the Bank's ability to manage through the application of its liquidity controls and contingency planning, this may have an adverse effect on the Bank's day-to-day operations, maintain the Bank's planned lending which may have an adverse effect on the Bank's business, results and financial position and could, in extreme circumstances, prevent the Bank from meeting its financial obligations as they fall due, meeting its regulatory minimum liquidity requirements or fulfilling its commitments to lend. In such circumstances, the Bank may be subject to a resolution procedure under the Banking Act.

The Bank's ability to access retail and wholesale funding sources on satisfactory economic terms or at all is subject to a variety of factors, some of which are outside the control of the Bank. Factors which apply generally include general economic conditions (including interest rates) and market volatility, market dislocation, confidence in the UK banking system and the economy in general and the financial services industry specifically, regulatory requirements, and major disasters. These risks can be exacerbated by enterprise-specific factors, such as over-reliance on a particular source of funding. There is also a risk that the funding structure employed by the Bank may prove to be inefficient, giving rise to a level of funding cost that is not sustainable in the long-term for the Bank to grow its business.

If the Bank's sources of short-term funding become volatile or unavailable, the Bank may be required to utilise other, possibly more expensive, sources to meet its short-term funding needs. The availability of wholesale funding depends on a variety of factors including market conditions, the general availability of credit, the volume of trading activities, the overall availability of credit to the financial services industry, and rating agencies' and funding markets' assessment of the Bank's credit strength.

The Bank is also a participant in the Bank of England's sterling monetary framework and, as such and subject to certain eligibility criteria at the Bank of England's discretion (as detailed in Chapter VIII of the Bank of England's Red Book), the Bank may be granted access to the Bank of England's Discount Window Facility (the **DWF**). The DWF offers liquidity insurance for idiosyncratic as well as system-wide shocks and is a bilateral facility designed to be able to address short-term liquidity shocks without disturbing the Bank of England's incentives for prudent liquidity management. At the Bank of England's discretion, eligible banks may therefore borrow gilts for 30 or 364 days, against a wide range of collateral in return for a fee, which will vary with the collateral used and the size and maturity of the borrowings. In the event that the Bank was not granted access to the DWF and the Bank at such time was dependent on the provision of

liquidity from the DWF, the absence of such liquidity may have an adverse effect on the Bank's business, results and financial position, and could, in extreme circumstances, prevent the Bank from meeting its financial obligations as they fall due, from meeting its minimum liquidity requirements or from fulfilling its commitment to lend.

The credit rating downgrade experienced by the Bank has (i) 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 (ii) negatively impacted the Bank's ability to access short-term unsecured wholesale funding, and (iii) increased the Bank's collateral requirements used in the clearing systems. In addition, the total amount of the Bank's corporate deposits also fell by approximately £1.4 billion in the first half of 2013, which the Bank believes was probably caused by the credit rating downgrade. To a lesser extent, the Bank's regulatory capital shortfall, its disappointing results for the six months ended 30 June 2013, and the continued press attention and speculation to which the Bank is subject have also affected the Bank's funding profile and the cost to the Bank of raising new funding. The Bank's business plan also envisages that the Bank will raise approximately £400 million by way of additional tier 2 capital during the plan period. This continued impact on access to funding and increased cost of funding may, over the longer term, have adverse effects on the Bank's business, financial performance or future prospects and/or adversely affect the Bank's ability to achieve its strategy.

Whilst the retail deposit base has remained broadly stable (in appropriate circumstances, the Bank has managed its retail offering to mitigate against the risk of depositors withdrawing funds), a failure by the Bank to achieve its strategy, a deterioration in the Bank's operating results or financial position, or the continued press attention and speculation to which the Bank is subject may result in a severe decline in customer confidence which could result in the withdrawal of retail funds.

The Bank is dependent on its Directors, senior management team and skilled personnel and the loss of one or more Directors or members of senior management or the loss of or failure to recruit and retain skilled personnel may have an adverse effect on the Bank's business, financial position and prospects and its ability to achieve its strategy.

The Bank depends on the continued contributions of its Directors, senior management and other key persons with the experience, knowledge and skills in retail banking and asset management for its success. The board has recently been strengthened through the appointment of Richard Pym as Chairman of the board and Niall Booker as Chief Executive Officer and the Bank intends to further strengthen the Board. The senior management team has also recently been strengthened through the appointment of Robert Rickert as Chief Operating Officer and Julie Harding as HR Director. The Directors and senior managers therefore have a limited track record of working for the Bank and working together. Notwithstanding these appointments, a number of further appointments are still required. In particular, following completion of the Liability Management Exercise, the Bank intends to appoint a finance director to the Bank's board. Grahame McGirr is currently both head of CoAM and Chief Risk Officer; following completion of the Liability Management Exercise the expectation is that a new Chief Risk Officer will be appointed allowing Grahame McGirr to focus solely on CoAM. In addition, Rodney Bulmer, the current Deputy Chief Executive Officer of the Bank (and the Executive Director responsible for the Bank's Core Business) has given notice to terminate his contract and is expected to leave the Bank in March 2014. A replacement will need to be found for Rodney Bulmer. The failure to recruit, or delay in recruiting suitable members of the senior management team, or the loss of one or more Directors or members of senior management without finding suitable replacements, or any adverse perception resulting from the change in the Bank's ownership structure following the successful completion of the Recapitalisation Plan, may delay or impact on the ability of the Bank to implement its strategy and may have an adverse effect on the Bank's business, prospects, results of operations and financial position. In the delivery of its strategy, the Bank is reliant on the skill, commitment and support of appropriately skilled and experienced persons working for the Bank to deliver the required changes. The successful implementation of the strategy will necessitate changes to a more performance-based culture, with clear accountability and with more commercially driven decision making whilst retaining the co-operative principles that help differentiate the Bank. At the same time, in areas where the Bank lacks or does not have sufficient number of skilled persons, the Bank is reliant on being able to attract and recruit such persons and to do so within the timescales envisaged by the Bank. The challenges which the Bank faces

in the implementation of its strategy, the impact of any proposed staff redundancies and cost reductions, and the impact of transferring employees to the Bank as part of the Bank's separation process from Co-operative Group (for further information see paragraph 8 titled "*Separation*" in Section 8 (*Description of the Bank*)), may adversely impact staff morale, retention and the ability to recruit new staff, in particular highly competent specialists. Any significant reduction in staff morale may have a consequential impact on service delivery and customer service and, potentially, the Bank's brand, positioning and its ability to maintain its retail funding. In addition, and more generally, competition for personnel with skills (in particular highly competent specialists, particularly those with financial, banking, IT and other specialist skills) and proven ability is intense among financial institutions. Given the current difficult situation facing the Bank, it is harder for the Bank to retain and to attract and recruit appropriately skilled and experienced individuals.

There is no guarantee that the Bank will be able to retain and to attract and recruit a sufficient number of appropriately skilled and experienced employees to deliver the required changes and a failure to do so may impact on the Bank's ability to achieve the strategy which, in turn, may negatively impact on its business, operating results, financial position and prospects.

As at 30 June 2013, approximately 73 per cent. of the individuals who currently provide the Bank's services, are engaged by CFS Management Services Limited (**CFSMS**) and their services are then provided to the Bank through secondment arrangements agreed with CFSMS under the terms of the CFSMS-Bank 2006 Agreement. The significant majority of these people work full time for the Bank but in some cases, these individuals only spend part of their working time servicing the Bank and the rest is spent servicing other parts of Co-operative Group. Whilst the Bank intends to continue to operate through the use of secondment arrangements in the short-term as described in paragraph 8 titled "*Separation*" in Section 8 (*Description of the Bank*) the Bank and the Co-operative Group expect to amend these arrangements such that, the Bank expects to agree an arrangement whereby the services of relevant individuals would transfer to the Bank. However, until such agreement can be reached the current arrangements will continue with the consequential risks of significant additional VAT charge for Bank and reliance of CFSMS for staff on terms that are not sufficiently robust (see the risk factor titled "*It may not be possible to agree new arrangements pursuant to which the Co-operative Group and CFSMS will continue to provide services, personnel and assets to Bank. A failure or delay in agreeing the new arrangements will result in a significant VAT charge for the Bank. The new arrangements may be less favourable to Bank than the existing arrangements*").

The Bank's inability to attract, retain and (where relevant) obtain PRA and/or FCA approval for, directors and highly skilled personnel, and to retain, motivate and train its staff effectively could adversely affect its competitive position, which could in turn result in an adverse effect on its business, prospects, results of operations and financial position.

Union representation subjects the Bank's business to the risk of interruptions through strikes or delays resulting from any restructuring of the Bank or in renegotiating labour contracts.

The Bank collectively recognises three trade unions – Britannia Staff Union, Unite and the National Association of Co-operative Officials. As at 30 June 2013, approximately 60 per cent. of the Bank's employees are union members. Whilst the Bank has not experienced any significant business interruption as a result of labour disputes at any of its businesses since August 2005, and the Bank considers its relations with employees to be good, the Bank does have a high proportion of staff, including senior individuals, who are members of a trade union. Union representation subjects the Bank's business to increased risk of interruptions through strikes or delays resulting from any restructuring of the Bank or in renegotiating labour contracts.

The Bank's strategy includes a significant cost-cutting exercise, which includes workforce redundancies. In addition, the terms and conditions for the majority of the staff are negotiated through collective bargaining with the unions. The Bank may be unsuccessful in concluding any such negotiations with unions regarding redundancies and reaching an agreement with the unions. A failure to conclude negotiations and reach agreement, or any protracted negotiations, may result in interruptions to the business through strikes or delays, a diversion of management time from running the Bank's business and implementing the Bank's strategy, a deterioration in employee relationships, an adverse impact on the Bank's reputation, and/or an

adverse impact on the Bank's customer relationships. Such interruptions may, in turn, impact on the Bank's business, financial condition and results of operations and its ability to achieve its strategy.

There can be no assurance that such arrangements will always be in place in the future or that the Bank will be able to continue to negotiate wages and salaries and terms and conditions of employment on terms that support its ability to offer its services at competitive prices.

The processes for consolidating the Bank's financial results are manual in nature and involve significant spreadsheet overlays. The processes are reliant on checks and reconciliations to ensure accuracy of the results reported, and are resource intensive.

The Bank's financial reporting process is complex, reflecting reliance on legacy systems which have not been integrated following the merger of the Bank and Britannia. The Bank relies on manual processes to consolidate the Bank's financial results, and there is a significant use of spreadsheets, as opposed to automated consolidation processes. The manual nature of the processes increases the risk of accounting errors.

The Bank's statutory results and management accounts are drawn from five different ledgers on different versions of Oracle Financials. Spreadsheets are used to consolidate information from the five ledgers and to perform consolidation adjustments (e.g. remove intercompany balances and eliminate the cost of investment in subsidiaries). This process is further complicated through fair value adjustments (which arise from the accounting treatment of the Bank's merger with Britannia) and further manual adjustments (usually in relation to key judgements and estimates). Similarly, the production of the monthly management accounts requires the use of spreadsheets and templates to produce the consolidated Bank results.

Given the manual and complex nature of these processes, the Bank has implemented controls and checks to help ensure the accuracy of the financial results. These include reconciliations between ledgers and operating systems and further detailed account reconciliations performed by the financial control team. They also include the production and review of board performance reports, which detail the composition of each balance sheet item in the statutory balance sheet.

Since 2012, a project has been ongoing to improve the consolidation process. As the Bank will continue to use five ledgers for the foreseeable future, it will not have a fully automated consolidation process. The project will, however, result in greater automation and in improved processes and controls in respect of the spreadsheet consolidation. The Bank intends to have completed implementation of these changes by the end of 2014. These changes may take longer or prove to be more expensive than currently anticipated.

Although the Bank will not have implemented all these changes by the time of completion of the Liability Management Exercise, the Bank does not believe that the Bank's financial reporting processes will result in inaccuracies or delays in the financial or other information which the Bank is required to publish as a company with securities admitted to the Official List. Notwithstanding anything in this risk factor, this risk factor should not be taken as implying that the Bank will be unable to comply with its obligations as a company with securities admitted to the Official List.

The Bank is exposed to a number of conduct risks

The Bank is exposed to many forms of legal and regulatory risk, which may arise in a number of ways. In particular:

- certain aspects of its business may be determined by the PRA, the FCA, HM Treasury, the Financial Ombudsman Service or the courts as not being conducted in accordance with applicable laws or regulations, or, in the case of the Financial Ombudsman Service, with what is fair and reasonable in the Ombudsman's opinion. If the Bank fails to comply with any relevant regulations, there is a risk of an adverse impact on its business due to sanctions, fines or other actions imposed by the regulatory authorities;
- the alleged mis-selling of financial products, including as a result of having sales practices and/or reward structures in place that are determined to have been inappropriate, may result in disciplinary action (including significant fines) or requirements to amend sales processes, withdraw products or

provide restitution to affected customers, all or any of which could result in the incurrence of significant costs, may require provisions to be recorded in the Bank's financial statements and could adversely impact future revenues from affected products; and

- the Bank may be liable for damages to third parties harmed by the manner in which the Bank has conducted one or more aspects of its business.

Failure to manage these risks adequately could lead to significant liabilities or reputational damage, which could have a material adverse effect on the Bank's business, financial condition, results of operations and relations with customers. The Bank also faces both financial and reputational risk where legal or regulatory proceedings are brought against it or members of its industry generally, or where complaints are made against it or members of its industry generally to the Financial Ombudsman Service or another relevant body.

The Bank's provision for customer redress is reflected in a significant item charge of £163.0 million in the six month period ended 30 June 2013, which includes provisions for potential customer compensation claims relating to past sales of payment protection insurance (**PPI**), alleged failings relating to the introduction of third-party sales of card and identity protection products, arrears charges and the processing of first payments on certain mortgages, the mis-selling of interest rate swaps and an additional provision following identification of a technical breach of the CCA as announced by the Bank on 21 October 2013.

In the past, the Bank sold PPI alongside mortgage and non-mortgage credit products. Although the Bank stopped selling loans PPI in January 2009 and mortgage PPI in March 2012, there can be no assurance that its estimates for potential liability are correct, and its reserves taken to date might prove inadequate. Given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies, the media and politicians, there is a risk that certain other aspects of the Bank's current or historic business may be determined by the FCA and other regulatory bodies or the courts as not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment in their opinion. In particular, there is currently a significant regulatory focus on the sales practices and reward structures that financial institutions have used when selling financial products. The Bank faces the possibility of regulatory investigations and actions against it in regards to the alleged mis-selling of financial products such as interest-only mortgages, packaged accounts, customer first mortgage payments and lending into retirement plans. The nature of any future disputes and legal, regulatory or other investigations or proceedings into such matters cannot be predicted in advance. Furthermore, the outcome of any on-going disputes and legal, regulatory or other investigations or proceedings is difficult to predict. However, it may be that in connection with any such on-going and future matters the Bank will incur significant expense investigating and, where applicable, defending such claims. In addition, such action could lead to substantial monetary damages and/or fines, public reprimands, a negative effect on the Bank's reputation, increased regulatory compliance requirements or other potential regulatory restrictions on the Bank's business. Any of these risks, should they materialise, could have an adverse impact on the Bank's operations, financial results and condition and prospects. There is also a risk that the outcome of such investigations or proceedings may give rise to changes in law or regulation as part of a wider response by relevant law makers and regulators. An adverse decision in any one matter, either against the Bank or another financial institution facing similar claims, could lead to further claims against the Bank.

Potential regulatory investigation could cause reputational damage to the Bank's brand arising from any association, action or inaction which is perceived by stakeholders to be inappropriate or unethical. Failure to appropriately manage conduct and reputation risks may reduce – directly or indirectly – the attractiveness of the Bank to stakeholders, including customers, and may lead to negative publicity, loss of revenue, litigation, higher scrutiny and/or intervention from regulators, regulatory or legislative action, loss of existing or potential client business, reduced workforce morale, and difficulties in recruiting and retaining talent. Sustained damage arising from conduct and reputation risks could have a materially negative impact on the Bank's operations, financial condition and prospects.

The Bank faces competition in all of the core markets in which it operates.

Competition in the UK personal financial services markets may adversely affect the Bank's operations. The Bank competes mainly with other providers of personal financial services, including other banks, building societies and insurance companies, and operates in an increasingly competitive UK personal financial

services market. Each of the main personal financial services markets in which the Bank operates is mature and slow-growing, so that growth requires taking market share from competitors. This places elevated focus on price and service as the key differentiators, each of which carries a cost to the provider. The quality of the Bank's products and systems, in particular distribution and IT, in turn impact on price and service. If the Bank is unable to match its competitors in these respects, it risks losing customers to its competitors which may adversely affect its business and prospects.

The UK market for financial services and the mortgage market in particular have been reshaped by the recent financial crises. Lenders have moved increasingly towards a policy of concentrating on the highest quality customers, judged by credit score and loan-to-value criteria, and there is strong competition for these customers.

Notwithstanding the Funding for Lending Scheme, which has seen banks drawing on this rather than pricing up in the retail deposit market, there remains significant competition for retail deposits, which has inevitably impacted lenders' margins. Competition may intensify further in response to consumer demand, technological changes, the impact of consolidation by the Bank's competitors, regulatory actions and other factors. If increased competition were to occur as a result of these or other factors, the Bank's business, financial condition and results of operations could be materially adversely affected. In particular, the implementation of the draft Banking Reform Bill, which requires, among other things, the separation of retail banking activities from the wholesale and investment banking activities carried on by large banking groups operating in the UK between 2015 and 2019 could reduce the distinctiveness of the co-operative model. The Bank's revised strategy is designed to meet the requirements of the Banking Reform Bill by 2016.

In addition, each of the major UK banks has announced that it will focus on improving its customer service. If the Bank's customer service levels were perceived to be negatively impacted by the implementation of its strategy, in particular, as a consequence of the Bank's cost reduction programme and the reorientation of its distribution channel, including branch closures, or were perceived by the market to be only in line with, or materially below, those of competitor UK financial institutions, it could lose existing and potential new business. In contrast to the Bank, a number of the Bank's competitors have recently increased the marketing of their brands and products. Whilst such increased marketing efforts are not specifically directed at the Bank, there is a risk that such efforts are successful in attracting customers of the Bank to transfer their banking relationship or primary account relationships to the Bank's competitors. If the Bank is not successful in retaining and strengthening its core relationship with retail and SME customers, it may lose market share as a result of the targeting of the Bank's customers by its competitors or otherwise, incur losses on some or all of its activities or fail to attract new deposits or retain existing deposits, which could have a material adverse effect on its business, financial condition and results of operations. In September 2013 a new Current Account Switch Service, overseen by the UK Payments Council, was launched. This has given rise to increased competition for the Bank. Whilst it is too early to establish any trends in this activity, based on prior period monthly averages the Bank has experienced, over the short period since the introduction of the Current Account Switch Account Service, a period which has seen significant incremental advertising spend by the Bank's competitors, a material reduction in the number of accounts switching to the Bank. This Current Account Switch Account Service may result in the Bank losing customers to competitors and/or needing to provide an enhanced proposition for retail customers in order to retain and attract customers.

The Bank's business and financial performance have been and may continue to be affected by general economic conditions in the UK, and adverse developments in the UK or global financial markets could cause the Bank's earnings and profitability to decline.

As with its competitors, the Bank is directly and indirectly subject to inherent risks arising from general economic conditions in the UK and other economies and the state of the global financial markets both generally and as they specifically affect financial institutions. Since mid-2008, the global economy and the global financial system, and the Eurozone in particular, have experienced a period of significant turbulence and uncertainty. The severe dislocation of the financial markets around the world that began in August 2007 and significantly worsened in mid-2008 triggered widespread problems at many commercial banks, investment banks and other financial and related institutions in the UK and around the world. The dislocation severely impacted general levels of liquidity, the availability of credit and the terms on which credit is

available. This crisis in the financial markets led the Government and other governments to inject liquidity into the financial system and take other forms of action relating to financial institutions, including bank recapitalisations and the provision of government guarantees for certain types of funding, aimed at both supporting the sector and providing confidence to the market. There can be no guarantee of such support in the future, and such support is likely to be on more punitive terms for financial institutions than in the past.

These market dislocations were also accompanied by recessionary conditions and trends in the UK and many economies around the world. The widespread deterioration in these economies adversely affected, among other things, consumer confidence, levels of unemployment, the state of the housing market, the commercial real estate sector, bond markets, equity markets, counterparty risk, inflation, the availability and cost of credit, transaction volumes in wholesale and retail markets, the liquidity of the global financial markets and market interest rates, which in turn had, and continues to have, in a number of respects, a material adverse effect on the Bank's business, operating results, financial condition and prospects.

Although there have been periods where market conditions have generally improved, developments in 2011 and 2012, particularly in the Eurozone, have demonstrated that there continues to be significant uncertainty; see the risk factor titled "*The Bank's business and financial performance would be adversely affected by a break-up of the single European currency*" below.

The sovereign debt crisis in Europe led to an increase in the cost of funding. The initial impact of this increase was felt in the wholesale markets, and there was a consequent increase in the cost of retail funding, with greater competition in a savings market which is growing only slowly by historical standards. A number of policy interventions, including most recently the Bank of England's Funding for Lending Scheme have helped to ease these funding pressures. However, if there were to be further escalations in the European sovereign debt crisis, the cost of funding could increase again.

Prospects for the UK economy continue to be challenging and continued uncertainty surrounding the combined economic prospects of the Eurozone presents a risk of a significant slowdown in economic activity in the UK's principal export markets, which would have a corresponding effect on the broader UK economy. Domestically, both public and household spending are being constrained by austerity measures, an on-going squeeze on household incomes, and declines in real disposable incomes. These pressures on households may, particularly if combined with an increase in interest rates, lead to an increase in arrears in the Bank's residential lending portfolios, in particular Optimum, and an associated increase in retail impairment provisions; see the risk factor titled "*Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in increased residential mortgage and unsecured loan losses which would adversely impact the Bank's financial and operational performance*" below. The Bank continues to expect the UK's economic recovery to be slow, with the Bank of England's explicit forward guidance regarding the future conduct of monetary policy presently anticipating base rate rises only when the official measure of unemployment falls to 7 per cent. (subject to certain conditions), currently anticipated to occur in 2016. In the meantime, the low interest rate environment will continue to exert downward pressure on net interest income across the financial sector. The continuation of the low interest rate environment, however, continues to support affordability of the Bank's mortgages by its customers. The Bank has experienced a decline in its net interest margin since the market dislocations commenced in August 2007 from 259 bps for the year ended 31 December 2007 to 104 bps for the six months ended 30 June 2013. The UK housing market, which the Bank is exposed to, has remained muted since late 2009, with transaction levels below historic norms and with house prices essentially flat since mid-2010 although recent indicators suggest that the UK housing market is improving, particularly London and the South East. Whilst forecasts of the UK housing market are difficult to make with any certainty, the Bank expects overall buyer activity across the UK in the short/medium term to continue to be relatively subdued, with the potential to decline should the labour market situation deteriorate markedly, or if strains in the financial system re-emerge and impair the flow of credit to the wider economy. Similarly, the outlook for the commercial property market continues to be uncertain in the light of the uncertain broader macroeconomic conditions. Potential for further weakening in tenant demand and investor appetite means the impairment outlook for the Bank's commercial lending business has become more uncertain; for further information see the risk factor titled "*Worsening economic and market conditions could result in increased commercial loan losses beyond what*

the Bank has already provided for, which would adversely impact the Bank's financial and operational performance" below.

The continued effect of margin compression and exposure to both retail and commercial loan impairment charges resulting from the impact of general economic conditions means that the Bank's results of operations and financial position may continue to be adversely impacted by such factors, and there remains the possibility of further downward pressure on its results of operation and financial position and growth depending on a number of external influences, such as the consequences of a more austere economic environment.

Rating downgrades and/or negative market sentiment with respect to the Bank, the sector and/or the UK may have an adverse effect on the Bank's performance.

The Bank's ratings have been adversely affected by concerns regarding the Bank's capital position with the result that the Bank's debt is no longer rated with an investment grade rating.

On 20 June 2013, Fitch downgraded the Bank's long-term Issuer default rating by three notches to BB- from BBB- reflecting concerns regarding the Bank's capital requirements following the announcement of the Recapitalisation Plan. This followed a two notch downgrade on 5 April 2013 from BBB+ to BBB- and a one notch downgrade on 19 July 2012 from A- (which was the long-term rating the Bank had held since 2009) to BBB+.

On 18 June 2013, Moody's downgraded the Bank's senior unsecured debt and deposit ratings by four notches to Caa1 from Ba3 reflecting concerns regarding the Bank's capital requirements following the announcement of the Recapitalisation Plan. This followed a six notch downgrade in the Bank's deposit and senior debt ratings on 9 May 2013 from A3 to Ba3 and the placing of the Bank onto watch for a possible downgrade on 30 July 2012. Previously, the Bank had held a credit rating of A3 since October 2011.

The Bank raises the majority of its funding through accepting retail and corporate deposits. The Bank also maintains a range of funding programmes (including medium-term note, securitisation and covered bond programmes), targeting wholesale investors. In addition, the Bank maintains a high quality portfolio of marketable asset pools that it uses for liquidity management within the Treasury operation. Specifically, this includes a core portfolio of liquid assets comprising gilts, cash at the Bank of England and multilateral development bonds. In addition, the Bank also has access to a wider pool of liquid assets which, though not as liquid as its core portfolio, provide further diversification within the Bank's total liquid asset portfolio.

The total amount of the Bank's corporate deposits fell by approximately by £1.4 billion in the first half of 2013, probably caused by the downgrading of the Bank's credit rating by the credit rating agencies. In addition, the credit rating downgrade has: (i) led to sub-investment grade ratings on the Bank's senior debt leading to a significant reduction in the demand for these types of instruments; (ii) negatively impacted the Bank's ability to access short-term unsecured wholesale funding; and (iii) increased the Bank's collateral requirements used in the clearing systems. The retail deposit base has, however, remained broadly stable. The credit rating downgrades and, to a lesser extent, the announcement of the Bank's regulatory capital shortfall, its results for the six months ended 30 June 2013 and the continued press attention and speculation to which the Bank is subject have affected the Bank's funding profile and the cost to the Bank of raising new funding.

The securitisation and covered bond programmes are in the process of being amended due to the downgrade received by the Bank from the rating agencies in the first half of 2013. These proposed amendments relate to the appointment of back up servicing and back up cash management and bank account triggers to accommodate, amongst other things, the latest structured rating agency methodology and changes to the rules relating to direct debits and payment schemes. The Bank will consider further issuance from these programmes after these modifications are complete and if market conditions permit.

There can be no guarantee that the implementation of the Bank's strategy or other actions taken by the Bank will restore the Bank's investment grade rating. Further negative change in sentiment towards the Bank as a result of market or other conditions could result in the Bank's credit rating being kept at below investment grade and/or reduced further. Any future declines in those aspects of the Bank identified by the rating agencies as significant business or a failure by the Bank to achieve its strategic objectives could also

adversely affect the rating agencies' perception of the Bank's credit and cause them to take further negative ratings actions.

The continuation of the Bank's current rating or any further downgrade in the Bank's credit ratings could:

- trigger additional collateral requirements on derivative contracts and other unsecured funding arrangements;
- undermine confidence in the Bank and/or result in an outflow of deposits from the Bank;
- increase its borrowing costs; and/or
- further limit its access to the capital markets or limit the range of counterparties willing to enter into transactions with the Bank, as many institutions require their counterparties to satisfy minimum ratings requirements.

By way of an illustration of the potential financial effect of a downgrade, the Bank is party to contracts which specify collateral requirements based on the Bank's rating. As a result, a downgrade of the Bank's long-term debt rating results in cash outflows to meet the new collateral requirements. However, the contractually required cash outflow would not necessarily match the actual cash outflow as a result of other actions that could be taken by management to reduce the impact of the downgrades.

Furthermore, in February and April 2013, both Moody's and Fitch reduced the 'UK's long-term ratings, from Aaa to Aa1 (in the case of Moody's) and from AAA to AA+ (in the case of Fitch). Although these actions have not impacted the respective agencies' ratings of the Bank, any further downgrade of the UK sovereign credit rating or the perception that such a downgrade may occur could destabilise the markets, impact the Bank's own rating and borrowing costs and have a material adverse effect on the Bank's operating results and financial condition. In addition, on 13 December 2012, S&P affirmed its AAA/A-1+ long- and short-term unsolicited sovereign credit ratings for the UK, but revised the outlook to negative from stable. A further UK sovereign downgrade or the perception that such a downgrade may occur could depress consumer confidence, restrict the availability, and increase the cost, of funding for the Bank and/or its customers, further depress economic activity or inhibit any recovery, increase unemployment and reduce asset prices. These risks are exacerbated by concerns over the levels of the public debt of, the risk of further sovereign downgrades of, and the weakness of the economies in, Greece, Italy, Ireland, Portugal and Spain (the **GIIPS countries**) in particular. Further instability within these countries or others within the Eurozone might lead to contagion.

Future legislative and regulatory changes could impose operational restrictions on the Bank, increase the Bank's expenses and/or otherwise adversely affect its business, results, financial condition or prospects.

Future changes in regulation, fiscal or other policies are unpredictable and beyond the Bank's control and could materially adversely affect its business or operations. Regulators and other bodies in the UK and worldwide have produced a range of proposals for future legislative and regulatory changes which could impose operational restrictions on the Bank, cause the Bank to raise further capital, increase the Bank's expenses and/or otherwise adversely affect its business results, financial condition or prospects. These include, amongst others:

- measures contained in the Financial Services (Banking Reform) Bill (the **Banking Reform Bill**) including: (i) ring-fencing domestic retail banking services of UK banks; (ii) increasing UK banks' and building societies' loss-absorbing capacity (including by way of bail-in bonds); and (iii) increasing the ranking of insured depositors on a winding-up to rank ahead of all other unsecured creditors. On 1 October 2013, HM Treasury published amendments to the Banking Reform Bill under which it is proposed, amongst other things, that the Bank of England be given the power, in a resolution scenario, to cancel, reduce or defer the equity liabilities of a bank (including divesting shareholders of a bank of their shares), convert an instrument issued by a bank from one form or class to another (for example, a debt instrument into equity) and/or transfer some or all of the securities of bank to an appointed bail-in administrator. The Bank's revised strategy is designed to meet the requirements of the Banking Reform Bill by 2016, but as the legislation is still subject to the UK legislative procedure, it is possible that more stringent requirements than currently envisaged will be

imposed on the Bank, which would require the Bank to raise additional capital, change its current legal structure and/or revise its strategy;

- at the EU level, structural reform measures that are similar to some of those contained in the Banking Reform Bill are also under consideration, following the report of the Liikanen Group, which was published in October 2012. This report's proposals were heavily influenced by the UK experience but there remains a risk that any subsequent EU legislation implementing the recommendations in the report may impose requirements which are more onerous than those in the Banking Reform Bill or which may not be completely consistent with those in the Banking Reform Bill. The Bank (and therefore holders of its securities) may be negatively affected if the EU reforms impose requirements on the Bank in excess of those currently contemplated in the UK;
- also at the European level, the draft RRD, which requires Member States to ensure that regulatory authorities have, among other things, powers to intervene in failing banks. The draft RRD also provides for Resolution Authorities to have the power to require institutions and groups to make structural changes to ensure legal and operational separation of "critical functions" from other functions where necessary, or to require institutions to limit or cease existing or proposed activities in certain circumstances. The exercise of these powers may require the Bank to change its current structure or operations, having negative consequences for the Bank's strategy and causing the Bank to incur potentially significant costs. It is currently contemplated that the RRD will be implemented in Member States by 31 December 2014 except for certain bail in provisions which are to be implemented by 1 January 2018. The draft RRD is not in final form and changes may be made to it in the course of the legislative process; and
- on 19 June 2013, the Parliamentary Commission on Banking Standards published its final report ("*Changing banking for good*"). This was followed by the publication of the Government's response on 8 July 2013, accepting the overall conclusions of the report and all of its principal recommendations. Among other things, this included proposals for a new banking standards regime governing the conduct of bank staff, the introduction of a criminal offence for reckless misconduct by senior bank staff, and steps to improve competition in the banking sector. Depending on how the Government decides to implement these proposals, they may have a substantial impact on banks in the UK generally, including the Bank, and ensuring future compliance with the requirements is likely to cause the Bank to incur potentially significant costs.

There is also a risk that the recent restructuring of regulatory bodies and, in particular, the creation of multiple regulators in the UK could lead to a lack of co-ordination and the emergence of inconsistencies between policies of the different regulatory bodies. Any such development could adversely impact the Bank's ability to manage its business efficiently and subject it to increased costs through managing as a result of the need to manage an increasingly complex compliance burden.

If implemented in their current form, none of these anticipated or forthcoming changes to the legal and regulatory framework to which the Bank is subject give rise to specific and quantifiable risks for the Bank. However, at this point it is impossible to predict the effect that any of the proposed changes listed above will have on the Bank's operations, business and prospects or how any of the proposals discussed above will be implemented in light of the fundamental changes to the regulatory environment proposed by the Government. Depending on the specific nature of the requirements and how they are enforced, such changes could have a significant impact on the Bank's operations, structure, costs and/or capital requirements. Accordingly, the Bank cannot assure potential investors that the implementation of any of the foregoing matters or any other regulatory or legislative changes that may be proposed will not have a material adverse effect on its operations, business, results, financial condition or prospects.

The Bank has a regulated branch in Guernsey and a regulated branch and subsidiary in the Isle of Man, each of which are subject to local regulatory requirements that may impact on their business or profitability and thus on the business or profitability of the Bank.

The Bank's relevant regulated branch in Guernsey and regulated branch and subsidiary in the Isle of Man are also subject to the local regulatory regime and the potential for regulatory intervention in Guernsey and the Isle of Man respectively.

The principal risk associated with regulated branches is that the local regulators may require the branch to hold liquidity locally; the local regulators also have oversight of the branch's operations and may have powers to require changes to those operations.

Regulated subsidiaries are subject to the full scope of regulation in the jurisdiction in which they are established – including locally imposed capital requirements and liquidity requirements, as well as conduct of business and other operational requirements. The local regulator may impose requirements on the subsidiary which will affect that subsidiary's ability to generate a return for the Bank, including requirements to hold both further capital and liquidity. The consequence of these requirements is that they will impact the Bank's liquidity and consolidated capital requirements. For example, the Bank's Isle of Man subsidiary has been required to hold additional collateral against its existing lending to the Bank following the announcement of the Bank's Recapitalisation Plan. The Bank intends to approach the Isle of Man regulators to request permission to terminate these additional collateral arrangements upon successful completion of the Recapitalisation Plan. There is no guarantee that the Isle of Man regulator will agree to this.

The Bank's earnings and net interest margins have been adversely affected by a number of factors, including a prolonged period of low Bank of England base rates and competition for retail funds, and may continue to be adversely affected for so long as one or more of these factors persist. In addition, the ratings downgrade, regulatory capital shortfall and other recent events impacting the Bank may have an adverse effect on the Bank's net interest margin.

The Bank's net interest margin and, consequentially, earnings are affected by the pricing on the lending products it offers to its customers and the cost of funding. The Bank's net interest margin has been squeezed by a number of factors which have negatively impacted on the pricing of its lending products and the cost of its funds.

The very low level of the Bank of England base rate since March 2009 contributed to a decline in the Bank's net interest margin as funding costs rose relative to base rate, in turn caused by savings rates falling below base rate. The Bank of England base rate has remained at 0.5 per cent. since March 2009, having fallen from 5.75 per cent. in July 2007 through eight consecutive cuts of between 0.25 per cent. and 1.0 per cent. In the 30 years preceding July 2007, the lowest level of the base rate was 3.5 per cent. Following the announcements by the Bank of England's Monetary Policy Committee on 7 June 2013, the Bank currently does not expect any short-term increase in the base rate and, accordingly, is likely to continue to be impacted by the effects which the low base rate has on its net interest margin.

Competition for the highest quality mortgages is intense and is likely to continue, putting downward pressure on returns available for the lowest risk-weighted mortgage assets. The ratings downgrade, regulatory capital shortfall and other recent events impacting the Bank, together with the publicity surrounding those events, has made it more difficult for the Bank to access funding for such mortgages and therefore to compete for such mortgages.

At the same time, price comparison websites have become more popular and widely used, allowing customers more easily to compare products and make buying decisions based on price. Whilst the Bank aims to provide fair pricing to its customers there is a risk that there will always be a number of other providers offering better pricing that will attract customers who may otherwise have joined or stayed with the Bank. In consequence, there is a risk that industry pricing will be forced lower, impacting on the Bank's ability to deliver its strategic income targets and impacting on its financial performance.

For a number of years, the retail savings market has been under pressure from restrictions on households' ability to save, historically low interest rates and competition from banks seeking to lower their loan-to-deposit ratios and to reduce their reliance on wholesale funding. Notwithstanding the Funding for Lending Scheme (which has reduced competition for retail deposits by providing financial institutions with cheap funding), the net result of these pressures has been an increase in the relative price for retail savings, adversely impacting the Bank's ability to manage its net interest margin. The ratings downgrade, regulatory capital downgrade and other recent events impacting the Bank have also increased the costs of funding as the Bank has sought to manage its deposits offering to mitigate against the risk of customers leaving the Bank.

Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in increased residential mortgage and unsecured loan losses which would adversely impact the Bank's financial and operational performance.

The performance of the Bank's core retail lending portfolios (which excluded Optimum, a closed book of intermediary and acquired mortgage book assets) has been stable over the past three financial years, with levels of arrears that are below industry averages published by the Council of Mortgage Lenders (the **CML**). The number of the Bank's customers greater than 2.5 per cent. in arrears is 0.3 per cent. (excluding Platform and Optimum) at 30 June 2013 (CML average was 1.40 per cent. as of 30 June 2013). However, despite some deleveraging, the personal sector in the UK remains heavily indebted and vulnerable to increases in unemployment, rising interest rates and/or falling house prices.

Increased unemployment could lead to borrowers who lose their jobs being unable to service the loan payments in a timely fashion which would result in higher levels of arrears in both the Bank's secured residential mortgage loan and unsecured consumer loan portfolios which, in turn, would lead to an increase in the Bank's impairment charges in respect of these portfolios. Increased unemployment could also result in less demand for the Bank's products.

Rising interest rates would put pressure on existing and new borrowers whose loans are linked to the base rate or the Bank's variable rates and who may have become accustomed to the current low interest rate environment. A significant portion of the Bank's outstanding residential mortgage loan products are potentially subject to changes in interest rates. In particular, the Optimum portfolio, being a portfolio of predominantly interest-only intermediary and mortgage book assets (as at 30 June 2013, £7.3 billion) is particularly sensitive to changes in interest rates. By way of example, and to illustrate the sensitivity of this portfolio to a rise in interest rates, if interest rates were to rise by 2.5 per cent. management estimate the impact on credit losses of Optimum resulting from such a rise in interest rates would be approximately £200 million (on a purely single stress basis). In addition, borrowers with a mortgage loan that is subject to a variable rate of interest or where the interest rate adjusts following an initial fixed rate or low introductory rate are exposed to increased monthly payments as and when their mortgage interest rate adjusts upward (or, in the case of a mortgage loan with an initial fixed rate or low introductory rate, at the end of the relevant fixed or introductory period). In an increasing interest rate environment, borrowers seeking to avoid these increased monthly payments by refinancing their mortgage loans may no longer be able to find available replacement loans at comparably low interest rates and this could lead to an increase in arrears in the Bank's retail lending portfolios as well as an increase in the Bank's retail loan impairment charges. In addition, a significant portion of the Bank's outstanding unsecured loan portfolio is also subject to changes in interest rates.

A number of loans are also linked to LIBOR and such loans would be impacted by an increase in LIBOR, whether or not there is an increase in underlying interest rates. The Bank has approximately 21,000 customers with aggregate balances of £2.2 billion on a LIBOR-linked mortgage (out of a total of approximately 245,000 customers). Virtually all these customers hold a mortgage originated on the Optimum platform.

According to the seasonally adjusted Halifax House Price Index, average house prices in the UK peaked in Q3 2007 at almost £200,000 before falling steadily until Q1 2009 to £158,000. Average house prices have then remained delicately balanced and in the three quarters to Q2 2013 have recovered to £167,000. If UK house prices were to fall generally or in particular regions to which the Bank has significant exposure in response to renewed economic pressures and/or the actions of lenders seeking to realise the values of impaired assets, this would be likely to result in an increase in the Bank's retail loan impairment charges as the value of the security underlying its mortgage loans was eroded. In addition, a key assumption in the judgement of estimated future credit losses is the Bank's estimate of future house price index movements. Optimum, which had an average loan-to-value of 79.2 per cent. as at 30 June 2013, is particulary exposed to movements in house prices. If Optimum's future house price index movements were to differ from management's expectations with a deterioration of 5 per cent., the impact on credit losses would be £22.1 million.

As a result of recent government initiatives, there has been an increased interest in buy-to-let loans, with buy-to-let lenders advancing 40,000 buy-to-let loans in Q2 2013 resulting in £5.1 billion of mortgages according to data published by the CML. Both the number of buy-to-let loans and the value of lending were the highest since Q3 2008, a trend which the Bank expects will continue in the near term. Whilst the Bank intends to constrain volumes of new buy-to-let mortgages as a proportion of total new lending, as at 30 June 2013, the Bank had £1.1 billion buy-to-let loans in its Core Business and £2.1 billion in its Non-core Business. As at 30 June 2013, 90.6 per cent. of the Bank's buy-to-let loans were interest-only. These borrowers have been supported through the financial crisis by a combination of low interest rates, stable house prices and rising rents as first-time buyers have struggled to raise the required deposit to allow them to purchase their own homes. Whilst, as at 30 June 2013, the percentage of buy-to-let loans with greater than 2.5 per cent. in arrears was low, if interest rates were to rise and/or the economy were to weaken and place pressure on employment, incomes and/or house prices, the credit performance of the Bank's buy-to-let mortgage book (together with the Bank's retail mortgage book), may deteriorate, which in turn could adversely impact the Bank's financial and operational performance. In addition, the buy-to-let market has not been through a period of significant decline in house prices and therefore it is difficult to predict how buy-to-let investors will react.

Worsening economic and market conditions could result in increased commercial property loan losses beyond what the Bank has already provided for, which would adversely impact the Bank's financial and operational performance.

The Bank's portfolio of loans secured on commercial property amounted to £3.5 billion at 30 June 2013. The underlying credit quality of these loans has been negatively impacted by continued poor economic conditions. The Bank has segregated much of the Bank's commercial property loans into its non-core division, CoAM. These commercial loans had already suffered a significant degree of impairment prior to being placed into run-off.

However, the conditions which continue to adversely impact the commercial property market include:

- falling commercial property valuations, in part as a result of a general focus by banks across Europe on reducing their exposures to higher risk assets through portfolio sales and individual asset disposals;
- lower availability of debt and equity finance to support restructurings;
- uncertainties about the capital treatment of commercial real estate lending, with a trend towards higher regulatory capital requirements for commercial real estate lending;
- several high-profile tenant failures in recent years; and
- a continuation in the market trend for shorter lease life and of tenants exercising breaks.

All these factors reduce the certainty of cash flows and exacerbate shifts in collateral values and difficulties in refinancing. Reflecting these factors, it is possible that there may be further declines in collateral values in the next few years, particularly in secondary office and retail properties, with some recovery thereafter with the result that further impairments in connection with the Bank's remaining commercial loan property portfolio may occur.

A number of the Non-core Asset classes have a small number of borrowers accounting for a large proportion of the total loans outstanding.

As at 30 June 2013 the Bank's Non-core Business gross loans and advances to customers, totalled £14.9 billion of exposure of which 47.9 per cent. represented the Optimum mortgage book, 23.5 per cent. represented commercial real estate (**CRE**) borrowers, 11.4 per cent. represented general corporate borrowers, 7.2 per cent. represented private finance initiative (**PFI**) borrowers, 6.2 per cent. represented registered housing associations, 3.6 per cent. represented energy and 0.2 per cent. represented local authorities. The top ten exposures in each asset class represented 24 per cent. of CRE, 21 per cent. of general corporate borrowers, 29 per cent. of PFI, 58 per cent. of registered housing associations, 47 per cent. of energy and 41 per cent. of leveraged finance exposure.

The nature of such assets and the complexity of the issues potentially involved requires detailed and careful management. The Bank may, in appropriate circumstances, decide to increase lending to a borrower in order to better facilitate a more successful exit. The complexity of the risks involved also increase the possibility

of not being able to successfully exit or run down such assets given their complexity. The concentration within certain asset classes also increases the risk that a failure to achieve a timely exit or to achieve an exit in a capital neutral or accretive manner in respect of one or more of such assets will have a greater negative impact on the Bank's results of operation and financial position.

The Bank will continue to rely on Co-operative Group and the Co-operative brand. Co-operative Group will also continue to exert substantial influence over the Bank.

Immediately following completion of the Liability Management Exercise, Co-operative Group will own 30 per cent. of the issued ordinary share capital of the Bank.

While it remains a significant shareholder of the Bank, Co-operative Group will continue to have the power, among other things, to affect or influence the Bank's legal and capital structure and certain changes to its operations. The interests of Co-operative Group could conflict with those of the Bank or other shareholders, and this concentration of ownership may also have the effect of delaying, deferring or preventing the Bank's ability to effect certain types of transactions that require approval by Co-operative Group, including by special resolution. In addition, the separation between the Bank and Co-operative Group will provide a challenge to the Bank's operating model.

In order to manage these risks, the Bank has entered into a Relationship Agreement with Co-operative Group which, as from and conditional upon completion of the Liability Management Exercise, will regulate (in part) the relationship between and the degree of control that Co-operative Group and its subsidiaries may exercise over the Bank. In addition, as referred to in the Relationship Agreement, the Articles of Association of the Bank, which will be proposed for approval at a general meeting of the Bank to be held on 15 November 2013, grant Co-operative Group the right to appoint up to two members to the Board depending on the size of its holding of Ordinary Shares (see paragraph 20.3 titled "*Relationship Agreement*" in Section 20 (*Additional Information*) of this Prospectus for further details of the Relationship Agreement).

The Bank is also dependent on the strength of the Co-operative Bank brand, the wider Co-operative brand and its reputation with customers and potential customers of the Bank. Whilst the Bank seeks to manage material risks to the Co-operative brand through careful monitoring, ultimately the Bank is exposed to the risk that Co-operative Group acts in a way such as to bring the Bank brand into disrepute. For example, litigation, employee misconduct or the misconduct of anyone associated with the Co-operative brand, operational failures, accidents, the outcome of regulatory investigations, press speculation and negative publicity, disclosure of confidential customer information, inadequate products and services, amongst others, could negatively impact the Co-operative brand or Co-operative Group's reputation. Should, as a result, the Bank's brand, levels of customer satisfaction or the co-operative movement more generally be damaged, this would have a negative effect on the Bank's business, financial position and prospects and negatively impact the ability of the Bank to achieve its stated strategy.

In addition, the Bank will, following completion of the Liability Management Exercise, continue to be dependent on Co-operative Group for the provision of certain services, in particular IT (see "*The Bank's operations are highly dependent on the proper functioning of IT and communication systems. Any significant delay in or failure of the Bank to re-engineer its existing IT platform to meet the requirements of its business strategy may adversely affect the future operational and financial performance of the business*" and "*The Bank relies on the provision of a number of services (including certain critical functions) by Co-operative Group, including IT*", below). There can be no guarantee that these arrangements between Co-operative Group and the Bank will be sufficient for the Bank's future needs or that such provision of services will not be interrupted or cease altogether. If the contractual arrangements with Co-operative Group are terminated, the Bank may not find an alternative outsource provider or supplier for the services, on a timely basis, on equivalent terms without significant expense, or at all. The additional costs and expenses incurred in doing so may have a material adverse effect on the Bank's cost base. This could have a material adverse effect on the Bank's business and the results of its operations. In relation to certain other administrative services provided by Co-operative Group to the Bank (such as finance, marketing and human resources) the Bank expects to agree with Co-operative Group to bring such services back into the Bank and that (depending on the separation method pursued) staff may transfer to it from CFSMS as a result, but the Bank does not have certainty that, in that scenario, it will get the right number or skill set of staff to maintain the necessary service level (see paragraph 8 titled "*Separation*" in Section 8 (*Description of the Bank*)).

Furthermore, the Secretary of State for Business, Innovation and Skills may, under section 76(1) of the Companies Act 2006, direct the Bank to change its registered name if, in his opnion, it gives so misleading an indication of the nature of its activities as to be likely to cause harm to the public. The FCA has the power to prevent the use of the "co-operative" name, or to take other action regarding the Bank's branding, if the FCA considers this desirable to protect consumers, to promote competition in the interests of consumers or to protect the integrity of the UK financial system (note 2.55L(2)(c) and (3), s.55N and the FCA's objectives in s.1C, 1D and 1E of FSMA).

The Bank's strategy is based in part on leveraging the Bank's reputation as being fairer, more responsible and more trusted than its competitors. This is a key competitive advantage for the Bank and there is a risk that, as a result of the Recapitalisation Plan and the Bank's new ownership structure, the Bank's reputation as being fairer, more responsible and more trusted than its competitors may be undermined.

The Bank has been wholly owned by Co-operative Group, which is a mutual organisation owned by and run for the benefit of, its members. As a result, the Bank has sought to manage its business so as to target a higher quality of service and a superior product offering to its customers, sometimes including more customer attractive interest rates, rather than focusing specifically on profit maximisation.

Upon the successful completion of the Recapitalisation Plan, 70 per cent. of the equity of the Bank will be owned by its former lower tier 2 bondholders (i.e. the holders of the Dated Notes). As a result of the Bank's new ownership structure or as a result of implementing its newly adopted strategy, the Bank may find itself in conflict between its obligations to its new Ordinary Shareholders and its mutual ethos and heritage, in particular around profit maximisation and the steps required to implement certain elements of the Bank's strategy. There is a risk therefore that the Bank decides to follow a course of action which is inconsistent with the Bank's mutual ethos and heritage. This may, unless the consequential reputational damage is mitigated, make customers, depositors and investors unwilling to do business with the Bank which may, in turn, result in customer attrition. Furthermore, such conflict may lead to the Bank reconsidering all or certain aspects of its strategy, such as building on the Bank's co-operative brand strength and high levels of customer satisfaction (see paragraph 3 titled "*Strategy*" in Section 8 (*Description of the Bank*)).

The group of Holders of Dated Notes who were involved in the negotiation of the terms of the revised Recapitalisation Plan with the Bank and Co-operative Group (the **LT2 Group**) have acknowledged that the Bank is unique for its ethics, mission and heritage which are essential components of the Bank's differentiated approach and it is important to them that the Bank maintains its unique characteristics and ethos. Further, to ensure that the Bank continues to have a clear ethical focus, cooperative values and ethics shall be, for the first time, with the agreement of the Co-operative Group and the LT2 Group, been embedded in the constitution of the Bank and the Bank will set up a values and ethics committee, with an independent director as chair.

However, shareholders of the Bank may decide to remove those provisions of its constitution that entrench Co-operative values and ethics. The Bank has agreed principles of co-existence with Co-operative Group pursuant to which the use of trade-marks as between Co-operative Group and Bank is governed. Under this agreement, Bank's removal of those provisions without Co-operative Group's consent, would result in the Bank being obliged to cease exploitation of Co-operative Group's trademarks and ceasing to offer membership rights in Co-operative Group or any other benefits associated with being a co-operative. This would, in turn, under the Bank's current strategy, conflict with those aspects of its strategy focused on building on the co-operative brand strength and leveraging off the Bank's relationship with Co-operative Group and the Co-operative Group membership. It is therefore likely that the removal of these entrenched values and ethics would result in the Bank changing its strategy which could adversely effect the Bank's business and financial condition and results of operations and could damage its relationships with its regulators.

The Bank's operations are highly dependent on the proper functioning of IT and communication systems. Any significant delay in or failure of the Bank to re-engineer its existing IT platform to meet the requirements of its business strategy may adversely affect the future operational and financial performance of the business.

The Bank relies heavily on its operational processes and on IT and communication systems to conduct its business, including the pricing and sale of its products, payment processing, data collection, assessing acceptable levels of risk exposure, setting required levels of provisions and capital, and maintaining customer service and accurate records and security.

These processes and systems may not operate as expected, may not fulfil their intended purpose or may be damaged or interrupted by increases in usage, human error, unauthorised access, implementation/change activities, natural hazards or disasters or similarly disruptive events. Any failure of the Bank's IT and communications systems and/or third-party infrastructure on which the Bank relies, including that of Co-operative Group or other suppliers, could lead to significant costs and disruptions that could adversely affect the overall operational or financial performance of the business as well as harm the Bank's reputation, cause the Bank to breach its obligations as a regulated entity and/or attract increased regulatory scrutiny.

Notwithstanding anything in this risk factor, this risk factor should not be taken as implying that the Bank will be unable to comply with its obligations as a company with securities admitted to the Official List (as the case may be).

The Bank has recently undertaken a review of the IT resilience risks associated with the Bank's IT platform and infrastructure. The review has identified risks that fall broadly into the categories of "disaster recovery" "design of IT systems", "single points of failure", "end of life technology" and "third party suppliers". The output from this risk review has been shared with the PRA as part of their thematic review of IT resilience risks across the UK banking industry. The Bank has initiated a three-year IT resilience remediation programme which will remediate the critical risks identified by the review, and has committed significant additional investment to this programme. The resilience review also identified risks in the Bank's data centre facilities and the committed investment covers the required remediation activities. The Bank will continue to be subject to these risks until such time as it has completed its planned remediation activities, scheduled for the end of 2016 (and the intention is to prioritise remediation of high priority risks by the end of 2014 wherever possible). Any failure in systems as a result of not remediating the IT risks, or in the period to such remediation being completed, could adversely affect the Bank's ability to conduct its business and lead to the PRA imposing additional requirements on the Bank or subject the Bank to additional regulatory scrutiny.

There are also access control issues across the Bank that have been highlighted within past internal and external audit reports and internal assessments highlighting associated risk exposures. These issues include the overall governance of logical access and how access to data is managed within IT and the wider business. In response, there is targeted activity to address key areas of control weaknesses such as the Logical Access Management project. The need for further remediation is being assessed and will be reported to the Bank's Risk Committee.

The Bank had previously intended to replace key IT systems (including the existing core banking platform, and the applications that support the branch, internet and call centre channels) with a new core software platform which it had been developing or, had the planned acquisition of Lloyds TSB branches (the **Verde Business**) gone ahead, with the IT systems used by the Verde Business. The Bank has since undertaken a strategic review of its overall IT requirements against the backdrop of the strategy of the Core Business, and has agreed a new IT strategy. This strategy involves incremental re-engineering of the existing platform to create a target platform that supports the Core Business, including: introduction of new digital channel applications with improved capabilities as the Bank's digital channel offerings lag significantly behind its competitors; enhancements to the core mainframe platform to allow for simpler product development and management; improved reporting and analytics; and improved process and workflow automation. This re-engineering will be combined with simplification of IT systems in order to reduce running costs (as the IT running costs are currently above the Bank's industry peers) e.g. rationalisation of existing savings and mortgage platform. Cost reductions from improvements in IT operating efficiency will also be targeted although this will require management of the risk that these reductions reduce service below acceptable levels.

These IT initiatives are significant, both in terms of scale, complexity and cost and the Bank also has a poor historic track record of successfully implementing large-scale changes and therefore these initiatives involve delivery risk, although this is partially mitigated by the modular and iterative delivery approach that is being

adopted. Any significant delay in or failure of the Bank to deliver these IT re-engineering initiatives may result in significant additional investment costs and also significantly impact on the Bank's ability to achieve its business strategy, and may adversely affect the future operational and financial performance of the business. Whilst the investment costs continue to be assessed by the Bank, if investment costs materially exceed the level of cost that the Bank determines through the current assessment process, then the Bank would consider alternative IT strategies to implement the business strategy. The Bank recognises that there are aspects of the delivery of this re-engineering programme and the implementation of the IT strategy which will require the Bank to engage third parties to complement its intended delivery capability, in particular in respect of the digitalisation aspects of the programme (although others may be identified in due course).

As part of the Bank's wider strategy, the Bank is still in a process of transition from the merger with Britannia and is continuing to integrate heritage systems and processes. As a result, there are risks associated with the on-going integration of two organisations of the size of the Bank and Britannia. Particular areas of risk include: difficulties or unexpected costs relating to the integration of technology platforms, financial and accounting systems and difficulties or unexpected costs in realising synergies from the remaining consolidation of head office and back office functions. If the implementation of any such projects is not delivered on time, and/or the costs of implementation rise significantly and the Bank fails to exploit such projects once implemented, there is a risk that there could both be a delay to the future benefits, and an increased cost for the transformation process which may have an adverse effect on the Bank's business, financial position and results of operations.

The Bank relies on the provision of a number of services (including certain critical functions) by Co-operative Group, including IT.

The IT services provided by Co-operative Group include core infrastructure services, colleague technology services, network services, service management services (including change management services), architecture direction, architecture design, supplier management, IT programme management and management operations. For further information see paragraph 7 titled "*Technology/IP/IT*" in Section 8 (*Description of the Bank*).

It is intended that one of the IT functions which is currently provided to the Bank by Co-operative Group under the Existing IT Service Agreement will return to the Bank under a New IT Services Agreement (as defined in paragraph 20.1(a) titled "*IT Services Agreement*" in Section 20 (*Additional Information*)), the terms of which are to be finalised. The returned function is IT service continuity and disaster recovery. Under the New IT Services Agreement the Bank would manage the Bank's receipt of Co-operative Group's provision of these services. For further information please see paragraph 20.1(a) titled "*IT Services Agreement*" in Section 20 (*Additional Information*). Following completion of the Liability Management Exercise, a significant majority of the IT functions provided to the Bank by Co-operative Group are expected to return, over time, to the Bank.

In addition, the Bank relies on Co-operative Group to provide certain services in respect of finance (including procurement), marketing, human resources, risk, corporate affairs, secretariat (governance), secretariat (legal), estates and investment property management functions. Some of these services are critical to maintaining the level of support for the on-going needs of the business and customers. Please see paragraph 20.1 titled "*Project Unity*" in Section 20 (*Additional Information*) for further details of these services.

The Bank intends that certain services which are currently provided to the Bank by Co-operative Group under the Existing MSA will return to the Bank on completion of the Liability Management Exercise under a New MSA (as defined in paragraph 20.1(b) titled "*MSA*" in Section 20 (*Additional Information*), the terms of which are under negotiation. These include secretariat services and corporate affairs. Under the New MSA the Bank would control and direct Co-operative Group's provision of these and other services. Please see paragraph 20.1(b) titled "*MSA*" in Section 20 (*Additional Information*) for further details. As described in paragraph 8 titled "*Separation*" in Section 8 (*Description of the Bank*), the Bank and Co-operative Group shall be considering further changes to the arrangements under the current MSA such that, following completion of the Liability Management Exercise, all services that would otherwise have been provided by Co-operative Group to the Bank under the MSA will return to the Bank.

The concentration of responsibility for providing a wide range of services with Co-operative Group, as a single supplier, increases the risk that any event or series of events impacting the ability of Co-operative Group to provide the services or perform its other obligations (such as an event of *force majeure* or an insolvency event) would have an impact on the Bank's ability to conduct its business.

Under the New IT Services Agreement and New MSA, to the extent implemented in their current form, the Co-operative Group would be required to provide the services in accordance with Co-operative Group policies, except where Co-operative Group and the Bank agreed that a Co-operative Bank policy should apply in substitution for a Co-operative Group policy. The Bank would be able to require that a Co-operative Bank policy is followed where required by applicable law or a regulator. As a result, Co-operative Group would seek to provide these services in a way that enables it to comply with its policies (e.g. its ethical policies which may be detrimental to the business of the Bank).

If Co-operative Group fails to provide or procure the services envisaged or provide them in a timely manner or to agreed levels under either of the Existing IT Services Agreement or Existing MSA, such failure could have a material adverse effect on the Bank's business, prospects, results of operations and financial position.

The Bank is dependent on third party providers of services, IT, software, data and other assets.

There is a risk that third-party providers will fail to supply services, IT, software, data or other assets. If third party providers fail to provide or procure the services envisaged or to provide them in a timely manner or to agreed levels, or the arrangements with those providers are terminated by the third party, such failure could have a material adverse effect on the Bank's business, prospects, results of operations and financial position. The Bank may be unable to source an alternative provider for the services, IT, software, data or other assets on a timely basis, on equivalent terms or without significant expense, or at all. The additional costs and expenses incurred in doing so may have a material adverse effect on the Bank's cost base. This could have a material adverse effect on the Bank's business and the results of its operations.

Any reduction in third party product quality or any failure by a third party to comply with the Bank's licensing or regulatory requirements, including requirements with respect to the handling of customer data, could cause a material disruption to or adverse financial and/or reputational impact on the Bank's business. Any of these events could have a material adverse effect on the Bank's business, prospects, results of operations and financial position.

The Bank is dependent on CFSMS to provide certain personnel and assets, and to on-supply certain services, data and assets supplied by third party providers.

A significant proportion of third party services and assets are procured by CFSMS for the benefit of the Bank and other members of Banking Group.

CFSMS was established as a wholly-owned subsidiary of Banking Group to facilitate economies of scale through the sharing of employees and the sourcing of third party services across Banking Group, including the Bank. It employs the majority of personnel within Banking Group. Banking Group utilises employees across its different businesses. As such, the Bank procures certain assets and third party services (including services provided by Steria Limited and SAS Software Limited) through CFSMS. The Bank receives third party services and assets with the support of procurement service provided by Co-operative Group, but the agreements under which those assets or third party services are provided are entered into by CFSMS.

As a result, the Bank is reliant on CFSMS to on-supply services, staff and assets to Bank. As part of the proposed separation (see paragraph 8 titled "*Separation*" in Section 8 (*Description of the Bank*)) the Bank intends to transfer from CFSMS the employees, assets and contracts it uses pursuant to the CFSMS-Bank 2006 Agreement, so that it is significantly less reliant on CFSMS to provide personnel and services to conduct its day-to-day activities. To the extent that these transfers or alternative arrangements cannot be implemented before completion of the Liability Management Exercise, the Bank's current proposal that the Bank and CFSMS will enter into a new agreement to replace the CFSMS-Bank 2006 Agreement, for the purpose of (amongst other reasons) ensuring the Bank has robust contractual recourse should CFSMS fail to deliver assets or secondees or fail to enforce the terms of any third party agreement under which those supplies are obtained or otherwise is in breach. A summary of the draft terms of the amended CFSMS-Bank Framework Agreement is set out in paragraph 20.2 titled "*CFSMS – Bank Framework Agreement*" in Section

20 (*Additional Information*). However, until such agreement can be reached, the current arrangements will continue with the consequential risk of significant additional VAT charge for the Bank and reliance on CFSMS staff on terms that are not sufficiently robust.

It may not be possible to agree new arrangements pursuant to which Co-operative Group and CFSMS will continue to provide services, personnel and assets to Bank. A failure or delay in agreeing the new arrangements will result in, amongst other things, a significant VAT charge for the Bank. The new arrangements may be less favourable to Bank than the existing arrangements.

The Bank is dependent on Co-operative Group for the provision of a number of services and is dependent on CFSMS for the provision of certain personnel, assets and the on-supply of certain third party services (see "*The Bank relies on the provision of a number of services (including certain critical functions) by Co-operative Group, including IT*" and "*The Bank is dependent on CFSMS to provide certain personnel and assets, and to on-supply certain services, data and assets supplied by third party providers*" above). There are a number of agreements in place to govern these arrangements (the "**Existing Service Agreements**").

In light of the fact that, on completion of the Liability Management Exercise, the Bank will cease to be part of the same group as Co-operative Group and CFSMS, the Bank, Group and CFSMS are currently renegotiating the terms of the Existing Service Agreements with a view to ensuring that the replacement arrangements are appropriate to reflect this fact.

As the terms of the replacement arrangements are still the subject of negotiation, there is a risk that the scope of or terms upon which the services are agreed to be provided to Bank may not be as favourable to Bank as the terms of the current arrangements or that Bank may not receive all the personnel, use of assets or services which it requires. In such circumstances, the Bank will be dependent on sourcing such personnel, assets or services from elsewhere and there is no guarantee that the Bank will be able to source such personnel, assets or services, to do so within a reasonable period of time, or to do so on favourable terms.

If, and for so long as, the terms of the new agreements cannot be agreed, the Existing Service Agreements will continue to apply with the result that the Bank would incur a significant VAT cost from completion of the Liability Management Exercise as a result of VAT becoming payable in respect of the services, as the Bank and Co-operative Group will no longer be in the same VAT group. In relation to staff, continuation of the Existing Service Agreements will result in the Bank continuing to have to rely on CFSMS for the provision of the majority of the staff in its business. In addition, if, and for so long as, the terms of the Existing Service Agreements continue to apply, Co-operative Group and CFSMS will continue to be able to terminate those agreements on relatively short notice with the consequence that, should they do so, the services provided under the Existing Service Agreements may cease before appropriate replacement arrangements have been found. Consequently, failure to reach agreement on the replacement arrangements could have a material adverse effect on the Bank's business, prospects, results of operations and financial position.

The Bank's requirement for standalone insurance arrangements.

The Bank has historically participated in Co-operative Group's insurance programme. On completion of the Liability Management Exercise, the Bank will need to arrange its own insurance on a standalone basis. As at the date of this Prospectus, there is no guarantee that the cover which the Bank will be able to obtain on a standalone basis will be equivalent to that available to it under Co-operative Group's programme, whether in respect of the level, pricing and terms (including continuity) of cover.

The contributions that the Bank is required to make to its pension schemes may change over time. The Bank may be obliged to make large one-off payments to the pension schemes if certain events occur.

Co-operative Group operates several pension schemes. The main Co-operative Group pension scheme is Pace, which provides defined contribution and defined benefit pensions for current employees and former employees. The Bank participates in Pace. In addition, Co-operative Group operates several other pension schemes, including the Britannia Pension Scheme (the **Britannia Scheme**). The Bank is a guarantor in respect of the Britannia Scheme.

The assets of the pension schemes are held and managed by trustees separate from the Bank's assets. At present there is an actuarial deficit in Pace, with the most recent actuarial report indicating that there was a funding deficit of £715 million as at 5 April 2013. The employers participating in Pace make aggregate contributions towards the deficit as agreed between Co-operative Group and the trustee of Pace following the advice of the independent scheme actuary. These contributions are reviewed by the trustee and Co-operative Group following each triennial actuarial valuation. The time by which the trustees and Co-operative Group are required, under pensions legislation to agree contributions is 15 months after the effective date of the valuation, although this deadline can often be extended. This may lead to an increase in the rate of contributions the participating employers are required to make to the scheme. Co-operative Group conducts negotiations with the trustee of Pace on behalf of all the employers in Pace and then allocates the agreed aggregate employer contributions among the participating employers. Although Co-operative Group seeks input from the Bank in connection with the valuation process, ultimately the Bank's contributions can be determined by Co-operative Group without the Bank's agreement. However Co-operative Group has undertaken to agree with the Bank its proportion of the employer contributions to Pace (if not agreed, the matter will be referred to an independent third party).

CFSMS is the employer in relation to the Britannia Scheme and charges the Bank for any payments due to the scheme in respect of members employed by CFSMS and working for the Bank. This means that the Bank is charged for contributions to the Britannia Scheme which have historically been determined without any input from the Bank. However, Co-operative Group has undertaken to procure that if CFSMS is not controlled by the Bank, CFSMS will not take or omit to take any action without the Bank's prior agreement if the result would be to increase the Bank's liabilities or contributions in respect of the Britannia Scheme. In addition the Bank has also provided guarantees in respect of the Britannia Scheme under which the Bank may become liable to contribute towards that scheme. The most recent actuarial report indicated that the funding deficit in the Britannia Scheme as at 5 April 2013 was £61 million.

Risk arises from the schemes because the value of their asset portfolios and returns from them may be less than expected and because there may be greater than expected increases in the estimated value of the schemes' liabilities (for example, due to rates of investment return, pensioner mortality, changes in interest rates, changes in pension regulations, changes in expenses (including the Pension Protection Fund levy) and changes in the trustees' view of the strength of the employer). In these circumstances, the Bank could be obliged, or may choose, to make additional contributions to the pension schemes.

Liabilities may also arise for the Bank as an employer participating in a defined benefit pension scheme (or as the guarantor of such employers) in certain circumstances set out in legislation, for example on ceasing to participate in the pension scheme or becoming insolvent. The liability will be the value of the employer's share of the deficit at the time, calculated by reference to the cost of buying out the scheme's liabilities in the insurance market (which commonly produces a greater deficit than the ongoing funding deficit – in some cases a substantially greater deficit). No formal calculations have been undertaken in respect of what the Bank's share of such deficit would be, and if calculated it could be very large. Co-operative Group has the power under the rules of Pace to require the Bank (or any other participating employer) to cease to participate in Pace; exercise of that power would result in a liability for the Bank of this type. However Co-operative Group has undertaken not to exercise its powers without the Bank's prior written approval except (i) where the Bank is in breach of the rules of Pace, (ii) where required by law or (iii) where all other employers cease participation at the same time so that a liability of this type does not arise. Further, if the Bank sought to address its risks as a participating employer in Pace by terminating its participation, a liability of this nature would result.

It is possible to agree arrangements that would reduce the Bank's liability on termination of participation in Pace. Any such arrangement would require the consent of the trustees of Pace and in some cases of Co-operative Group and the Pensions Regulator. No arrangements have been agreed and there is a risk that none can be agreed.

If CFSMS terminated its participation in the Britannia Scheme (for example as part of separating the Bank's pension arrangements from Co-operative Group's), CFSMS would incur a liability as described above which would have to be met by the Bank. Any arrangement to reduce CFSMS's liability would require the consent

of the trustees of the Britannia Scheme and in some cases of the continuing sponsoring employer after CFSMS's exit. No arrangements have been agreed and there is a risk that none will be agreed.

Pace is a non-segregated, hybrid pension scheme in which several Co-operative Group companies participate, including the Bank. On an on-going basis, each employer is responsible for funding a proportion of the Pace liabilities, as determined by Co-operative Group, subject to Co-operative Group's undertaking to agree the Bank's proportion with the Bank. In addition, there are circumstances in which funding from an employer may be required for liabilities relating to members' service with another employer. In particular, where other employers in Co-operative Group have ceased to participate in the pension scheme without satisfying their liabilities (for example due to insolvency) the Bank's share of the deficit could include liabilities relating to those other employers, up to the level of the entire deficit in the scheme (calculated on the insurance buy-out basis mentioned above).

The Pensions Regulator also has the power to require an employer of a defined benefit scheme or a person connected or associated with it to make a contribution to or provide financial support for that scheme in certain circumstances. There are eight defined benefit pension schemes within the Co-operative Group in addition to Pace and the Britannia Scheme and there is a risk that the Pensions Regulator could impose liability in respect of any of these Co-operative Group pension schemes on the Bank. Such liability could have a material adverse affect on the Bank.

Co-operative Group has engaged in discussions with the trustees of the pension schemes and the Pensions Regulator. These discussions have centred on the effect on the pension schemes of the turnaround plan, in particular on the future funding of the pension schemes and the position of the trustees as creditors compared with that of other creditors. These discussions have not yet concluded and Co-operative Group continues to seek to satisfy the trustees and the Pensions Regulator on the matters they have raised.

The burden on the Bank of the Financial Services Compensation Scheme, which imposes significant levies on the Bank, may increase in future periods.

FSMA established the FSCS, which pays compensation to eligible customers of authorised financial services firms which are unable, or are likely to be unable, to pay claims against them. An institution's FSCS levy is linked to its share of the UK deposit market, and therefore its FSCS levy may have a material impact on its profits. As at the date of this Prospectus, a number of claims against the FSCS have been triggered. Claims on the FSCS are funded by loans from HM Treasury, and until such loans are repaid, increased levies on UK deposit-taking institutions fund interest payments on such loans. As a result of the various claims under the FSCS, the Bank, in common with all regulated UK deposit takers, has recently been subject to significantly increased FSCS levies. In certain circumstances, regulated UK deposit takers may further be required to fund, by way of a further increase in the FSCS levy, the capital repayment to HM Treasury of such loans. There can also be no assurance that there will be no actions taken under the Banking Act that may lead to future claims against the FSCS, and concomitant increased FSCS levies payable by the Bank (and other regulated UK deposit takers), which may have a material adverse effect on its results of operations.

Based on its share of protected deposits, the Bank pays levies to the FSCS to enable the scheme to meet claims against it. The amount provided for in the Bank's accounts to meet its obligations to the FSCS was £38.4 million as at 30 June 2013. While it is anticipated that the substantial majority of claims will be repaid wholly from recoveries from the institutions concerned, there is the risk of a shortfall, such that the FSCS may place additional levies on all FSCS participants, which levies may be in significant amounts that may have a material impact on the Bank's profits. For example, in March 2012 the FSCS and HM Treasury agreed the refinancing of £20.4 billion in loans made to the FSCS by HM Treasury to fund the compensation payments made by the FSCS to customers whose savings were put at risk by bank failures in 2008 and 2009. As a result, the FSCS was required to pay a significantly increased amount of interest which it will recover through additional levies on the financial services industry. Following recoveries since March 2012, the FSCS currently has outstanding loans of approximately £17.3 billion.

As noted above, in common with other financial institutions which are subject to the FSCS, the Bank also has a potential exposure to future FSCS levies resulting from the failure of other financial institutions and consequential claims which arise against the FSCS as a result of such failure. The quantification and timing of such losses are, accordingly, yet to be determined and, therefore, although the Bank's share could be

significant (reflecting the fact that the share is calculated by reference to the level of each institution's protected deposits and, for the scheme year 2012/2013, the Bank's share of such deposits was 3 per cent.), the Bank has not made any provision in respect of such levies yet.

Historically, compensation scheme levies similar to the FSCS have tended to increase over time (especially during and in the aftermath of periods of economic crisis), and there can also be no assurance that there will not be any further claims against the FSCS and concomitant increased FSCS levies payable by the Bank. Any such increases in the Bank's costs and liabilities related to the levy may have a material adverse effect on the results of operations of the Bank. In July 2012, the FCA published a consultation paper as part of its FSCS Funding Model Review (**FFMR**). The FFMR will concentrate on issues such as the composition of the nine funding classes, the levy thresholds applicable to each and their tariff bases. However, the methodology for determining levies per institution will be driven primarily by revisions to the EU Deposit Guarantee Scheme Directive (**DGSD**). The European Commission published a legislative proposal in July 2010. The main changes proposed included a tighter definition of deposits, a requirement that the Deposit Guarantee Scheme pay customers within a week and that banks must be able to provide information on the aggregated deposits of a depositor, known as the single customer view, at any time. On 12 June 2013 the European Council announced that the negotiations on revisions to the DGSD were on hold, pending further development on the RRD.

As a result of the structural reorganisation and reform of the UK financial regulatory authorities, the FSCS is now the responsibility of the FCA. It is possible that future policy of the FSCS and future levies on the Bank may differ from those at present, and such reforms could result in the Bank incurring additional costs and liabilities, which may adversely affect its business, financial condition and/or results of operations.

During 2012, the FSCS indicated that it expected to raise a capital levy to cover the estimated shortfall in the amounts recovered from the failed banks to repay HM Treasury loans made to the FSCS. The Bank has provided £11.6 million (30 June 2012: £nil) in respect of its share of this levy.

Reputational risk could cause harm to the Bank and its business prospects.

The Bank's reputation is one of its most important assets and its ability to attract and retain customers and conduct business with its counterparties could be adversely affected to the extent that its reputation or the reputation of its brand is damaged. Failure to address, or appearing to fail to address, various issues that could give rise to reputational risk could cause harm to the Bank and its business prospects. Reputational issues include, but are not limited to:

- the reputational damage arising from the downgrades to the Bank's credit ratings and the implementation of the Recapitalisation Plan;
- litigation or objections from creditors in connection with the Liability Management Exercise or the Recapitalisation Plan as a whole and associated media coverage;
- being required to raise further capital in the future, which could affect, or be perceived to affect, confidence in the Bank;
- failure to implement the Bank's strategy;
- a reduction in the Bank's' customer service levels resulting from cost-cutting to the Bank's Core Business and/or the reorientation of the Bank's distribution channels;
- the Bank no longer being owned by Co-operative Group with the result that the mutual and ethical reputation of Co-operative Group could conflict with the profit maximisation objective of other holders of Ordinary Shares and the Board's duties to such shareholders;
- an impact to the Bank's reputation as a result of an action of Co-operative Group which adversely impacts the Bank brand, including as a result of adverse findings following from any legal or regulatory investigation into the Bank's conduct, in particular criticism arising from the independent Kelly Review into the events which led to the announcement of the Bank's Recapitalisation Plan, which is due to report to Co-operative Group's members' annual general meeting in May 2014;

- failing to appropriately address potential conflicts of interest;
- breaching or facing allegations of having breached legal and regulatory requirements (including money laundering and anti-terrorism financing requirements and conduct risk events such as past business reviews);
- acting or facing allegations of having acted unethically (including having adopted inappropriate sales and trading practices);
- failing or facing allegations of having failed to maintain appropriate standards of customer privacy, customer service and record-keeping;
- technology failures that impact upon customer services and accounts;
- internal fraud, such as market manipulation;
- failing to properly identify legal, reputational, credit, liquidity and market risks inherent in products offered; and
- generally poor company performance.

A failure to address these or any other relevant issues appropriately could make customers, depositors and investors unwilling to do business with the Bank, which could adversely affect its business, financial condition and results of operations and could damage its relationships with its regulators. The Bank cannot ensure that it will be successful in avoiding damage to its business from reputational risk.

In past years the Government has provided significant support to UK financial institutions, including most recently the Funding for Lending Scheme which commenced on 1 August 2012 and to which an extension was announced on 24 April 2013. Any significant reduction or withdrawal of the Funding for Lending Scheme could increase competition for other sources of funding which could adversely impact the Bank.

In past years the Government has provided significant support to UK financial institutions, including through the Special Liquidity Scheme, which is the liquidity scheme introduced by the Bank of England on 21 April 2008 for certain financial institutions, which was introduced in April 2008 to improve the liquidity position of the banking system by allowing banks and building societies to swap their high-quality mortgage-backed and other securities for UK Treasury Bills for up to three years, and the Credit Guarantee Scheme, which was introduced in October 2008 and under which the Government guaranteed eligible bank and building society debt securities for a limited period.

On 1 August 2012, the Funding for Lending Scheme became operational. The aim is to boost the incentive for banks and building societies to lend to UK households and non-financial companies. The Funding for Lending Scheme is designed to reduce funding costs for participating institutions so that they can make loans cheaper and more easily available. Access to the Funding for Lending Scheme is directly linked to how much each institution lends to the real economy. Those that increase lending are able to borrow more and at a lower cost than those that scale back their loans. Under the Funding for Lending Scheme, participating financial institutions are, for a period of 18 months to the end of January 2014, able to borrow funds with a maturity of up to four years. On 24 April 2013, the scheme was extended for a further 12 months, with drawings now permitted until the end of January 2015 and the funding under the scheme now running until January 2019. The Bank accessed the Funding for Lending Scheme in the first half of 2013, drawing £900 million of Treasury Bills. The Treasury Bills remain available to the Bank until March 2017. The fee payable under the scheme is linked to net lending growth and therefore may increase.

The availability of Government support for UK financial institutions, to the extent that it provides access to cheaper and more attractive funding than other sources, reduces the need for those institutions to fund themselves in the retail or wholesale markets. Any significant reduction or withdrawal of Government support will increase funding costs for those institutions which have previously utilised that support. In addition, other financial institutions that have relied significantly on Government support to meet their funding needs will also need to find alternative sources of funding when that support is reduced or withdrawn and, in such a scenario, the Bank expects to face increased competition for funding, particularly retail

funding on which it is reliant, in the future. This competition could further increase its funding costs and thereby adversely impact its results of operations and financial position.

The extension to the Funding for Lending Scheme announced in April 2013 has skewed the incentive towards lending to SMEs, by weighting net lending to that sector by a factor of 10 in 2013 and 5 in 2014. This will benefit eligible institutions which are seeking to reduce the residential mortgage element of their balance sheets but which are still providing loans to SMEs. As the Bank is seeking to reduce its exposure to commercial real estate lending but does conduct some lending with SMEs, there is a risk that its competitive position will be damaged through other institutions having greater access to new Funding for Lending Scheme funds that the Bank does not enjoy, with the result that the Bank might not be able economically to match the pricing of those competitors in the mortgage market.

The Bank's guidelines and policies for risk management may prove inadequate for the risks faced by its business and any failure to properly manage the risks which it faces could cause harm to the Bank and its business prospects. Certain controls have not in the past operated effectively

The management of financial, operational and legal risks requires, among other things, robust guidelines and policies for the accurate identification and control of a large number of transactions and events. In addition, the Bank's board is responsible for setting the overall Bank risk strategy, identifying the key business risks facing the Bank and planning the Bank's risk strategy and the acceptable level of risk appetite. The Bank's risk management guidelines and policies may not always prove to be adequate in practice. The operation of controls over credit risk have, in the past, not operated effectively and not adequately brought issues to the attention of senior management quickly enough. In recognition of this, credit risk controls were recently reviewed by senior management and external advisers, and such controls have been tightened.

Until September 2013, Banking Group maintained a common governance, organisational and risk management structure. From September 2013, and as a result of the separation of the Bank from Co-operative Group, the Bank has put in place its own revised, updated and independent risk management framework. The revised and updated risk management framework and policies have been adopted by the Bank, however these policies will take time to be embedded within individual business units, in particular in relation to awareness of responsibilities. In addition, whilst the revised overall risk management framework (and supporting documented risk policies) adheres to a clear three lines of defence model, there are still occasions where the first and second lines are blurred and improvements are still required to be made to the third line of defence, in particular improving the capability of the internal audit team. Prior to implementing changes to the internal audit team, the Bank is utilising outsourced resources from Deloitte to support its internal audit function. For further information of the Bank's risk management framework, see Section 14 (*Risk Management*).

The Bank faces a wide range of risks in its business activities, including, in particular:

- credit risk is the risk that a borrower or a counterparty fails to pay interest or to repay the principal on a loan or other financial instrument;
- liquidity risk, see the risk factor titled "*The Bank's business is subject to inherent risks concerning liquidity, particularly if the availability of traditional sources of funding such as retail deposits becomes limited and/or becomes more expensive, and this may have an adverse effect on the Bank's business, profitability and its ability to meet its liabilities as they fall due*" above;
- 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. The Bank's Treasury function also creates market risk through its various portfolio management and trading activities along with currency risk;
- interest rate risk (a type of market risk) is the risk arising out of changes in interest rate levels, yield curves and spreads, which may affect the Bank's interest rate margin realised between lending and

borrowing costs. Changes in currency rates, particularly in the sterling-dollar and sterling-euro exchange rates, affect the value of assets and liabilities denominated in foreign currencies and may affect income from assets and liabilities denominated in foreign currency. The performance of financial markets may also cause changes in the value of the Bank's investment and liquidity portfolios. The Bank seeks to minimise the volatility of future earnings from interest rate changes and all fixed interest rate risk exposure is removed from the Core Business and the Non-core Business and consolidated at the centre where it is managed from the core balance sheet within agreed limits. The Bank's Treasury function is responsible for interest rate risk management for the Bank;

- model risk is the risk that an adverse outcome occurs as a direct result of weaknesses or failures in the design or use of a model. Models are mathematical representations of business systems designed to help describe, predict, experiment with or optimise decisions and scenarios and are used throughout the Bank's business;
- operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or external events. The operational risk control framework is in the process of being strengthened to ensure that it meets regulatory requirements; and
- pension risk is the risk arising from exposure to scheme liabilities (to the extent liabilities are not met by scheme assets) and risks inherent in the valuation of scheme liabilities and assets.

In the past, there have been failings by the Bank's business units to adhere to the Bank's credit risk policies, including in respect of the origination and documentation of corporate loans. Weaknesses in the credit challenge and control process resulted in such failings not being brought to the attention of senior management quickly enough. These historic failings contributed to the impairment charges on the Bank's corporate loans, which were recognised in the financial year ended 31 December 2012 and the six month period ended 30 June 2013. As a consequence, and in March 2013, the Bank launched an internal review of its credit controls, in order to establish more robust control standards and to improve the ability of the Bank to identify and anticipate credit risk issues. In addition, a number of independent reviews, in particular in relation to corporate credit risk, have been undertaken by independent advisers. Consequential to such internal and external reviews, the Bank has documented and approved new credit control standards, and a number of changes have been made to limit the amount of credit control and discretion which can be exercised within the business units themselves, and more detailed checks are now being performed by the credit risk function. These reviews did not result in any amendments to the impairment provisions recorded in prior financial years. There can be no guarantee that the Bank's new control standards will be sufficient to minimise further credit losses in the future.

The Bank has a range of tools designed to measure and manage the various risks which it faces. These methods may prove to be inadequate for predicting risk exposure, which may prove to be significantly greater than is predicted. Methods for risk management are based on evaluation of information regarding markets, customers or other information that is publicly known or otherwise available to the Bank. Such information may not always be correct, updated or correctly evaluated. In addition, even though the Bank constantly measures and monitors its exposures, there can be no assurance that its risk management methods will be effective, particularly in unusual or extreme market conditions. It is difficult to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on the Bank's financial performance and business operations.

The Bank's business and financial performance would be adversely affected by a break-up of the single European currency.

In recent years, there has been significant volatility in financial markets around the world. The financial turbulence in 2008 and its after-effects on the wider economy have led to generally more difficult earnings conditions for the financial sector and, at the time, resulted in the failures of a number of financial institutions in the United States, the UK and elsewhere in Europe and unprecedented action by governmental authorities, regulators and central banks around the world. A number of countries in Europe, such as the GIIPS countries, together with Cyprus, have been particularly affected by the difficult financial and economic conditions since 2008 and are struggling with large sovereign debts and/or public budget deficits. These factors, together with weak economies and disruption in the capital markets, necessitated a range of international rescue packages

and other assistance, including for Greece and Ireland in 2010, Portugal in 2011, Greece and Spain in 2012 and, most recently, Cyprus in March 2013. The perceived risk of default on the sovereign debt of certain of the GIIPS countries intensified in the latter part of 2011 and into 2012, particularly in relation to Greece. This raised concern about the contagion effect such a default would have on other EU economies as well as the on-going viability of the euro currency and the Economic and Monetary Union (**EMU**).

Reflecting these and other concerns, in January 2012 one of the major international credit rating agencies lowered its long-term ratings in respect of nine European sovereigns, further increasing market uncertainty. Furthermore, the effectiveness of the actions aimed at stabilising European economies and reducing debt burdens is not assured and the possibility remains that the euro could be abandoned as a currency by countries that have already adopted its use or, in an extreme scenario, abandonment of the euro could result in the dissolution of the EMU. This would lead to the re-introduction of individual currencies in one or more EMU Member States. The effects on the European and global economies of the potential dissolution of the EMU, exit of one or more EU Member States from the EMU and the redenomination of financial instruments from euro to a different currency, are impossible to predict fully.

However, if any such events were to occur they would likely:

- result in significant market dislocation;
- heighten counterparty risk; and
- affect adversely the management of market risk and, in particular, asset and liability management due, in part, to redenomination of financial assets and liabilities.

If any such events were to occur, the Bank would be immediately exposed to certain potential losses on its portfolio of treasury assets and to redenomination risks as one or more individual countries introduced new currencies. However, as the Bank is a UK-focused retail and commercial operation it has no sovereign exposure to the GIIPS countries but does have sovereign exposures to other Eurozone governments. As at 30 June 2013, the Bank had a £306.6 million gross exposure to the Government of Finland, and £226.5 million to the Federal Republic of Germany, as well as, by way of exposure to non-Eurozone countries, £91.2 million to the Swedish Export Credit Corporation, repayable in over one year. It held no other material non-UK sovereign debt.

The Bank anticipates that the occurrence of any of the events described above would be likely to adversely impact the cost and availability of wholesale funding, thereby increasing competition for retail funds and adversely impacting the Bank's net interest margin.

The Bank could be negatively affected by a deterioration or a perceived deterioration in the soundness of other financial institutions and counterparties.

Given the high level of interdependence between financial institutions, the Bank is and will continue to be subject to the risk of deterioration of the commercial and financial soundness, or perceived soundness, of other financial services institutions. Within the financial services industry, the default of any one institution could lead to defaults by other institutions. Concerns about, or a default by, one institution could lead to significant liquidity problems, losses or defaults by other institutions, as was the case after the bankruptcy of Lehman Brothers in 2008, because the commercial and financial soundness of many financial institutions may be closely related as a result of their credit, trading, clearing or other relationships. Even the perceived lack of creditworthiness of, or questions about, a counterparty may lead to market-wide liquidity problems and losses or defaults by the Bank or by other institutions. This risk is sometimes referred to as "systemic risk" and may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with whom the Bank interacts on a daily basis. Systemic risk could have a material adverse effect on the Bank's ability to raise new funding and on its business, financial condition, results of operations, liquidity and/or prospects.

The Bank routinely executes a large number of transactions with counterparties in the financial services industry, resulting in large daily settlement amounts and significant credit exposure. As a result, the Bank faces concentration risk with respect to specific counterparties and customers. A default by, or even concerns

about the creditworthiness of, one or more financial services institutions could therefore lead to further significant systemic liquidity problems, or losses or defaults by other financial institutions.

Changes in the Bank's accounting policies or in accounting standards could materially affect how it reports its financial condition and results of operations.

From time to time, the International Accounting Standards Board (the **IASB**) and/or the EU change the international financial reporting standards issued by the IASB, as adopted by the European Commission for use in the EU (**IFRS**) that govern the preparation of the Bank's financial statements. These changes can be difficult to predict and could materially impact how the Bank records and reports its financial condition and results of operations. In some cases, the Bank could be required to apply a new or revised standard retroactively, resulting in restating prior period financial statements.

For example, amendments to International Accounting Standard 19 (**IAS 19**) are effective for accounting periods beginning on or after 1 January 2013. The amendments update the recognition, presentation and disclosures of retirement benefit plans. The most significant change in the treatment of defined benefit plans is the replacement of the expected return on plan assets and interest cost with a single measure of net interest income (or expense) based on the net retirement benefit asset (or obligation). The Bank is a participating employer in Pace. Pace is a non-segregated hybrid scheme providing defined contribution and defined benefit pensions for current employees and former employees. The Bank accounts under IAS 19 for its payments to Pace on a defined contribution basis, which are recognised as an expense on the income statement as incurred and based on a fixed percentage as agreed with the trustees. The Bank expects to adopt amended IAS 19 in its financial statements for its financial year ending 31 December 2013, however this amendment will not lead to a change in the pension costs disclosed by the Bank on the defined contribution basis.

In addition, changes to International Financial Reporting Standard 9 (Financial Instruments: Recognition and Measurement) (**IFRS 9**), which are due to become effective in relation to accounting periods beginning on or after 1 January 2015, address phase 1 of the IASB's project to replace International Accounting Standard 39, Financial Instruments: Recognition and Measurement. The changes will require the Bank to classify its financial assets either at amortised cost or at fair value and the available for sale category for financial assets currently used by the Bank will cease to be available. In addition, where the Bank opts to fair value its financial liabilities under IFRS 9, the movement in fair value due to own credit risk will be directly recognised in other comprehensive income unless this results in an accounting mismatch. Currently, other than derivatives which are required, to be carried at fair value, the Bank only fair values its liabilities on 'Customer accounts – capital bonds. The capital bonds are fixed term customer accounts with returns based on movements in an index, such as FTSE-100, over the life of the bonds. The Bank uses swaps to create economic hedges against all of its capital bonds and so has elected to carry them at fair value through income and expense in order to prevent an accounting mismatch. The IASB is currently proposing amendments to the classification and measurement requirements of Phase 1 of IFRS 9. The Bank expects that IFRS 9 will significantly impact its financial statements, the full extent of which is currently being considered.

The IASB may make other changes to financial accounting and reporting standards that govern the preparation of the Bank's financial statements, which the Bank may adopt, or which the Bank may adopt prior to the date on which such changes become mandatory if determined to be appropriate by the Bank, or which the Bank may be required to adopt. Any such change in the Bank's accounting policies or accounting standards could materially affect its reported financial condition and results of operations.

The Bank's accounting policies and methods are critical to how it reports its financial condition and results of operations. They require the Bank to make estimates about matters that are uncertain.

Accounting policies and methods are fundamental to how the Bank records and reports its financial condition and results of operations. The Bank must exercise judgement in selecting and applying many of these accounting policies and methods so that they comply with IFRS.

In the Bank's financial statements, the basis of preparation and accounting policies disclosures have identified certain accounting policies in respect of which significant judgement is required in determining appropriate assumptions and estimates when valuing assets, liabilities, commitments and contingencies.

These critical judgements and estimates relate to the assumptions used in the determination of loan impairment provisions, intangible and tangible assets impairments and deferred tax.

A variety of factors could affect the ultimate value that is obtained either when earning income, recognising an expense, recovering an asset or reducing a liability. The Bank has established detailed policies and control procedures that are intended to ensure that these judgements (and the associated assumptions and estimates) are well controlled and applied consistently. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. Because of the uncertainty surrounding the Bank's judgements and the estimates pertaining to these matters, the Bank cannot guarantee that it will not be required to make changes in accounting estimates or restate prior period financial statements in the future and any such changes or restatements could be material in nature.

Failure to maintain adequately and protect customer and employee information could have a material adverse effect on the Bank.

The Bank collects and processes personal data (including name, address, age, bank and credit card details and other personal data) from its customers, third party claimants, business contacts and employees as part of the operation of its business, and therefore it must comply with data protection and privacy laws and industry standards in the UK and the EU. Those laws and standards impose certain requirements on the Bank in respect of the collection, use, processing and storage of such personal information. For example, under UK and EU data protection laws and regulations, when collecting personal data, certain information must be provided to the individual whose data is being collected. This information includes the identity of the data controller, the purpose for which the data is being collected and any other relevant information relating to the processing. There is a risk that data collected by the Bank and its appointed third parties is not processed in accordance with notifications made to, or obligations imposed by, data subjects, regulators, or other counterparties or applicable law. Failure to operate effective data collection controls could potentially lead to regulatory censure, fines, reputational and financial costs as well as result in potentially inaccurate rating of risks or overpayment of claims.

The Bank is also subject to certain data protection industry standards, and may be contractually required to comply with those standards. For example, as a major processor of payments from payment cards, the Bank is required to comply with the Payment Card Industry Data Security Standard as part of its contractual obligations to merchant acquirers. For example, there is a risk that certain types of data security breaches could subject the Bank to liability and/or damage to the Bank's brands and reputation.

In addition, the Bank is exposed to the risk that the personal data it controls could be wrongfully accessed and/or used, whether by employees or other third parties, or otherwise lost or disclosed or processed in breach of data protection regulations. If the Bank or any of the third-party service providers on which it relies (including Co-operative Group under the Bank's separation arrangements) fail to process, store or protect such personal data in a secure manner or if any such theft or loss of personal data were otherwise to occur, the Bank could face liability under data protection laws. This could also result in damage to the Bank's brands and reputation as well as the loss of new or repeat business, any of which could have a material adverse effect on the Bank's business, prospects, results of operations and financial position.

The Bank has significant holdings of investment securities and negative changes in the fair value of these securities could have a material adverse effect on the Bank's comprehensive income, financial condition and prospects.

As at 30 June 2013, the Bank's portfolio of available for sale investment securities had a fair value of £3.4 billion. The Bank's investment securities are, where appropriate, fair valued on each balance sheet date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. As a wide range of valuation techniques are available, it may be inappropriate to compare the Bank's fair value information to that of independent market or other financial institutions. Changes to assumptions and different methodologies can have significant impacts, particularly on fair values which are based on unobservable inputs.

In addition, on the merger of the Bank with Britannia in 2009, Britannia's net assets were restated to fair value. The majority of these fair value adjustment unwinds are expected to be through the income statement over the lives of the associated assets and liabilities. Although over time the impact is broadly neutral, the

impact in any one year depends on the assumptions made about expected future arrears, interest rates, redemption rates and maturities. The timing of fair value adjustment unwinds may have a material adverse effect on the Bank's operating results, financial condition and prospects.

Any changes in fair value of available for sale investment securities during the relevant period are recorded in other comprehensive income, except for impairment losses and foreign exchange gains or losses which are recognised in the income statement. Gains and losses arising on the sale of available for sale investment securities are also recognised in the income statement, including any cumulative fair value gain or loss previously recognised in other comprehensive income which is reclassified to the income statement. Any changes in fair value of investment securities designated at fair value through income or expense during the relevant period are recognised in the income statement. In each of the three financial years ended 31 December 2012, 2011 and 2010 and the six-month period ended 30 June 2013, the Bank recorded other comprehensive income from available for sale investments (net of amounts reclassified to the income statement) of £10.5 million, £32.6 million, £(15.6) million and £(24.1) million, respectively. In each of the three financial years ended 31 December 2012, 2011 and 2010 and the six-month period ended 30 June 2013, the Bank also recognised net impairment gains on available for sale investment securities of £2.7 million, £nil million, £nil million and £nil million, respectively. The impairment gains related to a structured investment vehicle held by the Bank.

In each of the three financial years ended 31 December 2012, 2011 and 2010 and the six-month period ended 30 June 2013, the Bank recorded fair value movements through the income statement from investment securities designated at fair value through income or expense of £6.5 million, £(1.0) million, £nil and £(16.3) million, respectively.

Although the Bank has recorded other comprehensive income in respect of its available for sale investment portfolio in recent years, it has in previous years experienced significant fair valuation losses on securities included in the portfolio. Accordingly, there can be no assurance that fair valuations of its investment securities in future periods will not result in other comprehensive losses or impairments which could be material. In addition, the value that the Bank ultimately realises for its investment securities may be lower than their current fair value, resulting in losses being recorded in its income statement, which losses could be material. Any of these factors could have a material adverse effect on the Bank's operating results, financial condition or prospects.

The Bank is exposed to the risk of changes in tax legislation and its interpretation and to increases in the rate of corporate and other taxes.

The Bank's activities are principally conducted in the UK and it is therefore subject to a range of UK taxes at various rates. Future actions by the Government to increase tax rates or to impose additional taxes would reduce the Bank's profitability. Revisions to tax legislation or to its interpretation might also affect the Bank's financial condition in the future. In addition, the Bank is subject to periodic tax audits which could result in additional tax assessments relating to past periods of up to six years being made. Any such assessments could be material, which might also affect the Bank's financial condition in the future.

RISKS RELATED TO THE FEATURES OF THE NOTES

Key factors which are material for the purpose of assessing the risks associated with the Notes

The conditions of the Notes will include certain features which are specific to the Notes and which may have a material adverse effect on the amount of principal and interest which the Bank will pay to investors and the timing of such payments. There may be circumstances or events as a result of which investors will not receive any principal and/or interest. The risks associated with the particular features of the Notes include the following risks. Holders of Existing Securities should bear in mind that a number of these risks will also apply to their Existing Securities, and they should consider the following risks in that context.

The Notes are not protected by the Financial Services Compensation Scheme

The Notes will not be protected deposits for the purposes of the FSCS, which is the fund of last resort for customers of authorised financial services firms. In this regard, investors should note that the Bank is currently facing considerable financial difficulties. As a result, if the Bank does go out of business or

becomes insolvent, or if the Authorities take action under the Banking Act (or similar future legislation) to preserve or restore the viability of the Bank or part or all of its business, the FSCS will not pay compensation to an investor. Accordingly, in such circumstances, an investor in the Notes may lose some, or the entire amount, of its investment in the Notes.

The Notes are subordinated obligations of the Bank. On a winding-up or dissolution of the Bank, investors in the Notes may lose their entire investment in the Notes

The Notes will constitute unsecured and subordinated obligations of the Bank. On a winding-up or dissolution of the Bank, claims in respect of the Notes would rank behind the claims of all depositors and other unsubordinated creditors of the Bank, and rank equally with all claims of holders of all other dated subordinated obligations (and, potentially, certain undated subordinated obligations) of the Issuer.

Accordingly, in a winding-up, the assets of the Bank would be applied first in satisfying all senior-ranking claims in full, and payments would be made to holders of the Notes, proportionately with payments made to holders of any other instruments which rank equally with the Notes (if any), only if and to the extent that there are any assets remaining after satisfaction in full of all such senior ranking claims. If, in the winding-up of the Bank, the Bank's assets are not sufficient to repay all depositors and other senior creditors in full, investors in the Notes will not be eligible to receive any amounts in the winding-up process and will lose their entire investment in the Notes. If the Bank's assets are sufficient to repay all depositors and other senior creditors in full, but are insufficient to fully repay the Noteholders and other creditors who rank alongside the Noteholders, then the Noteholders will lose some of their investment in the Notes.

There is no restriction on the amount of securities or other instruments which the Bank may issue or incur and which rank senior to, or rank equally with, the Notes. The issue of any such securities or instruments may reduce the amount (if any) recoverable by holders of Notes on a winding-up, liquidation or dissolution of the Bank.

The Bank is currently facing considerable financial difficulties. If the Bank's Recapitalisation Plan is unsuccessful or if its financial condition deteriorates such that there is an increased risk that the Bank may be wound-up, such circumstances can be expected to have a material adverse effect on the market price of the Notes. Investors in the Notes may find it difficult to sell their Notes in such circumstances, or may only be able to sell their Notes at a price which may be significantly lower than the price at which they purchased their Notes. In such event, investors may lose some or substantially all of their investment in the Notes, whether or not the Bank is wound up.

The Notes may become subject to provisions requiring capital instruments to be written-down or converted to Common Equity Tier 1 Capital (as defined in Basel III) instruments under current proposals

On 16 December 2010 and on 13 January 2011, with a minor revision on 1 June 2011, the Basel Committee (which seeks to set global standards for making the banking system safer) issued final guidance on a number of fundamental reforms to its global regulatory capital framework (such reforms being commonly referred to as **Basel III**). The reforms included a proposal that (amongst other instruments) all tier 2 (as defined in Basel III) capital instruments issued by banks (which would include the Notes) should be capable of being written-down or converted into ordinary shares (or other common equity tier 1 instruments) at the option of the relevant national authorities if such action was considered by those authorities to be necessary to preserve or restore the financial viability of the bank. This mechanism is commonly referred to as 'loss absorption at the point of non-viability', and would be intended to be used before the bank becomes insolvent.

The Basel III proposals are not directly binding in any country, but are expected to be implemented by local law. In the EU (including the United Kingdom), the Basel III proposals are, broadly, being implemented on the basis of two sets of European legislation. The majority of the Basel III proposals will be implemented through CRD IV, which will take effect in the United Kingdom from 1 January 2014.

However, the mechanism enabling the Authorities to require the write-down (which means that the Authorities can reduce (to zero if necessary), the principal amount of the instrument) or conversion to ordinary shares of (amongst other instruments) tier 2 (as defined in Basel III) capital instruments at the point of non-viability is currently expected to be implemented from 1 January 2015 through an EU Directive commonly referred to as the RRD. A first draft of RRD was published on 6 June 2012, and further drafts

have since been made available. Whilst the text of RRD has not yet been finalised, and thus there remains significant uncertainty as to the effect and timing of this legislation, it is expected that, if and when the RRD is enacted and implemented in the United Kingdom, the United Kingdom Resolution Authorities will have the power to write-down or write-off the Notes at the point at which they consider such action to be necessary in order to preserve or restore the viability of the Bank.

In addition, it is possible that the Authorities will be afforded similar express powers (to the extent not already available), under current proposals to amend the Banking Act before RRD is finalised. On 1 October 2013, HM Treasury published amendments to the Banking Reform Bill under which it is proposed, amongst other things, that the Bank of England be given the power, in a resolution scenario, to cancel, reduce or defer the equity liabilities of a bank (including divesting shareholders of a bank of their shares), convert an instrument issued by a bank from one form or class to another (for example, a debt instrument (such as the Notes) into equity) and/or transfer some or all of the securities of bank to an appointed bail-in administrator.

The Resolution Authorities will have considerable discretion in determining the timing and circumstances in which they take any action under the Banking Act, but in any event such action would be expected before any injection of public funds by the Government. As such, investors of the Notes would expect to lose all or substantially all of their investment before any 'bail-out' of the Bank by the Government. The inherent unpredictability as to if and when the Resolution Authorities would exercise their powers could also lead to significant volatility in the market prices for the Notes.

If the Notes are written-down or written-off due to the exercise by the Authorities of powers under the Banking Act, Noteholders may receive no compensation or may in certain circumstances receive ordinary shares in the Bank (although, given the circumstances in which such powers would be exercised by the Authorities, the value of such shares is likely to be negligible). Accordingly, any such action taken by Resolution Authorities under the Banking Act would result in Noteholders losing some, or potentially all, of their investment in the Notes, notwithstanding that the Bank does not become insolvent.

In addition, the coming into force of RRD or the other proposed changes to the Banking Act or any similar legislation may have a material adverse effect on the market price of the Notes, and the market price of the Notes may be more volatile than the market prices of other securities or instruments that are not subject to similar write-down or write-off provisions, and may be more sensitive generally to adverse changes in the Bank's financial condition. Further, any anticipated write-down, write-off or conversion of the Notes can be expected to have a material adverse effect on the market price of the Notes, and such effects can be expected to become increasingly pronounced if the Bank's financial condition deteriorates such that it becomes more likely that the relevant non-viability powers will be exercised. Investors in the Notes may find it difficult to sell their Notes in such circumstances, or may only be able to sell their Notes at a price which may be significantly lower than the price at which they purchased their Notes. In such event, investors may lose some or substantially all of their investment in the Notes, whether or not any write-down, write-off or conversion of the Notes ultimately occurs.

The Bank is currently facing considerable financial difficulties. If the Bank's Recapitalisation Plan is unsuccessful or if its financial condition deteriorates, there is a real risk that the Authorities may elect to use their powers under the Banking Act, which could result in investors in the Notes losing some, or potentially all, of their investment in the Notes.

Noteholders could lose some or all of their investment if the United Kingdom authorities implement other resolution procedures under the Banking Act 2009

In addition to the potential risks under the proposed RRD and the proposed amendments to introduce bail-in powers under the Banking Act, the United Kingdom authorities already have broad powers to effect the resolution of the Bank under the Banking Act. The Banking Act currently empowers the United Kingdom authorities, where a bank is failing (or likely to fail) the threshold conditions for its authorisation to conduct banking business (which includes, amongst other things, the conducting of its business in a prudent manner, which is assessed by reference to its financial and non-financial resources), to impose the SRR on relevant entities. The SRR consists of three stabilisation options, a bank insolvency procedure and a bank administration procedure, which may be commenced by the authorities. For more detail on the Banking Act and the SRR, see the risk factor titled "*Resolution procedure under the Banking Act 2009*".

If the United Kingdom authorities were to take action under the Banking Act to resolve the Bank, an investor in the Notes may lose all or substantially all of its investment, including if the Bank's payment obligations on the Notes are modified, reduced or eliminated, or if the Notes are transferred to, or (in circumstances where the assets of the Bank are transferred to a new entity) left behind in, an entity with no, or non-performing, assets.

Further, if the market anticipates that the Bank may become subject to any such action, this can be expected to have a material adverse effect on the market price of the Notes, and the market price of the Notes may become more volatile, and may be more sensitive generally to adverse changes in the Bank's financial condition. Such effects can be expected to become increasingly pronounced if the Bank's financial condition deteriorates such that it becomes more likely that the relevant powers will be exercised. Investors in the Notes may find it difficult to sell their Notes in such circumstances, or may only be able to sell their Notes at a price which may be significantly lower than the price at which they purchased their Notes. In such event, investors may lose some or substantially all of their investment in the Notes, whether or not the United Kingdom authorities ultimately exercise their powers under the Banking Act.

The Bank is currently facing considerable financial difficulties. If the Bank's Recapitalisation Plan is unsuccessful or if its financial condition deteriorates, there is a real risk that the Authorities may elect to use their powers under the Banking Act, which could result in investors in the Notes losing some, or potentially all, of their investment in the Notes.

Whilst the Notes may pay a higher rate of interest than comparable notes in the market, investors should be aware that this reflects the greater risk which an investment in the Notes may involve when compared to those other notes.

The Notes will bear interest at a rate of 11 per cent. per annum. Whilst this rate of interest may initially appear to be favourable when compared to interest rates payable on some other products and notes in the market, investors should be aware that a higher rate of return tends to indicate a higher degree of risk in the investment. An investment in the Notes will involve considerable risks, given both the current financial condition of the Bank and the challenges it faces in the future and the specific features of the Notes (as described in the present section). Although the Notes may pay a higher rate of interest than other products or notes in the market, there is a real risk that an investor in the Notes will lose all or some of its investment should the Bank become insolvent or if the Authorities take action to resolve the Bank before it becomes insolvent.

An investor must determine for itself, together (if applicable) with its financial and other advisers, whether or not the Notes are a suitable investment for it, given the risks inherent in such an investment. Professional investors tend to invest in higher-risk investments only as part of a balanced and diversified investment portfolio. Investors should consider carefully the impact on their financial circumstances if they were to lose all or substantially all of their investment in the Notes.

There are circumstances in which the Bank (subject to certain conditions) may redeem all outstanding Notes, and an investor may not be able to reinvest the redemption proceeds at as effective a rate of return as that in respect of the Notes

The Bank may (subject to certain conditions) redeem all outstanding Notes at any time at an amount equal to 101 per cent. of their principal amount together with any accrued but unpaid interest if:

(a) as a result of a change in applicable law or regulation, payments in respect of the Notes (i) cease to be partly or fully deductible for United Kingdom corporation tax purposes or (ii) become subject to United Kingdom withholding tax and the Issuer is required to gross-up any such payments; and

(b) as a result of a change in applicable prudential and capital adequacy laws or regulations, the Notes outstanding are (or will, within 90 days, be) fully excluded from tier 2 capital of the Bank.

During any period when the Bank may elect to redeem the Notes, the market value of the Notes generally will not rise substantially above the price at which they can be redeemed. This also may be true prior to any redemption period.

An investor may not be able to reinvest the redemption proceeds at an effective rate of return as high as that in respect of the Notes and may only be able to do so at a significantly lower rate of return. Potential investors should consider reinvestment risk in light of other investments which may be available at that time.

Rights of enforcement in respect of the Notes are limited

No remedy against the Issuer, other than the institution of proceedings by the Trustee for the winding-up of the Issuer and/or proving in the winding-up of the Issuer, shall be available to the Trustee or the Noteholders for the recovery of amounts owing in respect of the Notes.

Further, no holder of Notes shall be entitled to take any enforcement action against the Bank in respect of its Notes unless the Trustee, having become bound to take action in accordance with the Conditions, fails to do so within a reasonable period and such failure shall be continuing.

Accordingly, if the Bank were to breach the terms of the Notes, the ability of the holders to require the Bank to resolve the breach, or to seek recompense, is very restricted. In the event of a significant breach of the terms of the Notes by the Bank (for example, if the Bank were to fail to make an interest payment when due), the main right of enforcement available to the Noteholders (through the Trustee) would be to take steps to initiate the winding-up of the Bank. If the Bank were to be wound up, the Noteholders' claim will rank behind the claims of depositors and other unsubordinated creditors of the Bank. In such circumstances, depositors and senior creditors would be repaid in full before the Noteholders receive any amounts, and accordingly investors in the Notes may lose some or all of their investment in the Notes.

The conditions of the Notes will contain provisions which may permit their modification without the consent of all investors and confer significant discretions on the Trustee which may be exercised without the consent of the Noteholders and without regard to the individual interests of particular Noteholders

The conditions of the Notes will contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally, as more fully described in the Trust Deed. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority. The powers afforded to majorities to bind minorities are significant, and could result in material changes to the terms of the Notes, including (without limitation) potentially reducing the amounts of interest and/or principal payable by the Bank, changes to the maturity of the Notes (including extending the time to maturity of the Notes) the timing of those payments of interest and/or principal, mandatory substitution of the Notes with other securities and, in the extreme, the complete abrogation (i.e. annulment) of all rights of the holders under the Notes. Accordingly, a Noteholder's rights under the Notes could be materially adversely affected – or removed altogether – without its consent, where the requisite majority of holders of the Notes exercise those powers.

The conditions of the Notes also provide that the Trustee may, without the consent of Noteholders and without regard to the interests of particular Noteholders, (i) agree to any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of the provisions of the Notes or (ii) determine without the consent of the Noteholders that any potential event of default shall not be treated as such or (iii) agree to the substitution of another company as principal debtor under any Notes in place of the Bank. Whilst the Trustee, in exercising those powers and discretions, can be expected to act in a manner in which it considers is not materially prejudicial to the interests of the Noteholders, the Trustee will be entitled to have regard to the Noteholders as a class and to disregard the particular interest or circumstances of individual Noteholders. Accordingly, there can be no assurance that the exercise of those powers and discretions will not result in adverse consequences for any given Noteholder.

Potential denomination should the United Kingdom join the European Monetary Union

If the UK joins the European Monetary Union prior to the maturity of the Notes, there is no assurance that this would not adversely affect investors in the Notes. It is possible that prior to the maturity of the Notes the UK may become a participating Member State (as such term is defined in Section 19 (*Taxation*)) and that the euro may become the lawful currency of the UK. In that event (i) all amounts payable in respect of any Notes denominated in Sterling may become payable in euro, (ii) the law may allow or require such Notes to be redenominated into euro and additional measures to be taken in respect of such Notes, and (iii) there may no longer be available published or displayed rates for deposits in Sterling used to determine the rates of

interest on such Notes or changes in the way those rates are calculated, quoted and published or displayed. The introduction of the euro could also be accompanied by a volatile interest rate environment, which could adversely affect investors in the Notes.

RISKS RELATED TO APPLICABLE TAX AND OTHER LEGISLATION

The Notes may be subject to withholding taxes in circumstances where the Bank is not obliged to make gross-up payments and this would result in holders receiving less interest than expected and could significantly adversely affect their return on the Notes

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income (the **EU Savings Directive**), Member States are required to provide to the tax authorities of another Member State details of payments of interest (or other similar income) paid by a person within its jurisdiction to an individual resident in that other Member State or certain limited types of entity established in that other Member State. However, for a transitional period, Austria and Luxembourg are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have adopted similar measures (a withholding system in Switzerland). In April 2013, the Luxembourg Government announced its intention to abolish the withholding system with effect from 1 January 2015, in favour of automatic information exchange under the EU Savings Directive.

The European Commission has proposed certain amendments to the EU Savings Directive, which may, if implemented, amend or broaden the scope of the requirements described above.

Foreign Account Tax Compliance Act Withholding

Sections 1471 through 1474 of the U.S. Internal Revenue Code of 1986 (**FATCA**) impose a new reporting regime and, potentially, a 30 per cent. withholding tax with respect to (i) certain payments from sources within the United States, (ii) "foreign passthru payments" made to certain non-U.S. financial institutions that do not comply with this new reporting regime, and (iii) payments to certain investors that do not provide identification information with respect to interests issued by a participating non-U.S. financial institution.

In respect of any Notes which are held within the clearing systems, in all but the most remote circumstances, it is not expected that the FATCA will affect the amount of any payment received by the clearing systems. However, FATCA may affect payments made to custodians or intermediaries in the subsequent payment chain leading to the ultimate investor if any such custodian or intermediary generally is unable to receive payments free of FATCA withholding. It also may affect payment to any ultimate investor that is a financial institution that is not entitled to receive payments free of withholding under FATCA, or an ultimate investor that fails to provide its broker (or other custodian or intermediary from which it receives payment) with any information, forms, other documentation or consents that may be necessary for the payments to be made free of FATCA withholding. Investors should choose the custodians or intermediaries with care (to ensure each is compliant with FATCA or other laws or agreements related to FATCA) and provide each custodian or intermediary with any information, forms, other documentation or consents that may be necessary for such custodian or intermediary to make a payment free of FATCA withholding. The Bank's obligations under the Notes are discharged once it has paid the common depositary for the clearing systems (as registered holder of the Notes) and the Bank has therefore no responsibility for any amount thereafter transmitted through the hands of the clearing systems and custodians or intermediaries.

The value of the Notes could be adversely affected by a change in English law or administrative practice

The conditions of the Notes will be based on English law in effect as at the date of this Prospectus. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of this Prospectus and any such change could materially adversely impact the value of any Notes affected by it.

RISKS RELATED TO THE MARKET GENERALLY

Set out below is a brief description of the principal market risks, including liquidity risk, exchange rate risk, interest rate risk and credit risk:

Secondary market

The Notes may have no established trading market when issued, and one may never develop. If a market does develop, it may not be very liquid. Illiquidity may have a severely adverse effect on the market value of the Notes. If the Notes are traded after their initial issuance, they may trade at a discount to their issue price, depending upon prevailing market rates of return, the market for similar securities, general economic conditions and investors' general perception of the credit risk of the Bank. The market prices may also be volatile, meaning that prices may go up and/or down sharply. In addition, any deterioration in the financial condition of the Bank can be expected to have a material adverse effect on the market price of the Notes, including if the Bank's financial condition deteriorates to an extent where the market anticipates that action may be taken in respect of the Bank or the Notes under the Banking Act or (if and when implemented in the United Kingdom) the RRD or otherwise if the Bank may become insolvent.

Therefore, investors may not be able to sell the Notes easily, or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. Investors in the Notes will lose some of their investment if they sell their Notes at a price that is lower than the price at which they purchased such Notes.

Interest rate and inflation risks

The Notes bear interest at a fixed rate. Investors should note that (i) if market interest rates start to rise then the income to be paid on the Notes might become less attractive and the price the investors get if they sell such Notes could fall (however, the market price of the Notes has no effect on the interest amounts due on the Notes or what investors will be due to be repaid on the Maturity Date if the Notes are held by the investors until they expire); and (ii) inflation will reduce the real value of the Notes over time which may affect what investors can buy with their investments in the future and which may make the fixed interest rate on the Notes less attractive in the future.

Exchange rate risks and exchange controls

The Bank will pay principal and interest on the Notes in Sterling. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the **Investor's Currency**) other than Sterling. These include the risk that exchange rates may significantly change (including changes due to devaluation of Sterling or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to Sterling would decrease (1) the Investor's Currency-equivalent yield on the Notes, (2) the Investor's Currency equivalent value of the principal payable on the Notes and (3) the Investor's Currency equivalent market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

RISKS RELATING TO THE HOLDING STRUCTURE OF THE NOTES

Risks relating to holding Notes in uncertificated form

CREST, Euroclear and Clearstream, Luxembourg are clearing systems which provide for instruments such as the Notes to be traded electronically, rather than in physical form.

The Bank will discharge its payment obligations under the Notes held in uncertificated form by making the relevant interest and principal payments to, or to the order of, the registered holder of the Notes. Investors in such Notes must rely on the procedures of CREST, any applicable nominee and, if applicable Euroclear or Clearstream, Luxembourg for their share of the relevant payments. Investors must also rely on the procedures of CREST, and, if applicable Euroclear or Clearstream, Luxembourg for trading their Notes and for certain communications with the Bank (including receipt of notices given by the Bank in accordance with the terms of the Notes).

3
INFORMATION ABOUT THE NOTES

The following is an overview of the key terms of the Notes.

The full Conditions of the Notes are contained in Appendix B (*Conditions of the Notes*) to this Prospectus. It is important that Holders read the entirety of this Prospectus, including the Conditions of the Notes, before deciding whether or not to exchange their Existing Securities (in whole or in part) for Notes. If a Holder has any questions, it should seek advice from its financial adviser or other professional adviser before deciding whether or not to invest.

INFORMATION ABOUT THE NOTES

What are the Notes?

The 11 per cent. Subordinated Notes due 2023 (the **Notes**) will be bonds issued by The Co-operative Bank p.l.c. (the **Bank**).

What is a bond?

A bond is a form of borrowing by a company seeking to raise funds from investors. The company that issues a bond usually promises to pay to the holder of such bond a rate of interest periodically until the date when the relevant bond becomes repayable (usually on the relevant maturity date, although a bond may also become repayable early in certain circumstances) when the company also promises to repay the amount borrowed.

An investor does not have to keep a bond until the date when the bond matures. A bond is a tradable instrument (which is one respect in which bonds can be differentiated from traditional bank loans or deposits in a bank account). The market price of a bond will fluctuate between the start of the bond's life and when it matures depending upon a number of factors, including (amongst other things) the financial condition of the company issuing the bond, the relative coupon of the bond and the relative appeal of other investments available in the market from time to time.

Who can buy the Notes?

The Notes are being offered exclusively in connection with a liability management exercise being conducted by the Bank and the Co-operative Group Limited (**Co-operative Group**) in respect of certain existing capital securities of the Bank (the **Liability Management Exercise** or **LME**) as originally announced by the Bank on 17 June 2013 and as more fully described in Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*) and Appendix C (*Consent and Exchange Offer Memorandum*).

Part of the Liability Management Exercise involves invitations to Eligible Holders of the Bank's 5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) (the **5.5555% Bonds**) to offer to exchange their 5.5555% Bonds for a portion of the Notes.

A further part of the Liability Management Exercise involves invitations to holders of the Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (the **2016 Notes**), the 5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942) (the **2019 Notes**), the 9.25% Subordinated Notes due 28 April 2021 (ISIN: XS0620315902) (the **April 2021 Notes**), the Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984) (the **November 2021 Notes**), the 7.875% Subordinated Notes due 19 December 2022 (ISIN: XS0864253868) (the **2022 Notes**), the 5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183) (the **2024 Notes**), the 5.875% Subordinated Notes due 2033 (ISIN: XS0145065602) (the **2033 Notes**) (together the **Dated Notes**) to vote on proposals under a scheme of arrangement under Part 26 of the Companies Act 2006 to authorise the Bank to exchange all outstanding Dated Notes (including those held by holders who do not vote in favour of the proposals) for a combination of (i) New Ordinary Shares to be issued by the Bank and (ii) a portion of the Notes.

Accordingly, only investors who hold Dated Notes or 5.5555% Bonds will be able to obtain the Notes upon their initial issue. Instead of paying for the Notes in cash, those investors will deliver their Dated Notes and 5.5555% Bonds to the Bank (or as the Bank directs) in exchange for the Notes.

What is the total amount of Notes to be issued?

The Notes will be issued only upon successful completion of the Liability Management Exercise, and no Notes will be issued if the Liability Management Exercise does not successfully complete.

If the Liability Management Exercise is successful and settles on 18 December 2013, the maximum principal amount of Notes which may be issued is expected to be £206,000,000.

The final principal amount of Notes to be issued (if any) will be announced by the Bank via the Regulatory News Service operated by the London Stock Exchange, which announcement is currently expected to be made on or around 12 December 2013 or, in the event that any meeting pursuant to the Proposals is adjourned, is currently expected to be made on or around 30 December 2013.

What is the issue price of the Notes?

The Notes will be issued at the issue price (which is 100 per cent. of the principal amount of the Notes).

When will the Notes be issued?

The issue date of the Notes will depend upon the progress of the Liability Management Exercise, including whether there are any delays in implementing the Liability Management Exercise. Delays may occur if, for example, the Bank is required to adjourn certain bondholder meetings which are being convened in connection with the Proposals, or if the Bank elects to extend the period during which the Offers remain open.

If there are no delays, the Bank expects to issue the Notes on 18 December 2013. If there are delays, the latest date on which the Bank currently expects to issue the Notes would be 31 December 2013.

The Bank will from time to time make announcements in connection with the Liability Management Exercise via the Regulatory News Service operated by the London Stock Exchange. Persons who participate in the Liability Management Exercise are recommended to check that service regularly in order to obtain any updates on the progress of the Liability Management Exercise, including the final issue date of the Notes assuming successful completion of the Liability Management Exercise.

What are the main features of the Notes?

The full terms and conditions of the Notes are set out in Appendix B (*Conditions of the Notes*) to this Prospectus. Key features of the Notes (some of which are further described below) include that:

(a) the Notes will have a denomination of £10 per Note;

(b) the Notes will pay a fixed rate of interest of 11 per cent. per year;

(c) interest will be paid quarterly at the end of each three-month accrual period;

(d) the Bank will be required to redeem the Notes in full at maturity on the tenth anniversary of the issue date (redemption means that the Bank will repay the principal amount of the Notes, upon which the Notes will be cancelled);

(e) subject to the consent of the Prudential Regulation Authority, the Bank may, in certain circumstances, elect to repay the Notes before maturity at an amount equal to 101 per cent. of their principal amount;

(f) the Notes will not be secured by or over any assets of the Bank;

(g) the Notes will be subordinated obligations of the Bank; and

(h) the Notes are intended to be admitted to trading on the London Stock Exchange.

In what form will the Notes be issued?

The Notes will be issued in registered form in denominations of £10 each. The Notes are intended to be held electronically either (i) in certificated form outside of CREST, Euroclear and Clearstream, Luxembourg, (ii) in uncertificated form in CREST, or (iii) in uncertificated form with Euroclear or Clearstream, Luxembourg through CREST.

Notes held in uncertificated form will be held in accordance with the Uncertificated Securities Regulations 2001, including any modification or re-enactment thereof for the time being in force (the **Uncertificated Securities Regulations**). Notes held in uncertificated form will be participating securities for the purposes of the Uncertificated Securities Regulations. Title to Notes held in uncertificated form will be recorded on

the relevant Operator register of corporate securities (as defined in the Uncertificated Securities Regulations) and the relevant "Operator" (as such term is used in the Uncertificated Securities Regulations) is Euroclear UK & Ireland Limited or any additional or alternative operator from time to time approved by the Issuer and the Registrar and in accordance with the Uncertificated Securities Regulations.

What is the interest rate on the Notes?

The Notes will bear interest at a fixed rate of 11 per cent. per year.

When will interest be paid?

Interest will accrue from (and including) the date of issue of the Notes and will be paid quarterly on each three-month anniversary of the issue date until the Notes are redeemed.

As noted above, the issue date of the Notes will depend upon the progress of the Liability Management Exercise. However, by way of example:

If the Notes were to be issued on 18 December 2013, then interest would be paid on 18 March, 18 June, 18 September and 18 December in each year, with the first payment being due on 18 March 2014 and the last payment being due on 18 December 2023.

If the Notes were to be issued on 31 December 2013, then interest would be paid on 31 March, 30 June, 30 September and 31 December in each year, with the first payment being due on 31 March 2014 and the last payment being due on 31 December 2023.

When will the Notes be repaid?

The Bank will be required to repay the Notes at their principal amount on the tenth anniversary of the issue date (the **Maturity Date**). By way of example:

If the Notes were to be issued on 18 December 2013, then the Bank would be required to repay the Notes on 18 December 2023.

If the Notes were to be issued on 31 December 2013, then the Bank would be required to repay the Notes on 31 December 2023.

Are there any circumstances in which the Notes may be repaid early?

The Bank will have the right (subject to the consent of the Prudential Regulation Authority), the United Kingdom banking regulator) to repay the Notes at an amount equal to 101 per cent. of their principal amount before the Maturity Date if either:

(i) there is a change in the tax laws of the United Kingdom resulting in the Bank having to pay additional amounts under the Notes or interest payments on the Notes ceasing to be partly or fully deductible for UK corporation tax purposes; or

(ii) there is a change in English law or applicable banking regulations (or their official application or interpretation) and as a result the Notes are fully excluded from the tier 2 capital of the Bank.

See "*What happens if the Bank fails to make a payment of principal or interest on the Notes*" below for information on what happens in that circumstance.

Can Noteholders require the Bank to repay their Notes before the Maturity Date?

No. The Noteholders do not have any right to require the Bank to repay or purchase their Notes prior to the Maturity Date.

Will the Bank be able to buy Notes in the market?

The Bank, or any of its subsidiaries, may at any time purchase Notes in any manner and at any price, subject to applicable law and regulatory consent of the Prudential Regulatory Authority.

Will the Notes be secured over the assets of the Bank?

No, the Notes will be unsecured.

The Notes are expressed to be 'subordinated'. What does that mean?

The Notes will be subordinated obligations of the Bank. This means that, on a winding-up of the Bank, the claims of holders in respect of the Notes would rank behind the claims of depositors and senior creditors of the Bank such as holders of senior notes issued by the Bank. Accordingly, the assets of the Bank would be used to pay all depositors and senior creditors in full before any payment is made to holders of the Notes. This feature makes the Notes a riskier investment than other investments in the Bank which are not subordinated.

If, in the winding-up of the Bank, the Bank's assets are not sufficient to repay all depositors and other senior creditors in full, investors in the Notes will not be eligible to receive any amounts in the winding-up process and will lose their entire investment in the Notes. If the Bank's assets are sufficient to repay all depositors and other senior creditors in full, but are insufficient to fully repay the Noteholders and other creditors whose claims rank alongside the Noteholders' claims, then the Noteholders will lose some of their investment in the Notes.

Will there be withholding on any payments in respect of the Notes?

Under current United Kingdom tax law, the Bank will not need to withhold or deduct any amounts for or on account of United Kingdom taxation. If in the future withholding or deduction is required under United Kingdom tax law, the Bank will pay an additional amount to ensure that Noteholders will receive the same amount as they would have received without the withholding or deduction, subject to certain customary exceptions.

Who represents the Noteholders?

Law Debenture Trustees Limited (the **Trustee)** will act as trustee for the holders of the Notes under the terms of a trust deed to be entered into between the Bank and the Trustee on the issue date of the Notes (the **Trust Deed**).

What happens if the Bank fails to make a payment of principal or interest on the Notes?

If the Bank fails to make a payment of any principal or interest when due on the Notes and such payment default continues in the case of principal for a period of 7 days and in the case of interest for a period of 15 days, the Trustee may, subject as provided in the Conditions, at its discretion (or, in certain circumstances, if directed by the Noteholders), institute proceedings for the winding-up of the Bank and prove in the winding-up, but may take no other action in respect of such payment default.

If, otherwise than for the purposes of a reconstruction or amalgamation on terms previously approved in writing by the Trustee, an order is made or an effective resolution is passed for winding-up the Bank, the Trustee may, and, if so requested in writing by the holders of at least one-fifth in nominal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution of the holders of the Notes shall subject as provided in the Conditions, give notice to the Bank that the Notes are, and they shall thereby become, immediately due and repayable at their principal amount, together with accrued interest. This means that the holders of the Notes will have a claim in the winding-up of the Bank, and such claim will be equal to the principal amount of their Notes together with accrued and unpaid interest. That claim will, however, be subordinated as described above under the paragraph titled "*The Notes are expressed to be 'subordinated'. What does that mean?*".

How will notices be given to Noteholders?

The terms of the Notes provide for the Bank to give Noteholders notices in certain circumstances. Notices to the Noteholders are to be mailed to them at their respective addresses in the register of Noteholders maintained by the Registrar and may also be published on the Regulatory News Service operated by the London Stock Exchange.

Can the Conditions of the Notes be amended?

The terms of the Notes and the Trust Deed contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities of the Noteholders attending the relevant meeting to pass resolutions which will bind all Noteholders, including Noteholders who did not attend the meeting as well as Noteholders who voted against the resolution. The powers afforded to majorities to bind minorities are significant, and could result in material changes to the terms of the Notes, including (without limitation) potentially reducing the amounts of interest and/or principal payable by the Bank, the timing of those payments of interest and/or principal, mandatory substitution of the Notes with other securities and, in the extreme, the complete abrogation (i.e. annulment) of all rights of the holders under the Notes.

All Noteholders will have the right to receive notice of such meetings and to vote on any resolution proposed at such meetings. For the avoidance of doubt, Noteholders are not, by virtue of their holding of Notes, entitled to attend or vote at any meeting of the shareholders of the Bank.

The Trustee may also agree to minor or technical amendments to the terms of the Notes or amendments which, in the opinion of the Trustee, are not materially prejudicial to the interests of Noteholders.

Does an investment in the Notes involve any risks?

Yes. As with any investment, an investment in the Notes involves certain risks. Given, in particular, the current financial difficulties which the Bank is facing and also the specific features of the Notes, the risk of an investment in the Notes is considerably higher as of the date of this Prospectus than many other investments (although many of those risks will also apply to the Dated Notes and 5.5555% Bonds which may be exchanged for Notes). Holders of the Dated Notes and 5.5555% Bonds are urged to read carefully the risk factors set out in Section 2 (*Risk Factors*) of this Prospectus.

Will any expenses and taxes be charged to the Noteholders?

The Bank and the Dealer Managers will not charge any expenses or taxes.

4

LETTER FROM THE CHAIRMAN OF THE BANK, BACKGROUND TO AND REASONS FOR THE RECAPITALISATION PLAN AND POTENTIAL CONSEQUENCES OF HOLDERS FAILING TO SUPPORT THE LIABILITY MANAGEMENT EXERCISE

The following section contains a brief explanation of the background to and reasons for the Recapitalisation Plan and potential consequences of holders failing to support the Liability Management Exercise.

LETTER FROM THE CHAIRMAN OF THE BANK, BACKGROUND TO AND REASONS FOR THE RECAPITALISATION PLAN AND POTENTIAL CONSEQUENCES OF HOLDERS FAILING TO SUPPORT THE LIABILITY MANAGEMENT EXERCISE

PART A – LETTER FROM THE CHAIRMAN OF THE BANK

The co-operative bank

(*incorporated in England and Wales under the 1948 Companies Act, as amended and restated, with registered number 990937*)

Registered office:
1 Balloon Street
Manchester
M60 4EP

4 November 2013

Dear Holders

On 17 June 2013, following the conclusion of the Bank's review of its capital position and discussions with the Prudential Regulation Authority (the **PRA**), the Bank and Co-operative Group announced that the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion (the **June Announcement**). In the June Announcement, the Bank and Co-operative Group also announced the initial details of the Recapitalisation Plan, which was intended to address this capital requirement. At least £1 billion is expected to be contributed pursuant to the Liability Management Exercise by the end of 2013 and, conditional on completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is expected to be contributed by Banking Group during 2014.

The publication today of the various documents launching the Liability Management Exercise in relation to the Bank's Existing Securities and describing the Recapitalisation Plan in the form that has developed since June represents a significant milestone in the Bank's plan to address this shortfall.

I said in June that the announcement of the Recapitalisation Plan was an important turning point for the Bank and the Bank Board continues to believe that the completion of that plan will provide the foundations to support the long-term success of the Bank in offering a real alternative to customers. If the initial details of the Recapitalisation Plan had not been announced in June, the Bank believes it is likely that it would have been resolved almost immediately by the Bank of England or HM Treasury. The Recapitalisation Plan which is being announced today is different from the initial plan announced in June but we believe it is much better for all stakeholders than the plan previously announced. The Liability Management Exercise launched today is the cornerstone of the Recapitalisation Plan. The support of Holders is critically important to the success of the Liability Management Exercise and the viability of the Bank. It is only with Holders' support that the Bank will be able to move forward.

The Bank believes that there are only two realistic outcomes for the Bank following the launch of the Liability Management Exercise, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Bank being subject to a resolution procedure under the Banking Act 2009 (**Banking Act**). The Bank believes that its recapitalisation through the Liability Management Exercise would be substantially more beneficial to Holders of any class of its Existing Securities than resolution of the Bank.

Part C of this Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*) sets out a description of the hypothetical position that Holders would be likely to face if the Bank were to be resolved. The purpose of the resolution analysis contained in Part C of this Section 4 is to assist Holders in determining whether or not to accept the Liability Management Exercise and the offer and proposals set out in this Prospectus (including the Offer Memorandum) and the other documentation we have published today.

In summary, the Bank believes that, if the Bank were to be resolved and go into an insolvency proceeding as a result of that resolution, Holders would not receive any recovery in respect of their Existing Securities in any such insolvency proceeding and would not be entitled to any compensation under the resolution regime arising from their holding of Existing Securities. Further, the Bank considers that there are fundamental uncertainties as to whether the Bank could be successfully resolved such that the Bank itself remained a going concern without the active participation of Co-operative Group and a substantial amount of additional capital.

Over the last few months, we have worked hard to bring the Bank to this stage of announcing the Recapitalisation Plan. In developing the details of the Recapitalisation Plan we know we cannot please everyone but we have sought to balance the interests of a large number of stakeholders and we believe that the Recapitalisation Plan provides an outcome which is in the long-term interests for all stakeholders given the current circumstances of the Bank.

The Bank has listened carefully to the often competing demands of its various stakeholder groups as it has put together the revised Recapitalisation Plan. As a result, the Recapitalisation Plan which is being announced today is different from the initial plan announced in June, but we believe that the revised Recapitalisation Plan is much better for all stakeholders.

Following discussions we have held with certain Holders of Dated Notes and their representatives, these Holders (who represent approximately 49 per cent. of the nominal value of the Dated Notes) have agreed to lock-up their holdings and vote in favour of the Recapitalisation Plan (the **LT2 Group**). This is a significant vote of confidence by these Holders in the revised Recapitalisation Plan.

Upon the successful completion of the Recapitalisation Plan, 70 per cent. of the equity of the Bank will be owned by the LT2 Group. The LT2 Group has acknowledged that the Bank is unique for its ethics, mission and heritage, which are essential components of the Bank's differentiated approach and it is important to them that the Bank maintains its unique characteristics and ethos. Holders of the Dated Notes will also receive the Notes as part of the Recapitalisation Plan.

On completion of the Recapitalisation Plan, Co-operative Group, which will hold the remaining 30 per cent. of the equity in the Bank, will be the Bank's largest single shareholder by far, which will enable it to maintain significant influence over how the Bank operates. Further, to ensure that the Bank continues to have a clear ethical focus, co-operative values and ethics shall be, for the first time, with the agreement of Co-operative Group and the LT2 Group whom we have held discussions with, been embedded in the constitution of the Bank and the Bank will set up a values and ethics committee, with an independent director as its chair. The Bank's values and ethics committee will be entrusted with ensuring that the Bank conducts itself in a manner informed by the established values of the co-operative movement.

In the initial details of the Recapitalisation Plan published in June it was indicated that Holders of the Bank's more junior ranking subordinated securities were likely to be offered a substantially greater proportion of New Ordinary Shares in the Bank as opposed to debt instruments as part of the proposed recapitalisation. Many of the Holders of these junior ranking securities are retail investors and a strong preference has been expressed by, or on behalf of, many of those investors to receive income producing debt instruments rather than Ordinary Shares. Accordingly, the Recapitalisation Plan provides for the issue to such holders of income producing debt instruments rather than Ordinary Shares.

The Recapitalisation Plan also provides for a contribution of £462 million from Co-operative Group, which has been consented to by bank creditors of Co-operative Group on terms which Co-operative Group believes not to be materially detrimental to the development of its other businesses.

As a result, I would urge you to read the rest of the documentation that has been published and which is applicable to the Existing Securities you hold and consider the actions to be taken by Holders set out in Section 6 (*Details of the Liability Management Exercise*) and the Offer Memorandum. I would particularly draw your attention to the description of the risks relating to the Liability Management Exercise, the Bank and its business and the rights related to the features of the Notes, set out in Section 2 (*Risk factors*).

In conclusion therefore, I present to you our Recapitalisation Plan, which has the benefit of the strong backing of both Co-operative Group and the LT2 Group, including strong support for the preservation of the unique co-operative principles and ethics of the Bank, whilst also being able to cater for the demands of the Bank's retail investors. So, whilst the journey has been most unusual, what we are still trying to achieve is a more sustainable bank better placed to serve its customers in the future. I remain convinced that this is a worthwhile enterprise and that, with your support, we can rebuild our Bank.

Your decision as to whether to accept the invitation to exchange or sell your Existing Securities for New Securities to be issued by the Bank, and in certain cases, Co-operative Group, will depend on your individual circumstances. If you are in any doubt as to the action you should take, you are recommended to seek your own personal financial advice from an independent financial adviser authorised under the Financial Services and Markets Act 2000 (as amended) if you are in the UK or, if you are outside the UK, from an appropriately authorised independent financial adviser, without delay.

Yours faithfully

Richard Pym
Chairman

PART B: BACKGROUND TO AND REASONS FOR THE RECAPITALISATION PLAN

1. Introduction

On 17 June 2013, following the conclusion of the Bank's review of its capital position and discussions with the PRA, the Bank and Co-operative Group announced that the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion. The Bank and Co-operative Group also announced the initial details of the Recapitalisation Plan, which was intended to address this capital requirement. The Recapitalisation Plan consists of the Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Bank's Existing Securities surrendered in the Liability Management Exercise. The Liability Management Exercise is expected to generate at least £1 billion of Common Equity Tier 1 Capital in 2013 and, conditional upon successful completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is expected to be contributed by Banking Group during 2014, under the 2014 Commitment, of which £170 million is to be contributed by 30 June 2014 (with £70 million of this contribution to be paid by 31 January 2014) and the remaining £163 million by 31 December 2014.

The purpose of this Part B is to set out the background to, and the reasons for, the Recapitalisation Plan and the potential consequences of Holders failing to support the Liability Management Exercise.

The key objective of the Recapitalisation Plan is to strengthen significantly the Bank's Common Equity Tier 1 Capital base and this can only be achieved with the support and participation of Holders of Existing Securities in the Liability Management Exercise. The Board, having explored extensively (both before the June Announcement and since that time) various potential means of strengthening the Bank's capital position, remains of the view that the Recapitalisation Plan (notwithstanding the revisions to the Recapitalisation Plan announced today), and the Liability Management Exercise that forms the cornerstone of that plan, is the only viable means of recapitalising the Bank in a manner outside of a resolution procedure under the Banking Act. If the initial details of the Recapitalisation Plan had not been announced in June, the Bank believes it is likely that it would have been resolved almost immediately by the Bank of England or HM Treasury. The Recapitalisation Plan which is being announced today is different from the initial plan announced in June but the Bank believes that the revised Recapitalisation Plan is much better for all stakeholders than the plan previously announced.

Further details of the background to and components of the Recapitalisation Plan are set out in paragraphs 2, 3 and 6 of this Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*), Section 6 *(Details of the Liability Management Exercise*), Section 2 (*Risk Factors*) and in the Offer Memorandum.

The decision originally taken in June by Co-operative Group to support the Recapitalisation Plan was taken in the belief that the Recapitalisation Plan was in the long-term interest of all Co-operative Group's and the Bank's respective stakeholders and of the Bank itself. As explained in more detail in section 5 below and Part C of this Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*), absent the willingness of sufficient Holders to participate in and, where requested, to support the proposals being made in the Liability Management Exercise, the Board believes that the Bank would be subject to a resolution procedure under the Banking Act. For a description of the resolution procedure under the Banking Act see paragraph 2.6 "*Recovery and resolution Regime*" in Section 17 (*Supervision and Regulation*).

In the event that the Bank enters an insolvency procedure following action taken by the Resolution Authorities under the Banking Act, and as further described in Part C of this Section 4, the Board believes it likely that Holders would not receive any recovery in any such insolvency proceedings and would not be entitled to any compensation as a result of a bank insolvency procedure or administration of the Bank. The Bank also believes that there are fundamental uncertainties as to whether it is capable of being resolved as a going concern. The Board therefore believes that the Recapitalisation Plan represents the only realistic opportunity for Holders to recover any value in return for their investment in the Bank.

The details of the Recapitalisation Plan have been discussed with the PRA, which announced on 29 August 2013 (and as reconfirmed to the Bank on 21 October 2013) that its assessment remains that the Bank has a capital shortfall of £1.5 billion relative to the requirement for 7 per cent. Common Equity Tier 1 Capital after adjustments.

The announcement of the Recapitalisation Plan in the June Announcement marked an important turning point for the Bank and the Board continues to believe that the completion of this plan, as amended, will provide the foundations to support the long-term success of the Bank in offering a real alternative to customers. The Bank's strategy to achieve this goal is described in further detail in paragraphs 2 "*Key Strengths*" and 3 "*Strategy*" in Section 8 (*Description of the Bank)*. Only following the implementation of the Liability Management Exercise and the other elements of the Recapitalisation Plan, will the Bank be in a position to pursue this four to five year turnaround plan and seek to achieve the key targets described in paragraph 3 "*Strategy*" in Section 8 (*Description of the Bank*).

However, the support of Holders is critically important to the viability of the Bank and it is only with Holders' support that the Bank will be able to move forward.

Further information on the Recapitalisation Plan (including a summary of the Liability Management Exercise) is set out in the remainder of this Prospectus. You should read the whole of this Prospectus, (including the Offer Memorandum) and the documents (or parts thereof) incorporated therein by reference before taking any decision in connection with the Liability Management Exercise.

Co-operative Group is also today publishing a prospectus (the *Group Notes Prospectus*) in respect of the Group Notes which it intends to issue in connection with the Liability Management Exercise. In addition, certain elements of the Liability Management Exercise are being implemented by way of the Scheme, which is summarised in the Offer Memorandum, the Explanatory Statement and the other Scheme documents (which will be published following the court hearing to convene the Scheme Meeting). Holders should also read all other documents which relate to their holding of Existing Securities, as described in the section of the Offer Memorandum titled "*What documents do I need to read?*" in the part titled "*Introduction to this document*", before taking any decision in connection with the Liability Management Exercise.

A list of defined terms and certain technical terms used in this Part B is included in Appendix A (*Defined Terms*).

2. Background to and reasons for the Recapitalisation Plan

The Bank's capital shortfall

Common Equity Tier 1 Capital is a form of capital which banks and other financial institutions are required to maintain to help absorb losses in times of financial distress. As a direct result of the recent global financial crisis, the PRA, in line with banking regulators around the world, is requiring UK banks to bolster their capital resources so that the banks, and the UK banking system generally, are better able to withstand future asset write-downs and financial shocks.

In March 2013, a meeting of the then interim Financial Policy Committee (**FPC**), a part of the Bank of England responsible for macro-prudential regulation, voted unanimously that the PRA should take steps to ensure that, by the end of 2013, major UK banks and building societies, including the Bank, hold capital resources equivalent to at least 7 per cent. of their risk-weighted assets assessed using the Basel III definition of equity capital but after: (i) making deductions from currently-stated capital to reflect an assessment of expected future losses and a realistic assessment of future costs of conduct redress; and (ii) adjusting for a more prudent calculation of risk weightings. The FPC noted that, relative to that benchmark, major UK banks and building societies in aggregate had a shortfall in capital of around £25 billion. The PRA's calculation of capital adequacy was based on CRD IV definitions, applying them on a fully loaded basis with certain PRA adjustments (such adjustments to reflect the FPC's assessment of expected losses and future costs of conduct redress, and adjusting for a more prudent calculation of risk weights, amounting to £1.7 billion for the Bank at that point in time).

Continuing losses in the first half of 2013 have reduced the Bank's capital to a point where, if the Liability Management Exercise is not successfully completed, the Bank will not remain a going concern. Following these losses, as at 30 June 2013 the Bank's Core Tier 1 Capital ratio stands at 4.9 per cent. (2012: 8.8 per cent.) (ie which is the applicable test under Basel II) and at 3.0 per cent. on a Common Equity Tier 1 Capital basis (i.e. which is the applicable test under CRD IV). As a result, the Bank has a significant capital shortfall against the PRA's target of a Common Equity Tier 1 Capital Ratio based on the Basel III/CRD IV definition of at least 7 per cent., and after any required adjustments. See Section 13 (*Capital Adequacy*) for further details of the Bank's capital position.

The Bank remains dependent on the successful completion of the Recapitalisation Plan to return to compliance with its regulatory capital requirements.

For further details of CRD IV and its expected impact on the Bank, please see Section 17 (*Supervision and Regulation*) and Section 2 (*Risk Factors*).

The launch of the Recapitalisation Plan

On 17 June 2013, following the conclusion of the Bank's review of its capital position and discussions with the PRA, it was stated in the June Announcement that the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion, of which at least £1 billion is expected to be contributed pursuant to the Liability Management Exercise in 2013 and, conditional on completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is to be contributed by Banking Group in 2014 pursuant to the 2014 Commitment (of which £170 million must be satisfied at the latest by 30 June 2014 (with £70 million of this contribution to be paid before 31 January 2014), and the remaining £163 million by 31 December 2014).

On 17 June 2013, the PRA made the following statement:

"The PRA's current assessment is that the Co-operative Bank needs to generate an additional £1.5 billion in Common Equity Tier One capital in order to absorb potential losses over coming years. We will hold the Co-operative Group to the delivery of its plans. In relation to the Co-operative Bank this action will deliver the Financial Policy Committee's recommendation to the PRA in March regarding the capital position of the banking system."

On 29 August 2013, the PRA reconfirmed its assessment of the Bank's capital shortfall of £1.5 billion of Common Equity Tier 1 Capital following the announcement of the Bank's interim results for the six month period ended 30 June 2013. The PRA also reconfirmed that this requirement remained unchanged following the announcement by the Bank on 21 October 2013 of an expectation of an increase in its overall provisions of approximately £103 million relating to customer redress. The Liability Management Exercise is intended to generate at least £1 billion of the required £1.5 billion of Common Equity Tier 1 Capital by the end of 2013. Successful completion of the Liability Management Exercise is conditional upon the entire principal amount of all Existing Securities being exchanged or sold pursuant to the Liability Management Exercise.

The contributions that a successful Liability Management Exercise would provide by the end of 2013 would increase the Bank's Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9 per cent. but above the regulatory minimum requirement" by the end of 2013, including after taking into account the impact of the impairment charges of £496.0 million incurred for the six month period ended 30 June 2013 and potential impairment charges for the remainder of the Bank's financial year ending 31 December 2013.

3. The Recapitalisation Plan

The key objective of the Recapitalisation Plan is to strengthen significantly the Bank's Common Equity Tier 1 Capital base and to refocus the Bank's strategy around its strength in core relationship retail banking providing current accounts, residential mortgages and savings products to retail customers and SMEs. The Liability Management Exercise forms a critical element of the Recapitalisation Plan. The Liability Management Exercise is intended to generate at least £1 billion of the £1.5 billion of Common Equity Tier

1 Capital required by the Bank. The Liability Management Exercise will generate Common Equity Tier 1 Capital in two ways:

- first, to the extent that the Bank exchanges Dated Notes for New Ordinary Shares and issues Additional New Ordinary Shares pursuant to the Scheme, the amount of such New Ordinary Shares and Additional New Ordinary Shares issued will constitute Common Equity Tier 1 Capital for the Bank; and
- second, to the extent that Existing Securities are exchanged or sold for New Securities at a discount to the Bank's book value of those Existing Securities (i.e. by imposing a discount on the Existing Securities through the Liability Management Exercise), the amount of that discount will also be recognisable as Common Equity Tier 1 Capital (on the basis that the Bank will reduce a liability for less than the book value of that liability in the Bank's accounts).

The offers in respect of the Preference Shares and Perpetual Subordinated Bonds are being conducted by way of exchange offers (the **Exchange Offers**) and certain proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds (the **Proposals**). The offer in respect of the Dated Notes is being conducted by way of the Scheme. The Liability Management Exercise will only be successfully completed if the entire principal amounts of the Existing Securities are exchanged or sold pursuant to the Liability Management Exercise.

The Scheme will also provide that 62,500,000 Additional New Ordinary Shares will be made available to Holders of the Dated Notes for subscription for an aggregate consideration equal to £125 million on the terms of the Scheme as described in the Explanatory Statement (the **Additional New Ordinary Shares Offer**).

The Exchange Offers, the Proposals and the Scheme are collectively referred to in this Prospectus as the Liability Management Exercise. In addition, as part of the Liability Management Exercise Holders of certain of the Existing Securities (being Preference Shares and 13% Bonds) will have the option to either exchange their Existing Securities for Final Repayment Notes or sell their Existing Securities to Co-operative Group for cash consideration payable in instalments (represented by Instalment Repayment Notes). Each such Holder will have the opportunity to choose whether it would prefer to receive Final Repayment Notes or Instalment Repayment Notes (if the Liability Management Exercise is successfully completed) each to be issued by Co-operative Group pursuant to the Group Notes.

In addition, the Bank expects that capital created through interest savings on the Existing Securities surrendered in the Liability Management Exercise net of any coupon payments on the New Securities should contribute an additional amount of Common Equity Tier 1 Capital towards the Recapitalisation Plan, beyond that created as a result of the Liability Management Exercise. The Bank currently estimates that net interest savings should result in allowable Common Equity Tier 1 Capital in the region of £40 million during the course of 2014.

2014 Commitment

Under the Recapitalisation Plan, Banking Group has agreed to contribute £333 million of Common Equity Tier 1 Capital during 2014 (the **2014 Commitment**). On 4 November 2013 (being the date of the launch of the Recapitalisation Plan), Banking Group entered into a legally binding and irrevocable undertaking to pay (the **Undertaking to Pay**) in favour of the Bank in consideration for the issuance of 54,058,442 New Ordinary Shares immediately prior to the completion of the Liability Management Exercise (the **2014 Commitment Agreement**). Banking Group's obligations under the 2014 Commitment and the Undertaking to Pay are conditional only upon the successful completion of the Liability Management Exercise.

As announced on 17 June 2013, Banking Group is expecting to satisfy the 2014 Commitment from the net proceeds of the sale by Banking Group of Royal London (CIS) Limited (formerly known as Co-operative Insurance Society Limited) and Royal London Asset Management (CIS) Limited (formerly known as The Co-operative Asset Management Limited) (**Co-operative Life Insurance and Asset Management**) and the net proceeds of the proposed sale of CIS General Insurance Limited (CIS General Insurance) (together the **Insurance Proceeds**). The sale of Co-operative Life Insurance and Asset Management to The Royal London

Mutual Insurance Society Limited (**Royal London**) completed on 31 July 2013. The total consideration for the sale is £219.0 million, of which £39.0 million has already been paid to Banking Group in respect of the disposal of Royal London (CIS) Limited. Payment of the remaining £180 million (as deferred consideration) is subject to the approval of the court under a transfer of the life insurance fund of Co-operative Life Insurance Society Ltd (now named RL (CIS) Ltd) into Royal London under Part VII of FSMA. There is no certainty as to timing or outcome of the court process and therefore no certainty as to when the deferred consideration may be received by Banking Group or if it will be received at all. In respect of the disposal of CIS General Insurance, the Bank has been told that, whilst Co-operative Group is currently in discussions with various interested parties to sell CIS General Insurance, as at the date of this Prospectus, no legally binding agreement to sell CIS General Insurance has been entered into and any such agreement may, when entered into, be subject to various conditions precedent.

To provide support to Banking Group's obligations under the Undertaking to Pay should the Insurance Proceeds not materialise or be insufficient to satisfy the Undertaking to Pay, Banking Group has entered into an intra-group loan with Co-operative Group and the Bank (the **Intra-group Loan**). The Intra-group Loan allows Banking Group to draw down sufficient amounts to satisfy the Undertaking to Pay taking into account Banking Group's existing cash resources and is intended to be unconditional before 2014 (see the paragraph number 20.6 "*Intra-group Loan*" in Section 20 (*Additional Information*) for further details of the small number of customary conditions precedent)). Banking Group, under the terms of the Intra-group Loan is obliged to pay any amounts drawn down under that loan to the Bank in satisfaction of the Undertaking to Pay.

Co-operative Group has informed the Bank that it has appropriate arrangements in place to satisfy the discharge of its obligations under the Intra-group Loan from alternative resources in the event that the Insurance Proceeds are not sufficient to satisfy the amount of the 2014 Commitment or otherwise not received in time to satisfy the PRA's required timing to satisfy the 2014 Commitment. For further details, see the risk factor titled "*The commitment by Banking Group to contribute £333 million of Common Equity Tier 1 Capital during 2014, in addition to being solely conditional upon the successful completion of the Liability Management Exercise, is subject to the ability of Banking Group and/or Co-operative Group to fund the commitment, which is dependent on certain actions, some of which are partially outside the control of Co-operative Group*" in Section 2 (*Risk Factors*).

The Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Bank's Existing Securities are together referred to in this Prospectus as the **Recapitalisation Plan**.

Structure of the 2014 Commitment

The 2014 Commitment has been structured as follows:

(a) The 54,058,442 New Ordinary Shares to be issued to Banking Group against the Undertaking to Pay will be issued immediately following the implementation of the Scheme in accordance with its terms (including the subscription of Additional New Ordinary Shares to Holders of Dated Notes in accordance with the Scheme). The New Ordinary Shares issued in consideration for the Undertaking to Pay will be fully paid up for the purposes of the Companies Act and will be freely transferable (subject to the lock-up restrictions imposed under the 2014 Commitment Agreement, which are to be superseded by the lock-up restrictions imposed in the Relationship Agreement between Banking Group, Co-operative Group and the Bank once this comes into force (as described in paragraph 20.3 "*Relationship Agreement*" in Section 20 (*Additional Information*)) and fungible with all other Ordinary Shares. The New Ordinary Shares issued against the Undertaking to Pay, which will be issued in the same exchange ratio as the New Ordinary Shares to be issued to Holders of the Dated Notes pursuant to the Liability Management Exercise, will represent 21.6 per cent. of the Ordinary Shares in issue at completion of the Liability Management Exercise.

(b) The Undertaking to Pay does not generate Common Equity Tier 1 Capital of the Bank until such time as the cash proceeds of the undertaking are received by the Bank.

(c) The 2014 Commitment requires Banking Group to deliver the cash proceeds to discharge the relevant proportion of the Undertaking to Pay by such dates as to satisfy the PRA's timing requirements. The PRA has stipulated that the 2014 Commitment must be satisfied in two tranches, with £170 million payable by 30 June 2014 and £163 million payable after 30 June 2014 but not later than 31 December 2014. In the 2014 Commitment Agreement, Banking Group has agreed to contribute the 2014 Commitment and satisfy the Undertaking to Pay in a number of tranches, with (i) £20 million payable by no later than 31 December 2013; (ii) £50 million by no later than 31 January 2014; (iii) £100 million by no later than 30 June 2014; and (iv) £163 million by no later than 31 December 2014. In addition, following receipt by Banking Group of the Co-operative Life Insurance and Asset Management Deferred Consideration or the net proceeds of the disposal of CIS General Insurance, Banking Group is required to apply such proceeds as soon as reasonably practicable following receipt of such proceeds in satisfaction of the Undertaking to Pay (in part or in full as the case may be).

See paragraph 20.4 "*2014 Commitment Agreement*" in Section 20 (*Additional Information*) for more details of the 2014 Commitment.

(d) The Intra-group Loan allows Banking Group to draw down sufficient amounts to satisfy the Undertaking to Pay taking into account Banking Group's existing cash resources and is intended to be unconditional before 2014 (and is only subject to a small number of customary conditions precedent – see the paragraph number 20.6 "*Intra-group Loan*" in Section 20 (*Additional Information*) for further details). Banking Group, under the terms of the Intra-group Loan is obliged to pay any amounts drawn down under that loan to the Bank in satisfaction of the Undertaking to Pay.

4. Impact of the successful implementation of the Liability Management Exercise

The Liability Management Exercise, if successful, will generate at least £1 billion of Common Equity Tier 1 Capital for the Bank being comprised of the Common Equity Tier 1 Capital generated pursuant to the Exchange Offers, the Proposals and the Scheme, together with £125 million in respect of the Additional New Ordinary Shares Offer under the Scheme. The completion of the Liability Management Exercise will, in turn, mean that the Undertaking to Pay will become unconditional and, when taking into account the allowable capital benefits from interest savings on Existing Securities surrendered as a result of the Liability Management Exercise, means the Bank will be in a position to satisfy the requirement that the Bank raise an additional £1.5 billion of Common Equity Tier 1 Capital by the end of 2014.

Assuming the Liability Management Exercise is completed and therefore at least £1 billion of Common Equity Tier 1 Capital is raised in respect of the Exchange Offers, Proposals and the Scheme, and £125 million is in 2013 raised pursuant to the Additional New Ordinary Shares Offer under the Scheme, the Bank expects to report, for the end of 2013, a Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9% but above the regulatory minimum requirement". Taking into account the benefit of the additional Common Equity Tier 1 Capital to be provided by Banking Group to satisfy the 2014 Commitment and a reduction in risk weighted assets, partially offset by expected losses in the Bank in 2014, it is currently expected that the Bank's Common Equity Tier 1 Capital ratio will remain broadly stable, improving only modestly from this level in the coming years. The Bank expects to achieve a leverage ratio above the regulatory minimum by the end of 2014.

5. Consequences of a failure of the Liability Management Exercise

The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities are exchanged or sold pursuant to the Liability Management Exercise.

As stated in the June Announcement, Co-operative Group and the Bank continue to believe that the Recapitalisation Plan (including in its revised form), of which the Liability Management Exercise forms an integral part, is in the long-term interests of their respective stakeholders and of the Bank itself.

Absent the support of sufficient Holders to participate in and, where requested, approve the proposals being made in the Liability Management Exercise, it will fail.

The uncertainty around the implementation of the Recapitalisation Plan constitutes a material uncertainty which casts significant doubt on the Bank's ability to continue as a going concern. The Bank's Interim Financial Information, therefore, included an emphasis of matter statement as to the Bank's ability to continue as a going concern (see note 2 to the Interim Financial Information for further details of the going concern position of the Bank contained in Part A in Section 16 (*Financial Information*)).

Given the discretionary nature of the powers available to the Resolution Authorities under the Banking Act, the Bank is unable to predict with certainty the precise outcome for Holders, if the Liability Management Exercise is not successfully implemented during 2013. However, the Bank has no other source available to it to raise the required additional capital. As stated in the Bank's Interim Financial Information, if the Liability Management Exercise is not successfully completed, the Bank will cease to be a going concern and the Bank considers that it is likely to fail to satisfy its threshold conditions for authorisation (within the meaning of Section 55B of FSMA). In such circumstances, the relevant Resolution Authority may then exercise a stabilisation power under the Banking Act. These threshold conditions include a requirement that the PRA is satisfied that the Bank, in particular, has appropriate financial and non-financial resources, including that the Bank has made appropriate provisions for its liabilities. In addition, the Resolution Authorities may also exercise their powers to resolve the Bank even if it remains a going concern.

If the Liability Management Exercise is not successfully implemented on or before 31 December 2013, the Bank therefore considers that the PRA would have a basis for determining that the Bank is failing, or is likely to fail, to satisfy its threshold conditions; that the power of the Resolution Authorities to exercise stabilisation powers under the Banking Act had arisen; and the Bank believes that it is likely that it would be subject to a resolution procedure under the Banking Act. The Bank therefore believes that there are only two realistic outcomes for the Bank, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Bank becoming subject to a resolution procedure under the Banking Act.

For further details of the risks of the Liability Management Exercise, see the section entitled "*Risks relating to the Liability Management Exercise*" in Section 2 (*Risk Factors*) of this Prospectus. For further information on the consequences of a failure of the Liability Management Exercise, see Part C of this Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*).

6. Details of the Liability Management Exercise

The Liability Management Exercise being conducted by the Bank and Co-operative Group involves inviting the Holders of the Existing Securities to exchange or sell their Existing Securities for New Securities to be issued by the Bank and, in certain cases, Co-operative Group.

Details of the Liability Management Exercise can be found in Section 6 (*Details of the Liability Management Exercise*) and in the Offer Memorandum, which is appended to and forms part of this Prospectus.

PART C: POTENTIAL CONSEQUENCES OF HOLDERS FAILING TO SUPPORT THE LIABILITY MANAGEMENT EXERCISE

RESOLUTION ANALYSIS

1. Purpose of this resolution analysis

The purpose of the resolution analysis contained in this Part C is to assist Holders of Existing Securities in determining whether or not to vote in favour of the proposals set out in this Prospectus, and in particular the Offer Memorandum, and the Explanatory Statement. The resolution analysis compares the position which Holders of Existing Securities would be likely to face if the Bank were resolved on 31 December 2013 and the position for Holders of Existing Securities if the Liability Management Exercise is successfully implemented, to assist Holders of Existing Securities in deciding whether or not to vote in favour of the Scheme or, as the case may be, the resolutions to approve the Proposals or otherwise to participate in the Liability Management Exercise.

The Bank of England and HM Treasury (the **Resolution Authorities**) have wide discretionary powers as to how to effect a resolution of the Bank. Analysing the position of Holders of Existing Securities following resolution of the Bank is therefore subject to a number of uncertainties and Holders of Existing Securities should take careful note of the significant limitations and uncertainties set out in section 5 below.

2. Why participate in the Liability Management Exercise?

The Bank believes that if the Liability Management Exercise were to fail this would result in the Bank being subject to a resolution procedure under the Banking Act. If, following resolution, the Bank goes into an insolvency proceeding, the Bank believes, on the basis of the hypothetical analysis described in section 5 below, that Holders of Existing Securities would receive no dividend at all in that insolvency proceeding and no compensation, whether directly or indirectly, as a result of the resolution. The Bank also believes that there is fundamental uncertainty whether the Bank could be resolved a going concern without the active support of Co-operative Group and a substantial amount of additional capital, as described in section 8 below.

If the Liability Management Exercise is successfully completed Holders of the Dated Notes will be entitled to receive Notes and New Ordinary Shares in the Bank (together with the opportunity to participate in the Additional New Ordinary Shares Offer), Holders of the 5.5555% Bonds will receive Notes (together with a cash amount equal to the accrued and unpaid interest on the 5.5555% Bonds) and Holders of the 13% Bonds and Preference Shares would receive the choice to receive either Final Repayment Notes or cash consideration payable in instalments (represented by Instalment Repayment Notes (together with a cash amount equal to the accrued and unpaid dividends on the Preference Shares or interest on the 13% Bonds (as the case may be)) (in each case subject to compliance with the relevant procedures described in the Offer Memorandum and, in the case of the Holders of the Dated Notes, the Explanatory Statement and depending on the extent of their participation in the Liability Management Exercise) (the **Restructuring Consideration**).

3. What happens if the Liability Management Exercise is successfully completed?

If the Liability Management Exercise is successfully completed each Holder of Existing Securities will be entitled to receive, for each £100,000 nominal of Existing Securities which it holds, the amount of Restructuring Consideration described in paragraph 2 "*Summary Offering Tables*" in Section 6 (*Details of the Liability Management Exercise*).

New debt securities

For details of the terms of the Group Notes and the Notes see the Offer Memorandum and for a summary of the associated risk factors relating to these securities see Section 2 (*Risk Factors*) and the prospectuses published in connection with the Group Notes and the Bank T2 Notes (as further described in the Offer Memorandum).

The value of the Group Notes and the Notes are shown in the tables above at nominal (face) value for illustrative purposes and should not be taken as a guide to the market value of these securities following implementation of the Liability Management Exercises.

New Ordinary Shares in the Bank

There is currently no public trading market for the New Ordinary Shares and there can be no certainty as to the development or liquidity of any market for the New Ordinary Shares. Holders of Existing Securities should therefore determine for themselves, based on the information set out in the Prospectus, the value to be ascribed by them to the New Ordinary Shares.

4. What is the likely outcome for Holders of Existing Securities if the Liability Management Exercise is not successfully completed?

Stabilisation powers of Bank of England and HM Treasury

As a preliminary point, regulatory policy (see, for example, Bank of England and FSA joint paper entitled "*A review of requirements for firms entering into or expanding in the banking sector*", March 2013 at pages 5, 9 and 13) is that if a bank is no longer able to survive as a going concern, the bank should be allowed to fail. That is to say, while both the payments system and insured depositors will be protected, there should be no bail out of a bank. In other words, public funds will not be made available in order to resolve a bank.

The stabilisation powers in relation to the Bank available to the Bank of England and HM Treasury, once the relevant conditions are satisfied are as follows:

1. to sell all or part of the business of the Bank to a commercial purchaser;
2. to transfer all or part of the business of the Bank to a company which is wholly owned by the Bank of England; or
3. to take the Bank into temporary public ownership.

HM Treasury may only exercise the Temporary Public Ownership power if the exercise for that power is necessary:

(i) to resolve or reduce a serious threat to the stability of the financial systems of the United Kingdom; or

(ii) to protect the public interest, where HM Treasury have provided financial assistance in respect of the Bank for the purpose of resolving or reducing a serious threat to the stability of the financial systems of the United Kingdom. HM Treasury have not provided any such financial assistance so this would not be applicable.

If the Resolution Authorities exercise a stabilisation power, HM Treasury must make an order which establishes a regime for compensation in respect of the resolution although there is nothing to prevent the application of the valuation principles in such an order establishing a scheme for compensation from resulting in no compensation being payable.[1] A compensation scheme order will provide for a transferor to be paid compensation or provide for a scheme to determine whether a transferor should be paid compensation and will establish a scheme for paying any such compensation. A compensation scheme order may provide for the amount of any compensation payable to be determined by an independent valuer appointed in accordance with the order and may specify principles to be applied in determining the amount of compensation.

[1] Valuation principles under a compensation scheme order may require or permit an independent valuer to make assumptions such as, for example, that the Bank has had its regulatory permissions varied or cancelled, is unable to continue as a going concern, is in administration or is being wound up.

A resolution fund order is an order establishing a scheme under which transferors become entitled to the proceeds of the disposal of things transferred in specified circumstances and to a specified extent.

A third party compensation order provides for compensation to be paid to persons other than transferors. A third party compensation order must provide that the independent valuer must assess the treatment (the **Insolvency Treatment**) which pre-transfer creditors would have received had the Bank entered into insolvency immediately prior to the time at which it was resolved. The independent valuer must assess the treatment (the **Actual Treatment**) which pre-transfer creditors have received, are receiving or are likely to receive if no compensation is paid. If the independent valuer considers that, in relation to any pre-transfer creditor, the Actual Treatment is less favourable than the Insolvency Treatment, the independent valuer must determine that compensation is paid to that pre-transfer creditor. The amount of compensation must be determined by reference to the difference in treatment and on the basis of the fair and equitable value of that difference in treatment.

The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities are exchanged or sold pursuant to the Liability Management Exercise.

As stated in the June Announcement, Co-operative Group and the Bank believe that the Recapitalisation Plan, of which the Liability Management Exercise forms an integral part, is in the long-term interests of their respective stakeholders and of the Bank itself.

Absent the support of sufficient Holders to participate in and, where requested, approve the proposals being made in the Liability Management Exercise will fail.

The uncertainty around the implementation of the Recapitalisation Plan constitutes a material uncertainty which casts significant doubt on the Bank's ability to continue as a going concern. The Bank's Interim Financial Information, therefore, included an emphasis of matter as to the Bank's ability to continue as a going concern (see note 2 to the Interim Financial Information for further details of the going concern position of the Bank contained in Part B in Section 16 (*Financial Information*).

Given the discretionary nature of the powers available to the Resolution Authorities under the Banking Act, the Bank is unable to predict with certainty the precise outcome for Holders if the Liability Management Exercise is not successfully implemented during 2013. However, the Bank has no other source available to it to raise the required additional capital. As stated in the Bank's Interim Financial Information, if the Liability Management Exercise is not successfully implemented, the Bank will cease to be a going concern and, as a result, the Bank is likely to fail to satisfy its threshold conditions for authorisation (within the meaning of Section 55B of FSMA) and the relevant Resolution Authority may then exercise a stabilisation power under the Banking Act. These threshold conditions include a requirement that the PRA is satisfied that the Bank, in particular, has appropriate financial and non-financial resources, including that the Bank has made appropriate provision for its liabilities. In addition, the Resolution Authorities may also exercise their powers to resolve the Bank even if it remains a going concern.

If the Liability Management Exercise is not successfully implemented on or before 31 December 2013, the Bank therefore considers that the PRA would have a basis for determining that the Bank is failing, or is likely to fail, to satisfy its threshold conditions; that the power of the Resolution Authorities to exercise stabilisation powers under the Banking Act had arisen; and the Bank believes it would be subject to a resolution procedure under the Banking Act. The Bank therefore believes that there are only two realistic outcomes for the Bank, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Bank ceasing to be a going concern and, as such, the Bank considers it likely that the Bank would be subject to a resolution procedure under the Banking Act.

For further details of the risks of the Liability Management Exercise, see the paragraph titled "*Risks relating to the Liability Management Exercise*" in Section 2 (*Risk Factors*). For further information on the consequences of a failure of the Liability Management Exercise, see Part C of this Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*).

5. The insolvency analysis

In order to form a view as to whether it is likely, if the Bank went into a hypothetical insolvency process following its resolution, that there would be any return to Holders of Existing Securities as a result of that process, the Bank has prepared an insolvency analysis.

The insolvency analysis represents an illustrative estimate of insolvency values and recovery percentages based upon hypothetical insolvency proceedings for the Bank commenced on 31 December 2013. The insolvency analysis is based on the balance sheet contained in the Interim Financial Information.

Insofar as insolvency might be an event that occurs in the future, the ultimate returns to Holders of Existing Securities will be determined by a series of complex circumstances relevant at the time of the insolvency. There may be unforeseen events, changes in economic conditions and many other potential variables that could impact on and change the actual outcome of an insolvency process.

The Bank has prepared the insolvency analysis on the basis of assumptions which the Directors believe are reasonable in the circumstances. However, the assumptions are subject to significant uncertainties which are beyond anyone's control, and unanticipated events and circumstances might materially affect the anticipated results.

Neither the assumptions nor the numbers generated in the insolvency analysis have been audited. While the insolvency values are presented with some specificity (albeit within a range), the actual results achieved would in all likelihood vary, and could vary in ways that may be material. Accordingly, there can be no assurance that the assumptions employed in determining the insolvency value of the assets will result in accurate estimations of such insolvency values.

None of the Bank, its directors or advisers makes any representation or warranty that the actual results for Holders upon an insolvency of the Bank would or would not approximate to the financial outcomes described below.

Nothing in this Part C constitutes a valuation. Where present values for different scenarios are shown they are provided for illustrative purposes only and are subject to assumptions set out in this Part C.

Estimated outcomes

Subject to the caveats and assumptions set out in this Part C, the Bank believes that the return to the Bank's senior unsecured creditors from a bank insolvency procedure or administration of the Bank would be in the range of 91.5 per cent. and that Holders of Existing Securities would receive no recovery at all in such an administration or bank insolvency procedure because their claims are subordinated to the claims of the senior unsecured creditors of the Bank.

The insolvency analysis indicates that there would be approximately £32.4 billion of estimated net recoveries (after secured creditor claims and costs) and approximately £37.3 billion of total senior unsecured creditors. Realisations in the insolvency procedure would therefore need to increase by over £3.1 billion in order for senior unsecured creditors to recover the full principal amount of their claims.

Key insolvency analysis assumptions

A. Insolvency procedures available for the Bank include a bank insolvency procedure, a bank administration procedure (both provided for under the Banking Act), a liquidation or an administration (both provided for under the Insolvency Act 1986). Under an administration pursuant to the Insolvency Act 1986, an administrator has powers to make distributions to creditors (a distributing administration). For the purposes of the insolvency analysis the Bank has assumed that the relevant insolvency procedure is either a bank insolvency procedure or a distributing administration. The Bank considers that the likely strategy of the insolvency office holder and the likely outcome for creditors would be similar under either procedure.

B. Any surplus realisations remaining after payment of the debts proved by senior unsecured creditors would be applied in the insolvency procedure in payment of the debts proved by subordinated

creditors in respect of the Dated Notes before being applied in payment of interest, whether on the debts proved by the senior unsecured creditors or on the debts proved by the holders of Dated Notes.

C. Under a bank insolvency procedure the liquidator has two statutory objectives: (i) to work with the FSCS so as to ensure that as soon as reasonably practicable each eligible depositor has the relevant account transferred to another institution or it receives payment from the FSCS; and (ii) to wind up the affairs of the bank so as to achieve the best result for the bank's creditors as a whole.

In relation to the second statutory objective, the Bank considers that the best results for its creditors as a whole would not be achieved through a fire sale on day 1 of the process which would flood the market and drive down pricing. At the opposite end of the scale, a very long term run-off may result in higher nominal recoveries but it is likely to result in significant cost inefficiencies and not achieve the best result for creditors as a whole taking into account the cost of funding of the creditors. The Bank considers that the best result will lie somewhere in between and in practice would anticipate the insolvency office holder's strategy to be a combination of medium term run-off combined with regular portfolio sales. In particular, a bank liquidator would be influenced as to strategy by his creditors committee which would include the FSCS who would be the majority creditor (following pay out to eligible depositors), Hence, maximising return for the Bank's creditors as a whole would need to take account of the FSCS's cost of funding relating to the depositor payments it has made. The Bank understands that this is likely to be "market rate" funding cost.

The result in an administration would be similar. An administrator must submit his proposals to a creditors' meeting which may approve them without modification or approve them with modifications to which the administrator consents. An administrator has a responsibility to have regard to the views of the creditors and is entitled to give considerable weight to the views of a substantial majority of creditors about how to proceed.

The Bank has therefore assumed for the purposes of the insolvency analysis a five year run off and a sale of the rump at the end of year five. The Bank considers that this five year period is appropriate by reference to loan repayment profiles and economic factors and that it does not appear inconsistent with relevant precedents.

6. Would Holders of Existing Securities be entitled to compensation as a result of a resolution of the Bank?

Holders of Existing Securities would, except in the circumstances referred to in section 8 below, be third parties for the purposes of the compensation regime which must be established by HM Treasury pursuant to the Banking Act. The independent valuer appointed pursuant to any third party compensation order must apply the principles set out in section 4 above. Applying these principles to the insolvency analysis set out in section 5, under the Insolvency Treatment, no holder of Existing Securities would be entitled to any recovery at all in the hypothetical insolvency process for the Bank and the Actual Treatment cannot therefore be less favourable than the Insolvency Treatment in this case. There is therefore no basis on which Holders of Existing Securities would be entitled to compensation under an order made pursuant to the Banking Act as a result of a resolution of the Bank.

7. Could the Bank be entitled to compensation as a result of its resolution?

If a resolution of the Bank involves a transfer of all or part of its assets or liabilities, the Bank will be entitled to claim compensation as a transferor under the compensation regime which must be established by HM Treasury. The Bank believes that the most likely circumstances in which compensation may be payable to it as a transferor would be either if all or part of its assets were transferred at an undervalue (in which case it would be entitled to claim under a scheme compensation order) or if the assets which were transferred were subsequently realised (in which case it may be able to claim under a resolution fund order).

Although the Resolution Authorities have wide discretionary powers and although the Bank is not waiving or abrogating any right to claim compensation as a transferor in the event of its resolution, the Bank is not aware of any circumstances which would lead it to believe that it would be able to recover compensation following its resolution either at all or of an amount which would result in an indirect return to Holders of Existing Securities.

8. Could the Bank be resolved as a going concern?

Under Section 19 of the Banking Act, the Resolution Authorities have a power (the **Section 19 Power**), in connection with an order for the resolution of the Bank, to make an order converting securities from one class to another. The extent of the Section 19 Power has not been tested, but the Bank believes that this power may permit the Resolution Authorities to order that the Existing Securities are converted into New Ordinary Shares of the Bank in connection with its resolution.

Even if the Section 19 Power were capable of being exercised in this manner, the Bank considers that there is material uncertainty whether the Bank would be capable of continuing as a going concern following the exercise of the Section 19 Power in this manner. The Recapitalisation Plan for the Bank requires the Bank to hold additional Common Equity Tier 1 Capital of at least £1.5 billion by the end of 2014. If the Section 19 Power were exercised, the conversion of the Existing Securities into New Ordinary Shares of the Bank would produce Common Equity Tier 1 Capital of approximately £1.23 billion for the Bank, which is less than the £1.5 billion minimum requirement imposed by the PRA by the end of 2014. The Bank also considers it likely that, if the Section 19 Power were to be used, the PRA would determine that a larger amount of capital would be required to be held by the Bank in order to ensure market confidence and reduce the risks of a second resolution.

It is possible, although the extent of this power is also untested, that the PRA may have power under section 192(C) of FSMA to direct Banking Group, as a qualifying parent undertaking, to contribute all or any of its shares in CIS General Insurance, the proceeds of sale of CIS General Insurance and/or the deferred consideration payable to Banking Group for the sale of its shares in Co-operative Life Insurance and Asset Management, for the purpose of increasing the capital of the Bank. However, even if the PRA were, successfully, to exercise its power under section 192(C) of FSMA in this way, both the timing for receipt of the proceeds of sale of CIS General Insurance and Co-operative Life Insurance and Asset Management and the quantum of the proceeds are uncertain. Furthermore, the trustees of Pace have a guarantee from CIS General Insurance for the liabilities of that scheme, which would need to be released as part of the sale process. It is therefore uncertain how much, if any, proceeds will be generated by Banking Group from disposal of CIS General Insurance as a result of this requirement. It is therefore uncertain whether the capital generated from the exercise of the Section 19 Power together with the capital generated from the exercise of this power would produce total Common Equity Tier 1 Capital for the Bank of £1.5 billion by the end of 2014, or that this would generate sufficient total capital for the Bank to continue to operate as a going concern with the total capital required by the PRA.

Further, there is no certainty that if the Bank were to be recapitalised in this manner, without the agreement of Co-operative Group, that it would continue to enjoy the support of Co-operative Group. See the risk factors titled "*The Bank will continue to rely on Co-operative Group and the Co-operative brand. Co-operative Group will also continue to exert substantial influence over the Bank", "The Bank's operations are highly dependent on the proper functioning of IT and communication systems. Any significant delay in or failure of the Bank to re-engineer its existing IT platform to meet the requirements of its business strategy may adversely affect the future operational and financial performance of the business. "The Bank relies on the provision of a number of services (including certain critical functions) by Co-operative Group, including IT"* and *"The Bank is dependent on third party providers of services, IT, software, data and other assets*" in Section 2 (*Risk Factors*).

As an alternative, it is possible that the powers of the Resolution Authorities extend to an ability to convert all or part of the £892 million outstanding amount of senior unsecured bonds issued by the Bank (**Senior Bonds**) into another class of securities. If the Resolution Authorities concluded that they could exercise their power in this manner it would be possible for sufficient capital to be generated to enable the Bank to be resolved as a going concern by converting sufficient Senior Bonds to make up the deficit between the amount of Common Equity Tier 1 Capital generated by converting the Existing Securities and the amount of total capital which the Bank requires. However, the Bank is not aware whether or not the Resolution Authorities are contemplating the exercise of this power in this manner.

The Bank therefore considers that there are material uncertainties as to whether the Bank could be successfully resolved under the current terms of the Banking Act such that the Bank itself remained a going concern.

In October 2013 HM Treasury published a briefing (the **Treasury Briefing**) on proposed treasury amendments to the Banking Act to introduce a bail in power (the **Proposed Bail in Power**). The Bank understands that the Proposed Bail in Power is due to become law in the first quarter of 2014. The Treasury Briefing contains detailed drafting amendments to the Banking Act which would be needed in order to implement the Proposed Bail in Power. It would, in principle, be open to HM Government to introduce the Proposed Bail in Power as emergency legislation so that it was available to resolve the Bank should this become necessary. The Proposed Bail in Power includes the power to make an order which contains a provision for cancelling, modifying or changing the form of a liability owed by the Bank, which includes the power to convert a debt security into an equity security. The Treasury Briefing notes that exercise of powers in the course of a bail in should in general respect the creditor hierarchy and the principle of equal treatment of equally ranking creditors and that regulations will be made making clear that a no creditor worse off safeguard is to apply in relation to resolutions using the Proposed Bail in Power. The Bank is not aware whether or not HM Government are contemplating the introduction of the Proposed Bail in Power ahead of its scheduled enactment if it proves necessary for the Bank to be resolved. The Bank considers that there are material uncertainties as to whether such emergency legislation would be introduced, how the Bank would be resolved pursuant to any such legislation and what, if any, recovery Holders of Existing Securities might receive as a result of such a resolution.

9. Conclusion

For the reasons set out in this Part C, the Bank believes that implementation of the Liability Management Exercise is substantially more beneficial to Holders of all classes of Existing Securities than resolution of the Bank.

5
EXPECTED TIMETABLE OF THE LIABILITY MANAGEMENT EXERCISE

The following section contains an indicative timetable for the Liability Management Exercise. Whilst the Bank currently expects to follow this timetable, the timetable is subject to change.

EXPECTED TIMETABLE FOR THE LIABILITY MANAGEMENT EXERCISE

The times and dates referred to below are indicative only and are subject to the right of the Bank and/or Co-operative Group to extend, re-open, amend and/or terminate the Exchange Offers or any of them at any time and the right of the Bank (if required or permitted by the Court) to amend and/or withdraw the Scheme at any time. Accordingly, the actual timetable may differ significantly from the expected timetable set out below.

If any of the below times and/or dates change, the revised time(s) and/or date(s) will be announced by the Bank and/or Co-operative Group as soon as reasonably practicable by publication of a supplement to this Prospectus.

Scheme Events	Dates and Times (all times are London time)	Offer Events
Announcement of the Scheme	**4 November 2013**	**Announcement of the Exchange Offers**
Scheme announced.		Exchange Offers announced. Prospectuses published.
Practice statement letter sent to Scheme Creditors.		Offer period commences. Eligible Holders of Preference Shares, 13% Bonds or 5.5555% Bonds can offer to exchange or sell their Existing Securities and/or vote in respect of the Proposals.
Announcement of Consideration Amounts in the Scheme	**On or around 14 November 2013**	
Announcement of the final Consideration Amounts and New Ordinary Shares Conversion Price.		
Scheme Convening Hearing	**18 November 2013**	
Initial Court hearing for leave to convene the Scheme Meeting.		
Explanatory Statement and Scheme Documents available	**19 November 2013**	
Explanatory Statement and Scheme Documents available to Scheme Creditors.		

Scheme Events	Dates and Times (all times are London time)	Offer Events
	4.30 p.m. on 29 November 2013	**Early Participation Deadline** The deadline by which the Early Participation Threshold must be achieved in order for Preference Shares 13% Bonds and 5.5555% Bonds to be exchanged or sold on the basis of the Early Consideration Amounts for such Existing Securities.
	4.30 p.m. on 6 December 2013	**Expiration Deadline** Deadline for receipt of all Exchange Instructions from Eligible Holders in respect of Preference Shares, 13% Bonds and 5.5555% Bonds.
Voting Instructions Deadline Deadline for receipt of all Account Holder Letters containing voting instructions in order for Holders to vote on the Scheme, elections to subscribe for Additional New Ordinary Shares pursuant to the Additional New Ordinary Shares Offer in the Scheme and confirming eligibility to receive Scheme Consideration under the Scheme on the Scheme Settlement Date.	**4.30 p.m. on 10 December 2013**	
Scheme Record Date Only those Holders who are Scheme Creditors as at the Scheme Record Date are entitled to attend and vote at the Scheme Meeting (unless the Bank, in its sole discretion, elects to recognise, for the purposes of the Scheme, a transfer of Dated Notes after the Scheme Record Date such that the transferee becomes a Scheme Creditor).	**10 December 2013**	

Scheme Events	Dates and Times (all times are London time)	Offer Events
Scheme Meeting Meeting of the Scheme Creditors to vote on the Scheme. The Bank will request the Court to convene the Scheme Meeting on 11 December 2013.	**11 December 2013**	**Meetings** Meetings of the Holders of the Preference Shares, 13% Bonds and 5.5555% Bonds held to consider the Extraordinary Resolutions pursuant to the Proposals. 1.00 p.m. in respect of the Preference Shares. 2.00 p.m. in respect of the 13% Bonds. 3.00 p.m. in respect of the 5.5555% Bonds.
	11 December 2013	**Offer Record Date** The record date for the purposes of ceasing trading in the Preference Shares, 13% Bonds and 5.5555% Bonds, and for determining entitlement to receive the relevant Group Notes, Bank T2 Notes, Accrued Dividends, Accrued Interest and other amounts payable under the terms of the Liability Management Exercise (if successfully completed).
Results Announcement Announcement of the results of the Liability Management Exercise	**12 December 2013**	**Results Announcement** Announcement of the results of the Liability Management Exercise.
Scheme Sanction Hearing Second Court hearing for sanction of the Scheme by the Court. The Bank will announce as soon as reasonably practicable after the Scheme Sanction Hearing whether or not the Scheme is sanctioned.	**16 December 2013**	
Filing of sanction order Sanction order (if granted) delivered to the Registrar of Companies. Scheme becomes effective in accordance with its terms.	**The date of the Scheme Sanction Hearing or the following business day**	

Settlement Date / Scheme Settlement Date	**18 December 2013**	**Settlement Date/ Scheme Settlement Date**
Expected settlement of the Scheme (subject to satisfaction of the Settlement Condition), including issue and delivery of New Ordinary Shares, Bank T2 Notes and Additional New Ordinary Shares.		Expected settlement of the Offers (subject to satisfaction of the Settlement Condition), including issue and delivery of Bank T2 Notes and Group Notes and payment of Accrued Dividends, Accrued Interest and other relevant amounts.

The above timetable may be impacted in certain respects if any of the Meetings in respect of the Preference Shares, the 13% Bonds and the 5.5555% Bonds are required to be adjourned. If the timetable is changed for any reason, the Bank and/or Co-operative Group will announce the new dates by publication of a supplement to this Prospectus.

If any of the Meetings are required to be adjourned, the Bank currently expects that the adjourned meeting(s) would be held on or around 27 December 2013 and the settlement date for the Offers and the Scheme will be postponed to on or around 31 December 2013. In such event, the Bank will announce the new dates by publication of a supplement to this Prospectus.

Unless stated otherwise or required by order of the Court, announcements in relation to the Liability Management Exercise will be made: (i) by the issue of a press release to a Notifying News Service; (ii) by the delivery of notices to Euroclear and Clearstream, Luxembourg for communication to Direct Participants; (iii) via the Regulatory News Service (RNS) operated by the London Stock Exchange; and (iv) as otherwise required by the rules of the London Stock Exchange. Copies of all announcements, notices and press releases can also be obtained from the Exchange Agent, the contact details for which are at the end of this Prospectus.

Holders are advised to check with any custodian, broker or other intermediary through which they hold their Existing Securities when such intermediary needs to receive instructions from a Holder in order for such Holder to participate in the Liability Management Exercise.

6
DETAILS OF THE LIABILITY MANAGEMENT EXERCISE

The following section contains information relating to the Liability Management Exercise. The full terms of the Liability Management Exercise are set out in the Offer Memorandum attached as Appendix C (*Consent and Exchange Offer Memorandum*) to this Prospectus, and the following overview should be read in conjunction with, and is qualified entirely by, the full terms as set out in the Offer Memorandum.

DETAILS OF THE LIABILITY MANAGEMENT EXERCISE

*The following is an overview of certain information relating to the Liability Management Exercise. This overview does not purport to be complete and is qualified in its entirety by the more detailed information appearing elsewhere in this Prospectus, and in particular the information set out in the Consent and Exchange Offer Memorandum attached to this Prospectus as Appendix C (Consent and Exchange Offer Memorandum) (the **Offer Memorandum**). Holders of the Existing Securities should read the Offer Memorandum, and the other documents to which Holders are referred to therein, in full before making any decision as to whether or not to participate in the Liability Management Exercise.*

The Notes which are being offered pursuant to this Prospectus are referred to in this section as the "Bank T2 Notes".

1. THE LIABILITY MANAGEMENT EXERCISE

Existing Securities

The Liability Management Exercise is being conducted in respect of the securities listed below (together, the **Existing Securities**):

Preference Shares

- 9.25% Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516) (the **Preference Shares**)

Perpetual Subordinated Bonds

- 13% Perpetual Subordinated Bonds* (ISIN: GB00B3VH4201) (the **13% Bonds**)
- 5.5555% Perpetual Subordinated Bonds* (ISIN: GB00B3VMBW45) (the **5.5555% Bonds** and, together with the 13% Bonds, the **Perpetual Subordinated Bonds**)

Dated Notes

- Floating Rate Callable Step-up Dated Subordinated Notes due 2016** (ISIN: XS0254625998) (the **2016 Notes**)
- 5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942) (the **2019 Notes**)
- 9.25% Subordinated Notes due 28 April 2021 (ISIN: XS0620315902) (the **April 2021 Notes**)
- Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984) (the **November 2021 Notes**)
- 7.875% Subordinated Notes due 19 December 2022 (ISIN: XS0864253868) (the **2022 Notes**)
- 5.75% Dated Callable Step-up Subordinated Notes due 2024** (ISIN: XS0188218183) (the **2024 Notes**)
- 5.875% Subordinated Notes due 2033** (ISIN: XS0145065602) (the **2033 Notes**)

(together the **Dated Notes**)

* Issued by the Bank in replacement of Britannia Building Society permanent interest bearing shares on its merger with Britannia Building Society on 1 August 2009

** Originally issued by Britannia Building Society and assumed by the Bank at the time of the merger

Component parts of the Liability Management Exercise

The holders (**Holders**) of the Existing Securities are being invited, subject to applicable securities laws, to participate in the Liability Management Exercise in the following manner:

(i) Eligible Holders of the Preference Shares and the 13% Bonds are being invited to either:

(a) offer to exchange their Preference Shares and 13% Bonds for new 11 per cent. Final Repayment Subordinated Notes due 2025 (the **Final Repayment Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group; or

(b) offer to sell their Preference Shares and 13% Bonds to Co-operative Group and receive cash consideration payable in twelve equal instalments over twelve years up to (and including 2025) and represented by new Instalment Repayment Subordinated Notes (the **Instalment Repayment Notes** and, together with the Final Repayment Notes, the **Group Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group;

(ii) Eligible Holders of the 5.5555% Bonds are being invited to offer to exchange their 5.5555% Bonds for new 11 per cent. Subordinated Notes due 2023 (the **Bank T2 Notes**) to be issued by the Bank; and

(iii) the Holders of the Dated Notes are being invited to vote on proposals under a scheme of arrangement under Part 26 of the Companies Act 2006 (the **Scheme**) to authorise the Bank to exchange all Dated Notes for a combination of Bank T2 Notes and new ordinary shares (**New Ordinary Shares**) to be issued by the Bank. The Scheme will also provide that 62,500,000 additional New Ordinary Shares will be made available to Holders of the Dated Notes for subscription for an aggregate consideration of £125 million pursuant to, and on the terms of, the Scheme.

The offers in respect of the Preference Shares and Perpetual Subordinated Bonds are being conducted by way of exchange offers (the **Exchange Offers**). The offer in respect of the Dated Notes is being conducted by way of the Scheme.

In addition, the Bank is convening meetings of the Holders of the Preference Shares, 13% Bonds and 5.5555% Bonds, respectively, to vote on resolutions which, if passed, will (amongst other things) (i) enable the Bank to mandatorily effect the exchange or sale to Co-operative Group of Preference Shares, 13% Bonds and 5.5555% Bonds (as applicable), which are not exchanged or sold pursuant to the Exchange Offers, on the same economic terms as those upon which Preference Shares, 13% Bonds and 5.5555% Bonds, respectively, are exchanged or sold to Co-operative Group (as the case may be) pursuant to the Exchange Offers (the **Proposals** and each a **Proposal**) and (ii) result in the holders agreeing to certain waivers and releases in favour of the Bank, Co-operative Group, their respective directors and certain other persons.

The Exchange Offers, the Proposals and the Scheme are collectively referred to as the **Liability Management Exercise**.

Conditionality

The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities is exchanged or sold pursuant to the Liability Management Exercise. The last date on which the Liability Management Exercise may successfully complete is 31 December 2013.

In order for the entire principal amount of all Existing Securities to be exchanged or sold pursuant to the Liability Management Exercise (i) each of the Proposals in respect of the Preference Shares, 13% Bonds and 5.5555% Bonds must be approved by the Holders thereof at meetings convened for the purposes of voting on such Proposals (and, in the case of the Preference Shares, a resolution in similar terms must also be approved at a general meeting of the shareholders of the Bank) and the Proposals must be capable of being implemented in accordance with their terms, and (ii) the Scheme must be approved by the requisite majority of the Holders of the Dated Notes at the Scheme Meeting and sanctioned by the Court, an office copy of the sanction order must be delivered to the Registrar of

Companies at Companies House and the Scheme must become unconditional in accordance with its terms (together referred to as the **Settlement Condition**), all as more fully described in the Offer Memorandum.

Successful completion of the Liability Management Exercise is conditional upon satisfaction of the Settlement Condition. **The Settlement Condition is not capable of being waived.** Accordingly, if the Settlement Condition is not satisfied, the Liability Management Exercise will not be implemented, and no Existing Securities will be exchanged or sold pursuant to the Liability Management Exercise.

Early Participation Incentive

If the Early Participation Threshold is achieved by 4.30 p.m. (London time) on 29 November 2013 (the **Early Participation Deadline**), the amount of consideration which all Holders of Preference Shares, 13% Bonds and 5.5555% Bonds will be eligible to receive upon the exchange or sale of their Preference Shares, 13% Bonds and 5.5555% Bonds in the Liability Management Exercise (if the Liability Management Exercise is successfully completed) will be higher than if the Early Participation Threshold is not achieved by the Early Participation Deadline.

The **Early Participation Threshold** will be achieved by the Early Participation Deadline only if, by that time, at least 75 per cent. of the aggregate nominal amount outstanding of each of the Preference Shares, the 13% Bonds and the 5.5555% Bonds has been validly offered for exchange or sale and/or otherwise validly voted in favour of the Proposals (and not revoked).

Delivery of New Securities

The New Securities to be delivered upon successful completion of the Liability Management Exercise (being the Final Repayment Notes, the Instalment Repayment Notes, the Bank T2 Notes and the New Ordinary Shares) will be capable of being held in Euroclear, Clearstream, Luxembourg, CREST or in certificated form outside those clearing systems, and will be delivered to each Holder in the same manner in which such Holder holds its Existing Securities.

Offer restrictions

Holders who wish to participate in the Liability Management Exercise should do so only in compliance with applicable securities laws. The Exchange Offers and the Scheme are subject to certain offer restrictions, which are set out in the Offer Memorandum (in respect of the Exchange Offers) and the Explanatory Statement (in respect of the Scheme).

Further details

The separate offers in respect of the Preference Shares, the 13% Bonds, the 5.5555% Bonds and the Dated Notes are summarised briefly below, but these descriptions are subject to the more detailed offer terms and conditions set out in the Offer Memorandum and (in respect of the Dated Notes) the Explanatory Statement.

2. SUMMARY OFFERING TABLES

2.1 Preference Shares and 13% Bonds

The following table summarises the consideration that Holders of Preference Shares and 13% Bonds will be eligible to receive if their Preference Shares and 13% Bonds (as applicable) are exchanged or sold pursuant to the Liability Management Exercise:

		Early Consideration Amount[1] (per £1,000 nominal of Existing Securities)			*Late Consideration Amount[1] (per £1,000 nominal of Existing Securities)*		
Existing Securities	*ISIN*	*Final Repayment Notes[2]*	*OR[4]*	*Instalment Repayment Notes[3]*	*Final Repayment Notes[2]*	*OR[4]*	*Instalment Repayment Notes[3]*
Preference Shares[5]	GB0002224516	£601		£1,110	£551		£1,060
13% Bonds	GB00B3VH4201	£844		£1,560	£794		£1,510

Notes:

1 If the Early Participation Threshold is achieved by the Early Participation Deadline (4.30 p.m. (London time) on 29 November 2013) and the Liability Management Exercise successfully completes, all Preference Shares and 13% Bonds will be exchanged or sold at the Early Consideration Amount. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise successfully completes, all Preference Shares and 13% Bonds will be exchanged or sold at the Late Consideration Amount.

2 New sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group.

3 New sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) (having their last instalment payment date in 2025) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group. The Instalment Repayment Notes represent the instalments of consideration to be received by Holders whose Preference Shares or 13% Bonds are sold to Co-operative Group in the Liability Management Exercise.

4 The amounts of Final Repayment Notes and Instalment Repayment Notes specified in the table above are alternative options. A holder will not receive both of these amounts. Holders will be able to elect either the Final Repayment Notes option or the Instalment Repayment Notes option only.

5 The Early Consideration Amount and Late Consideration Amount for the Preference Shares are presented in this table on a "per £1,000 in nominal amount" basis for ease of comparison with the 13% Bonds. Preference Shares can be offered for exchange or sale in any whole multiple of £1 (subject to a minimum of £2 if a holder elects the Final Repayment Notes option (which is the minimum amount required, based on the Late Consideration Amount, in order to receive the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if a holder elects the Instalment Repayment Notes option.

2.2 5.5555% Bonds

The following table summarises the consideration that Holders of 5.5555% Bonds will be eligible to receive if their 5.5555% Bonds are exchanged pursuant to the Liability Management Exercise:

Existing Securities	*ISIN*	*Early Consideration Amount[1] (per £1,000 nominal of Existing Securities)*	*Late Consideration Amount[1] (per £1,000 nominal of Existing Securities)*
		Bank T2 Notes[2]	Bank T2 Notes[2]
5.5555% Bonds	GB00B3VMBW45	£530	£480

Notes:

1 If the Early Participation Threshold is achieved by the Early Participation Deadline (4.30 p.m. (London time) on 29 November 2013) and the Liability Management Exercise successfully completes, all 5.5555% Bonds will be exchanged at the Early Consideration Amount. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise successfully completes, all 5.5555% Bonds will be exchanged at the Late Consideration Amount.

2 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank.

2.3 Dated Notes

The following table summarises the consideration available to Holders of Dated Notes in the Scheme:

		Consideration Amount[1,5] (per £1,000 of Scheme Claim[4])		
Existing Securities	*ISIN*	*Bank T2 Notes[2]*	*New Ordinary Shares[3]*	*New Ordinary Shares Conversion Price[5]*
2016 Notes[4]	XS0254625998	£102.63	£897.37	
2019 Notes	XS0189539942	£102.63	£897.37	
April 2021 Notes	XS0620315902	£102.63	£897.37	£7.7718292
November 2021 Notes	XS0274155984	£102.63	£897.37	per share
2022 Notes	XS0864253868	£102.63	£897.37	
2024 Notes	XS0188218183	£102.63	£897.37	
2033 Notes	XS0145065602	£102.63	£897.37	

Notes:

1 The number of New Ordinary Shares and principal amount of Bank T2 Notes which a holder of Dated Notes will be eligible to receive in respect of its Scheme Claim will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

2 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank.

3 New Ordinary Shares to be issued by the Bank. If the Liability Management Exercise is successfully completed, Co-operative Group's existing equity stake in the Bank will be converted into deferred shares and effectively reduced to nil and a total of 250,000,000 New Ordinary Shares will be issued at that time, of which:

(i) 75,000,000 (representing 30 per cent. of the total) will be issued to Co-operative Group in consideration for its fresh injection of capital into the Bank through the Liability Management Exercise and the 2014 Commitment (representing an effective subscription price of £6.16 per share);

(ii) 112,500,000 (representing 45 per cent. of the total) will be issued to holders of the Dated Notes in the Scheme in exchange for their Dated Notes, to be distributed in the Scheme *pro rata* amongst such holders based on their respective Scheme Claims (representing, based on the total value of Scheme Claims and the number of New Ordinary Shares issued in the Scheme to holders of Dated Notes, an implied subscription price equal to the New Ordinary Shares Conversion Price). The New Ordinary Shares referred to in the table above are these 112,500,000 New Ordinary Shares; and

(iii) 62,500,000 (representing the balance of 25 per cent. of the total) will be available for subscription by holders of Dated Notes pursuant to, and on the terms of, the Scheme for an aggregate consideration equal to £125 million (representing an effective subscription price of £2.00 per share).

4 A Holder's claim in the Scheme (its **Scheme Claim**) will be equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date (expected to be 10 December 2013), provided that a Holder's Scheme Claim in respect of Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (which are denominated in euro) shall be the Sterling-Equivalent of such sum, calculated on the basis of an exchange rate of £0.85644 per €1.00.

5 Since Scheme Claims will include a component of accrued and unpaid interest on the Dated Notes and there is a finite amount of New Ordinary Shares and Bank T2 Notes available in the Scheme, the Consideration Amounts and New Ordinary Shares Conversion Price in this table are indicative only, pending determination of the floating rate of interest applicable to the interest period commencing 18 November 2013 in respect of the Floating Rate Callable Step-up Dated Subordinated Notes due 2016. For the purpose of the indicative figures above, an assumed 3-month EURIBOR rate of 0.228 per cent. (the rate prevailing as at 30 October 2013) has been applied. The actual rate is expected to be determined on or around 14 November 2013 and, once determined, the Bank will announce the final Consideration Amounts and New Ordinary Shares Conversion Price via the Regulatory News Service (RNS) operated by the London Stock Exchange. The final Consideration Amounts and New Ordinary Shares Conversion Price are not expected to differ materially from the indicative Consideration Amounts and New Ordinary Shares Conversion Price specified above.

The Scheme will also provide that 62,500,000 Additional New Ordinary Shares will be made available to Holders of the Dated Notes for subscription for an aggregate consideration equal to £125 million, all pursuant to, and on the terms of, the Scheme.

3. PREFERENCE SHARES OFFER

Exchange Offer

Holders of the Preference Shares are being offered a choice of two options:

(i) to offer to transfer their Preference Shares to Co-operative Group in exchange for Final Repayment Notes; or

(ii) to offer to sell their Preference Shares to Co-operative Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by Instalment Repayment Notes.

Final Repayment Notes

The Final Repayment Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid annually in arrear on each anniversary of the issue date of the Final Repayment Notes up to (and including) the twelfth anniversary. Co-operative Group will be obliged

to repay the principal amount of the Final Repayment Notes in full on the twelfth anniversary of their issue date.

Instalment Repayment Notes

The Instalment Repayment Notes will not bear interest. However, the principal amount of such Instalment Repayment Notes (representing instalments of the cash purchase price for the Preference Shares) will be repaid in twelve equal instalments over twelve years. Those payments will be made on each anniversary of the issue date of the Instalment Repayment Notes, with the final payment falling on the twelfth anniversary of that issue date. If the Early Participation Threshold is achieved by the Early Participation Deadline, the principal amount of Instalment Repayment Notes which a Holder will receive upon the sale of its Preference Shares to Co-operative Group will be equal to twelve times the annual dividend on those Preference Shares (rounded down to the nearest £0.12 (12 pence), which is the minimum denomination of the Instalment Repayment Notes). **Accordingly, (in circumstances where the Early Participation Threshold is achieved by the Early Participation Deadline), by repaying those Instalment Repayment Notes in twelve equal instalments over twelve years, Co-operative Group will pay to the Holder, in each of those twelve years, an amount which is broadly equivalent to the amount of dividends which such Holder would have received had it continued to hold those Preference Shares which it sells to Co-operative Group in the Liability Management Exercise.**

Holder election

Each Holder of the Preference Shares will have the opportunity to choose one of the two options available.

Since Co-operative Group will repay the principal of the Instalment Repayment Notes in equal instalments over twelve years, the amount payable to a Holder in each year if it elects the Instalment Repayment Notes option will be higher than the annual interest payment to such Holder if it elects the Final Repayment Notes option. However, the final payment on the Instalment Repayment Notes in 2025 will be significantly lower than the final payment under the Final Repayment Notes in 2025 (reflecting the fact that the principal on the Final Repayment Notes is repayable in a single payment in that twelfth year).

After the twelfth and final payment, both the Final Repayment Notes and the Instalment Repayment Notes will have been fully repaid, and the Holder will have no further entitlement to any amounts under whichever of those securities it elected to receive.

If a Holder intends to hold its Final Repayment Notes or Instalment Repayment Notes for the full twelve years, an important point of distinction for such Holder will be whether it wishes to receive (i) the higher amount payable each year (except the twelfth) under the Instalment Repayment Notes, or (ii) the lower annual payments of interest under the Final Repayment Notes but a larger one-off payment in twelve years' time, in which latter case it should elect to receive the Final Repayment Notes.

The tax treatment of Holders opting to exchange their Preference Shares for Final Repayment Notes will be different to the tax treatment of Holders opting to sell their Preference Shares for a cash amount paid in instalments (represented by Instalment Repayment Notes). Holders are directed to section I (Taxation Considerations) of the Offer Memorandum and the section headed "Taxation" in the Group Notes Prospectus which contain further information relevant to the tax consequences of choosing one of the two options. Holders are advised to consult their own professional advisers regarding the differences for them in the tax treatment of the two options based on their own circumstances.

Principal amount of Group Notes to be delivered upon exchange or sale of Preference Shares

The principal amount of Group Notes which a holder will (if the Liability Management Exercise is successfully completed) receive for each £1,000 in nominal amount of Preference Shares (excluding

the Additional Preference Shares referred to below) exchanged or sold to Co-operative Group will depend upon (i) whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option; and (ii) whether or not the Early Participation Threshold is achieved by the Early Participation Deadline:

(a) *Final Repayment Notes*

An Eligible Holder who validly offers to exchange its Preference Shares in the Exchange Offer for Final Repayment Notes will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £601 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) exchanged (subject to rounding); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £551 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) exchanged (subject to rounding).

(b) *Instalment Repayment Notes*

An Eligible Holder who validly offers to sell its Preference Shares to Co-operative Group in the Exchange Offer for cash consideration payable in instalments under the Instalment Repayment Notes option will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £1,110 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) sold to Co-operative Group (subject to rounding); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £1,060 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) sold to Co-operative Group (subject to rounding).

Accrued dividends

A Holder whose Preference Shares are exchanged or sold in the Liability Management Exercise will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid dividends on its Preference Shares (other than Additional Preference Shares) from (and including) 30 November 2013 to (but excluding) the Settlement Date.

Preference Share dividend instalment scheduled for 30 November/Additional Preference Shares

The next instalment of the Preference Share dividend is, under the terms of the Preference Shares, scheduled to be paid on 30 November 2013 (which is during the offer period for the Liability Management Exercise).

Under the terms of the Preference Shares, the Bank will not be permitted to pay the dividend in cash, but will instead be required to allot additional Preference Shares to each Holder in lieu of cash payment (**Additional Preference Shares**). The Bank expects to allot such Additional Preference Shares on 29 November 2013 (since 30 November is a Saturday).

However, if the Liability Management Exercise successfully completes, then upon exchange or sale to Co-operative Group of those Additional Preference Shares, the Holders will not receive Final Repayment Notes or Instalment Repayment Notes in respect thereof but rather will receive an amount

in cash (in pounds sterling) equal to the cash dividend which the Bank would have paid on 29 November 2013 had it been able to do so under the terms of the Preference Shares.

Proposal

A meeting of the Holders of the Preference Shares is being convened in order for those Holders to vote on a proposed resolution which, if passed and implemented, would enable the Bank:

(i) to purchase and cancel any share capital of the Bank (which would include, without limitation, Preference Shares) from time to time, without the need for the further consent of the Holders of the Preference Shares; and

(ii) to mandatorily effect, at the Bank's option, the transfer to Co-operative Group of all (but not some only) of the Preference Shares, which are not offered for exchange or sale in the Exchange Offer, either (1) in exchange for Final Repayment Notes, or (2) in return for the cash consideration to be paid over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as those upon which Preference Shares are exchanged or sold in the Exchange Offer.

The proposed resolution also contains, on behalf of all Holders of the Preference Shares (i) a release, in favour of certain persons (including, amongst others, the Bank, Co-operative Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such Holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their Preference Shares; provided, however, that nothing in that resolution shall release the Bank or the Group from their respective obligations or liabilities as the persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

The submission of a valid Exchange Instruction pursuant to the Exchange Offer will also constitute the relevant Holder's instructions to appoint the chairman of the meeting as proxy to vote on behalf of the relevant Holder in favour of the resolution proposed.

4. 13% BONDS OFFER

Exchange Offer

Holders of the 13% Bonds are being offered a choice of two options:

(i) to offer to transfer their 13% Bonds to Co-operative Group in exchange for Final Repayment Notes; or

(ii) to offer to sell their 13% Bonds to Co-operative Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by Instalment Repayment Notes.

Final Repayment Notes

The Final Repayment Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid annually in arrear on each anniversary of the issue date of the Final Repayment Notes up to (and including) the twelfth anniversary. Co-operative Group will be obliged to repay the principal amount of the Final Repayment Notes in full on the twelfth anniversary of their issue date.

Instalment Repayment Notes

The Instalment Repayment Notes will not bear interest. However, the principal amount of such Instalment Repayment Notes (representing instalments of the cash purchase price for the 13% Bonds) will be repaid in twelve equal instalments over twelve years. Those payments will be made on each anniversary of the issue date of the Instalment Repayment Notes, with the final payment falling on the twelfth anniversary of that issue date. If the Early Participation Threshold is achieved by the Early

Participation Deadline, the principal amount of Instalment Repayment Notes which a Holder will receive upon sale of its 13% Bonds to Co-operative Group will be equal to twelve times the annual interest on those 13% Bonds (rounded down to the nearest £0.12 (12 pence), which is the minimum denomination of the Instalment Repayment Notes). **Accordingly, (in circumstances where the Early Participation Threshold is achieved by the Early Participation Deadline), by repaying those Instalment Repayment Notes in twelve equal instalments over twelve years, Co-operative Group will pay to the Holder, in each of those twelve years, an amount which is broadly equivalent to the amount of interest which such Holder would have received had it continued to hold those 13% Bonds which it sells to Co-operative Group in the Liability Management Exercise.**

Holder election

Each Holder of the 13% Bonds will have the opportunity to choose one of the two options available.

Since Co-operative Group will repay the principal of the Instalment Repayment Notes in equal instalments over twelve years, the amount payable to a Holder in each year if it elects the Instalment Repayment Notes option will be higher than the annual interest payment to such Holder if it elects the Final Repayment Notes option. However, the final payment on the Instalment Repayment Notes in 2025 will be significantly lower than the final payment under the Final Repayment Notes in 2025 (reflecting the fact that the principal on the Final Repayment Notes is repayable in a single payment in that twelfth year).

After the twelfth and final payment, both the Final Repayment Notes and the Instalment Repayment Notes will have been fully repaid, and the Holder will have no further entitlement to any amounts under whichever of those securities it elected to receive.

If a Holder intends to hold its Final Repayment Notes or Instalment Repayment Notes for the full twelve years, an important point of distinction for such Holder will be whether it wishes to receive (i) the higher amount payable each year (except the twelfth year) under the Instalment Repayment Notes, or (ii) the lower annual payments of interest under the Final Repayment Notes but a larger one-off payment in twelve years' time, in which latter case it should elect to receive the Final Repayment Notes.

The tax treatment of Holders opting to exchange their 13% Bonds for Final Repayment Notes will be different to the tax treatment of Holders opting to sell their 13% Bonds for a cash amount paid in instalments (represented by Instalment Repayment Notes). Holders are directed to section I (Taxation Considerations) of the Offer Memorandum and the section headed "Taxation" in the Group Notes Prospectus which contain further information relevant to the tax consequences of choosing one of the two options. Holders are advised to consult their own professional advisers regarding the differences for them in the tax treatment of the two options based on their own circumstances.

Principal amount of Group Notes to be delivered upon exchange or sale of 13% Bonds

The principal amount of Group Notes which a Holder will (if the Liability Management Exercise is successfully completed) receive for each £1,000 in nominal amount of 13% Bonds exchanged or sold to Co-operative Group will depend upon (i) whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option; and (ii) whether or not the Early Participation Threshold is achieved by the Early Participation Deadline:

(a) *Final Repayment Notes*

An Eligible Holder who validly offers to exchange its 13% Bonds in the Exchange Offer for Final Repayment Notes will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £844 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of 13% Bonds exchanged (subject to rounding); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £794 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of 13% Bonds exchanged (subject to rounding).

(b) *Instalment Repayment Notes*

An Eligible Holder who validly offers to sell its 13% Bonds to Co-operative Group in the Exchange Offer for cash consideration payable in instalments under the Instalment Repayment Notes option will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £1,560 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of 13% Bonds sold to Co-operative Group (subject to rounding); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £1,510 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of 13% Bonds sold to Co-operative Group (subject to rounding).

Accrued interest

A Holder whose 13% Bonds are exchanged or sold in the Liability Management Exercise will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid interest on its 13% Bonds from (and including) 31 July 2013 to (but excluding) the Settlement Date.

Deferred interest payment originally scheduled for 31 July 2013

In addition, as announced by the Bank on 12 July 2013, upon successful completion of the Exchange Offer the Bank will pay to all Holders of the 13% Bonds the deferred interest payment originally scheduled for 31 July 2013. Such payment will be made in cash on the Settlement Date.

Proposal

A meeting of the Holders of the 13% Bonds is being convened in order for those Holders to vote on a proposed resolution which, if passed and implemented, would result in amendments to the terms of the 13% Bonds to enable the Bank to mandatorily effect, at the Bank's option, the transfer to Co-operative Group of all (but not some only) of the 13% Bonds, which are not offered for exchange or sale in the Exchange Offer, either (1) in exchange for Final Repayment Notes, or (2) in return for the cash consideration to be paid over 12 years and represented by the Instalment Repayment Notes, in either case on the same economic terms as those upon which 13% Bonds are exchanged or sold in the Exchange Offer.

The proposed resolution also contains, on behalf of all Holders of the 13% Bonds (i) a release, in favour of certain persons (including, amongst others, the Bank, Co-operative Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such Holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their 13% Bonds; provided, however, that nothing in that resolution shall release the Bank or the Group from their respective obligations or liabilities as the persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

The submission of a valid Exchange Instruction pursuant to the Exchange Offer will also constitute the relevant Holder's instructions to appoint the chairman of the meeting as proxy to vote on behalf of the relevant Holder in favour of the resolution proposed.

5. 5.5555% BONDS OFFER

Exchange Offer

Holders of the 5.5555% Bonds are being invited to offer to exchange their 5.5555% Bonds for Bank T2 Notes.

Bank T2 Notes

The Bank T2 Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid quarterly in arrear on each three-month anniversary of the issue date of the Bank T2 Notes up to (and including) the tenth anniversary of the issue date. The Bank will be obliged to repay the principal amount of the Bank T2 Notes on the tenth anniversary of their issue date.

Principal amount of Bank T2 Notes to be delivered in exchange for 5.5555% Bonds

The principal amount of Bank T2 Notes which a Holder will (if the Liability Management Exercise is successfully completed) receive in exchange for every £1,000 in nominal amount of 5.5555% Bonds will depend upon whether or not the Early Participation Threshold is achieved by the Early Participation Deadline. Accordingly, an Eligible Holder who validly offers to exchange its 5.5555% Bonds in the Exchange Offer will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £530 in principal amount of Bank T2 Notes for every £1,000 in nominal amount of 5.5555% Bonds exchanged; or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £480 in principal amount of Bank T2 Notes for every £1,000 in nominal amount of 5.5555% Bonds exchanged.

Accrued interest

A Holder whose 5.5555% Bonds are exchanged will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid interest on its 5.5555% Bonds from (and including) 14 December 2013 to (but excluding) the Settlement Date.

Interest payment scheduled for 14 December 2013

The next scheduled interest payment date for the 5.5555% Bonds is 14 December 2013. The Bank intends to defer that interest payment (which it is entitled to do under the terms of the 5.5555% Bonds). If the Liability Management Exercise subsequently successfully settles, the Bank will (in addition to the accrued interest referred to in the paragraph above) pay the deferred interest payment originally scheduled for 14 December 2013 (to all investors in the 5.5555% Bonds) upon successful completion of the Liability Management Exercise. Such payment will be made in cash on the Settlement Date.

Proposal

A meeting of the Holders of the 5.5555% Bonds is being convened in order for those Holders to vote on a proposed resolution which, if passed and implemented, would result in amendments to the terms of the 5.5555% Bonds to enable the Bank to mandatorily effect the exchange, at the Bank's option, of all (but not some only) of the 5.5555% Bonds, which are not exchanged in the Exchange Offer, on the same economic terms as those upon which 5.5555% Bonds are exchanged in the Exchange Offer.

The proposed resolution also contains, on behalf of all Holders of the 5.5555% Bonds (i) a release, in favour of certain persons (including, amongst others, the Bank, Co-operative Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such Holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with

the Liability Management Exercise or their 5.5555% Bonds; provided, however, that nothing in that resolution shall release the Bank or the Group from their respective obligations or liabilities as the persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

The submission of a valid Exchange Instruction pursuant to the Exchange Offer will also constitute the relevant Holder's instructions to appoint the chairman of the meeting as proxy to vote on behalf of the relevant Holder in favour of the resolution proposed.

6. SCHEME IN RESPECT OF THE DATED NOTES

Nature of the Scheme

The Scheme is a scheme of arrangement under the laws of England and Wales. A scheme of arrangement is a formal procedure under Part 26 of the Companies Act 2006 which enables a company to agree a compromise or arrangement with its creditors or any class of its creditors in respect of its debts or obligations owed to those creditors. A scheme of arrangement requires the following to occur in order to become legally binding:

(i) the approval of a majority in number representing at least 75 per cent. in value of the creditors or class of creditors present in person or by proxy and voting at the meeting convened to approve the scheme of arrangement;

(ii) the approval of the court by the making of an order sanctioning the scheme of arrangement; and

(iii) the delivery of the court order sanctioning the scheme of arrangement to the Registrar of Companies.

If the scheme of arrangement is approved by the requisite majorities and sanctioned by the court and the order sanctioning the scheme of arrangement is delivered as set out above, the scheme of arrangement will bind all the creditors subject to it, both those creditors who voted in favour of it and those creditors who voted against it or did not vote at all.

A scheme of arrangement cannot be sanctioned by the court unless the court is satisfied, among other things, that the relevant provisions of Part 26 of the Companies Act 2006 have been complied with and an intelligent and honest person, a member of the class concerned and acting in respect of his own interest, might reasonably approve the scheme of arrangement.

Class composition

The Bank will propose that the Holders of the Dated Notes will vote together as one class at the Scheme Meeting.

Overview of Scheme Consideration

If the Scheme is sanctioned and implemented, all the Dated Notes, together with accrued and unpaid interest thereon up to (and including) the Scheme Record Date, will be exchanged on the Scheme Settlement Date for:

(i) a number of New Ordinary Shares in the Bank; and

(ii) a principal amount of Bank T2 Notes issued by the Bank.

The **Scheme Record Date** for the Scheme is currently expected to be 10 December 2013.

Scheme Consideration: accrued interest and Scheme Claims

A Holder's claim in the Scheme (its **Scheme Claim**) will be equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date; provided that a Holder's Scheme

Claim in respect of 2016 Notes (which are denominated in euro) shall be the Sterling-Equivalent of such sum, calculated as provided below.

The amount of a Holder's Scheme Claim will be used to determine the number of New Ordinary Shares and principal amount of Bank T2 Notes which such Holder will be entitled to receive in exchange for its Dated Notes if the Scheme is settled, as further described below. For the avoidance of doubt, no accrued interest will be paid in cash pursuant to the Scheme.

The Scheme will provide that any interest that accrues or falls due for payment after the Scheme Record Date will be irrevocably cancelled on the Scheme Settlement Date.

The number of New Ordinary Shares and principal amount of Bank T2 Notes which a Holder will receive in exchange for its Dated Notes (on the basis of its Scheme Claim) if the Liability Management Exercise is successfully completed will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

Note: Since Scheme Claims will include a component of accrued and unpaid interest on the Dated Notes and there is a finite amount of New Ordinary Shares and Bank T2 Notes available in the Scheme, the percentages and Conversion Price given in the following paragraphs are indicative only, pending determination of the floating rate of interest applicable to the interest period commencing 18 November 2013 in respect of the 2016 Notes. For the purpose of those indicative figures, an assumed 3-month EURIBOR rate of 0.228 per cent. (the rate prevailing as at 30 October 2013) has been applied. The actual rate is expected to be determined on or around 14 November 2013 and, once determined, the Bank will announce the final percentages and Conversion Price via the Regulatory News Service (RNS) operated by the London Stock Exchange. The final percentages and Conversion Price are not expected to differ materially from the indicative percentages and Conversion Price specified below.

Scheme Consideration: number of New Ordinary Shares

The number of New Ordinary Shares to which a Holder will (if the Scheme is settled) be entitled based on its Scheme Claim will be calculated by:

(a) multiplying such Holder's Scheme Claim by 89.737* per cent.; and

(b) dividing the resulting figure by £7.7718292* (being the Conversion Price for the New Ordinary Shares) and, if necessary, rounding such figure down to the nearest whole number of New Ordinary Shares (any fractional amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof).

* *Indicative only – see the Note in the paragraph above.*

Scheme Consideration: principal amount of Bank T2 Notes

The principal amount of Bank T2 Notes to which a Holder will (if the Scheme is settled) be entitled based on its Scheme Claim will be calculated by multiplying such Holder's Scheme Claim by 10.263* per cent. and, if necessary, rounding the resulting figure down to the nearest whole multiple of £10 (being the minimum denomination of the Bank T2 Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof).

* *Indicative only – see the Note in the paragraph above.*

Sterling-Equivalent amounts for the 2016 Notes

The **Sterling-Equivalent** of any euro amount in respect of a 2016 Note will, for the purposes of determining the Scheme Claim of a Holder of 2016 Notes (and for all other purposes under the Liability Management Exercise), be the amount in sterling determined by the Bank to be equivalent to such euro amount by reference to the Scheme FX Rate of £0.85644 per €1.00.

Early Participation Threshold not relevant

The number of new Ordinary Shares and principal amount of Bank T2 Notes which a Holder will receive in exchange for its Dated Notes (on the basis of its Scheme Claim as defined below) if the Liability Management Exercise is successfully completed will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

Additional New Ordinary Shares Offer

62,500,000 additional New Ordinary Shares (the **Additional New Ordinary Shares**) will be made available to Holders of the Dated Notes for subscription (at an effective subscription price of £2.00 per Additional New Ordinary Share) under the terms of the Scheme for an aggregate consideration of £125 million (the **Additional New Ordinary Shares Offer**).

All Holders of Dated Notes will be entitled to elect to subscribe for 62,500,000 Additional New Ordinary Shares. The allocation of such Additional New Ordinary Shares to a Holder of Dated Notes in respect of its election to participate in the Additional New Ordinary Shares Offer in accordance with the terms of the Scheme will be *pro rata* based on the proportion of its Scheme Claim (as at the Scheme Record Date) to the aggregate Scheme Claims of all Holders (as at the Scheme Record Date) who have elected to participate in the Additional New Ordinary Shares Offer subject to (i) a minimum election for that Holder of 50,000 Additional New Ordinary Shares (i.e. an effective aggregate subscription price of £100,000) and (ii) a maximum allocation of Additional New Ordinary Shares equal to the number of Additional New Ordinary Shares elected for by that Holder, provided always that the aggregate number of Additional New Ordinary Shares allocated to all Holders of Dated Notes under the Additional New Ordinary Shares Offer is no greater than 62,500,000.

The Bank has entered into an agreement with certain Holders of the Dated Notes (the **Purchasers**) on 4 November 2013 (the **Purchase Agreement**) (as described in more detail in paragraph 20.9 titled "*Purchase Agreement*" in Section 20 (*Additional Information*)). The terms of the Purchase Agreement provide that the Purchasers will subscribe for any Additional New Ordinary Shares unallocated or not taken up under the Additional New Ordinary Shares Offer. The Bank will pay the Purchasers a fee equal to 4 per cent. of £125 million (the **Purchaser Premium**).

All Holders of Dated Notes will be entitled to participate in a sub-purchase of the Additional New Ordinary Shares the subject of the Purchase Agreement (the **Sub-purchase Offer** and the sub-purchase of the Additional New Ordinary Shares the subject of the Purchase Agreement, the **Sub-purchase**). The Sub-purchase Offer will be available to all Holders of Dated Notes, including the Purchasers. To participate in the sub-purchase a Holder of Dated Notes (the **Sub-purchaser**) will be entitled to nominate the commitment that Holder is prepared to sub-purchase, subject to a maximum commitment of £125 million and a minimum commitment of £100,000. The allocation of sub-purchasing commitment to a Holder of Dated Notes that wishes to participate in the Sub-purchase Offer will, in the case of aggregate nominations being less than £125 million, be the amount of Sub-purchaser's nominations and, in the case of nominations in aggregate exceeding £125 million, be *pro rata* based on the proportion of its Scheme Claim (as at the Scheme Record Date) to the aggregate Scheme Claims of all Holders (as at the Record Date) who have elected to participate in the Sub-purchase Offer, subject to (i) a minimum commitment of £100,000 and (ii) a maximum commitment equal to the amount of the sub-purchasing commitment elected for by that Holder (the **Sub-purchasing Commitment**), provided always that the aggregate amount of all Sub-purchasing Commitments allocated to all Holders of Dated Notes that participate in the Sub-purchase is no greater than £125 million.

The Sub-purchasers will be required to enter into an agreement with Bank on or around the date of the Scheme Meeting (the **Sub-purchase Agreement**). The Bank will pay each Sub-purchaser a fee equal to 2 per cent. of their Sub-purchasing Commitment, provided that they comply with their obligations under the Sub-purchaser Agreement (the **Sub-purchaser Premium**). The aggregate Purchaser Premium payable to the Purchasers will be reduced in an amount equal to the aggregate Sub-purchaser Premium paid to the Sub-purchasers, such reduction to be allocated among the Purchasers based on their subscription commitment as set out in the Purchase Agreement.

To the extent that the aggregate allocation of Additional New Ordinary Shares to all Holders of Dated Notes who elect to participate in the Additional New Ordinary Shares Offer is less than 62,500,000 Additional New Ordinary Shares, the Sub-purchasers pursuant to the Sub-purchase Agreement will be required to subscribe for such number of remaining Additional New Ordinary Shares up to their Sub-purchasing Commitments. If there are still Additional New Ordinary Shares to be issued, the Purchasers under the Purchase Agreement will be required to subscribe for the remaining Additional New Ordinary Shares in accordance with the terms of the Purchase Agreement (as described in more detail in paragraph 20.9 titled "*Purchase Agreement*" in Section 20 (*Additional Information*)). Furthermore, if a Holder of Dated Notes elects to participate in the Additional New Ordinary Shares Offer, or participates in the Sub-purchase Offer, but, in either case, fails to fund the purchase of its allocation of Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer, or the Sub-purchasing Commitment, as applicable, the Purchasers will also be required to subscribe for those New Ordinary Shares in accordance with the terms of the Purchase Agreement.

The obligation of the Purchasers to subscribe for the Additional New Ordinary Shares is subject to certain conditions precedent.

Lock-up Arrangements

Each Holder of Dated Notes has the opportunity to enter into a lock-up arrangement (a **Lock-up Arrangement**) with the Bank pursuant to which such Holder will agree, amongst other things and subject to certain conditions, to vote the full amount of its Scheme Claim in favour of the Scheme.

Scheme Settlement Date

The Scheme will provide that if the Scheme Settlement Date does not occur on or before 31 December 2013, the Scheme shall lapse and the compromises and arrangements provided by the Scheme shall be of no effect. Accordingly, no exchange of the Dated Notes shall occur pursuant to the terms of the Scheme if the Scheme has not settled on or before 31 December 2013.

7
HOW TO PARTICIPATE IN THE LIABILITY MANAGEMENT EXERCISE

The following section points Holders to the appropriate sections of the Offer Memorandum describing the procedures for participating in the Liability Management Exercise.

HOW TO PARTICIPATE IN THE LIABILITY MANAGEMENT EXERCISE

Descriptions of the procedures to be followed in order to participate in the Exchange Offers or the Proposals relating to the Preference Shares, the 13% Bonds and the 5.5555% Bonds are set out in Part 4 of Section C of the Offer Memorandum.

The procedures for participating in the Scheme are described in the Explanatory Statement.

Holders of Existing Securities are responsible for complying with all of the relevant procedures for participating in the Liability Management Exercise. None of the Bank, Co-operative Group, the Dealer Managers, the Exchange Agent, the Information Agent and the Registrars assumes any responsibility for informing holders of Existing Securities of irregularities with respect to any Exchange Instruction, voting or Lock-up Arrangements or Account Holder Letters. Non-compliance with the applicable procedures by a Holder could result in, among other things, an inability to validly offer Existing Securities for exchange or to attend and vote at the Scheme Meeting.

8
DESCRIPTION OF THE BANK

This section sets out information about the Bank and its businesses.

DESCRIPTION OF THE BANK

1. OVERVIEW

The Bank's strategy, which involves a four to five year turnaround plan, is to de-risk the Bank by becoming a commercial bank focused on retail and small and medium-sized (**SME**) franchise businesses in the UK, built around the Bank's existing brand and franchise strength. The Bank is differentiated from other banks in the UK market as it is recognised by its customers as being a fair, responsible and trusted bank. These positive attributes are underpinned by the values of the co-operative movement with which the Bank is associated. As at 30 June 2013, the Bank has just over 4.7 million customers, of which just over 4.6 million are retail and 0.1 million are business customers, and operates through a network of 324 branches, 22 corporate banking centres and 3 primary call centres, over 2,700 ATMs, the internet and digital channels.

The Bank had total assets of £46,632.3 million as at 30 June 2013 (£49,694.8 million as at 31 December 2012).

During 2012, the Bank had already begun to separate its business into two distinct areas: core and non-core. As part of the Bank's plan to simplify, de-risk and reshape its business and to address the underlying issues facing the Bank as discussed below, the Bank accelerated this process and has now finalised the shape and structure of the core and non-core businesses. The Core Business (as defined below) (which as at 30 June 2013 had total segment assets of £30,021.8 million and Basel III final rules credit risk weighted assets of £6,213.9 million) represents lines of activity that are consistent with the Bank's strategy and risk appetite, and includes the core retail and corporate banking businesses, treasury and certain other businesses. The core retail banking business product offering consists of a range of current accounts and money transmission services, lending and savings products, to individuals and households in the UK, while the core corporate banking business provides services to small and medium sized businesses.

The Non-core Business (as defined below) (which as at 30 June 2013 had total segment assets of £14,164.4 million and Basel III final rules credit risk weighted assets of £10,032.9 million) consists of those asset classes which are not consistent with the Bank's Core Business strategy and are managed to achieve the most appropriate asset value on an individual portfolio basis or are targeted for run-down or exit. Those assets which sit within the Non-core Business contain a significant part of the Bank's impairment risk. This includes the Optimum portfolio (a closed book of predominantly interest only, intermediary and acquired mortgage book assets), Illius (a residential property company) and non-core corporate banking assets (including loans to businesses with turnover greater than £25 million, commercial real estate loans, PFI loans, housing association loans and renewable energy asset finance).

The Bank is currently facing a number of financial pressures which, following a review of the financial position of the Bank, led the boards of the Bank and Co-operative Group to announce on 17 June 2013 that the Bank required an additional £1.5 billion of Common Equity Tier 1 Capital, as assessed by the PRA. To meet the capital shortfall, Co-operative Group and the Bank also announced initial details of a comprehensive Recapitalisation Plan which was intended to address the capital requirement. Assuming the Liability Management Exercise is completed and therefore at least £1 billion of Common Equity Tier 1 Capital is raised in respect of the Exchange Offers, Proposals and the Scheme, and £125 million is in 2013 raised pursuant to the Additional New Ordinary Shares Offer under the Scheme, the Bank expects to report, for the end of 2013, a Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9% but above the regulatory minimum requirement". Taking into account the benefit of the additional Common Equity Tier 1 Capital to be provided by Banking Group to satisfy the 2014 Commitment and a reduction in risk weighted assets, partially offset by expected losses in the Bank in 2014, it is currently expected that the Bank's Common Equity Tier 1 Capital ratio will remain broadly stable, improving only modestly from this level in the coming years. The Bank expects to achieve a leverage ratio above the regulatory minimum by the end of 2014.

The capital shortfall is a result of continuing losses incurred by the Bank in part driven by impairment charges to the carrying value of the Bank's loans, a significant proportion of which relates to corporate loans acquired as part of the merger with Britannia in 2009. Impairment charges for the six months ended 30 June 2013 were £496.0 million.

The Bank also has a high cost base relative to its revenue when compared to its peers. The Bank has an ageing IT platform that has suffered from under-investment in recent years and has failed to fully integrate Britannia into the Bank's operations, resulting in significant cost duplications in front, middle and back office functions and a significant overlap in the branch network. In addition, the Bank's revenues are impacted by it not having achieved sufficient penetration of its current account customer base and by it pricing certain products on terms more generous to customers than the market.

In response, the Bank has adopted a new business strategy which is targeted at addressing the issues identified above, reducing the overall risk profile of the Bank in the long term and restoring the Bank to health. The strategy is described in more detail below. Whilst the Bank has already taken a number of actions to try to address the challenges it faces, it is clear that it is in the early stages of turning itself around and that the legacy issues identified above will continue to have an impact on the Bank for some time.

2. KEY STRENGTHS

The Directors believe that the Bank's key competitive strengths are:

The Bank brand is strong and differentiated, recognised as being fairer, more responsible and more trusted than its competitors.

The Bank brand is strong and differentiated within the UK retail banking market as it has been recognised as being fairer, more responsible and more trusted than its competitors.

The Bank has a significant presence in communities through its branch network and is committed to supporting local communities through charitable events and outreach programs. These positive attributes are underpinned by the values of the co-operative movement.

The Bank's focus on social responsibility, together with its recognition as a fair, responsible and trusted Bank (Bank was 'Top Rated' and Smile was the winner in the 'Most Trusted' category at the uSwitch Current Account Awards in May 2013), have a particular resonance in the UK retail banking market where recent national and international events have led to historically low levels of trust in banks generally and have increased the desire for a compelling alternative to the big five high street banks.

Independent research has indicated that the Bank is ahead of its peers in the extent to which its customers considers it fair (+4 percentage points ahead of its nearest competitor in its peer group set) and responsible (+7 percentage points ahead of its nearest competitors in its peer group set) (Source: Hall and Partners June/July 2013).

There are significant and unique opportunities available to the Bank to leverage off Co-operative Group's member base.

Co-operative Group is the UK's largest mutual business, with more than 7.3 million actively trading members, employing over 95,000 people and operating over 4,800 stores across the UK. It is the UK's fifth largest food retailer by sales and the UK's leading convenience store operator by number of stores. Co-operative Group includes the UK's leading funeral services provider by number of funerals, the UK's third largest pharmacy chain by number of branches and a rapidly expanding legal services business.

The Bank believes it has a unique and as yet under-developed opportunity to leverage off Co-operative Group's existing member base and customer base, and to benefit from cross-selling opportunities (where appropriate for the customer) and Co-operative Group's national store network. For example, the Bank already offers a range of services in association with Co-operative Group businesses, allowing customers to take advantage of such opportunities provided by the wider Co-operative Group such as wills and funeral plans.

Award winning levels of customer satisfaction

The Bank's excellent levels of customer service are evidenced through both internal tracking of customer satisfaction and external awards.

The Bank ranked third among UK retail banking providers in the most recent Which? survey in September 2012, receiving a customer satisfaction score of 79 per cent., which was considerably higher than the big five UK retail banks (with satisfaction scores between 46 per cent. and 60 per cent.).

Customer service continues to be recognised as an area of excellence for the Bank across multiple delivery channels. At the uSwitch Current Account Awards in May 2013, the Bank won the 'Best In-branch Customer Services' category and was 'Top Rated' in a further eight categories including 'Best Telephone Customer Service'. Smile also won 'Best Online/Email Customer Service' and was 'Top Rated' for its current accounts and customer satisfaction.

Furthermore, over 75 per cent. of customers rated the bank 8 or higher out of 10 throughout 2012 for service and, in the latest scores from June 2013, 76 per cent. rated the Bank 8 or higher out of 10 (Source: Optimisa research to June 2013).

3. STRATEGY

The Bank is split into two business areas: the Core Business and the Non-core Business.

The Bank's overarching strategy, which involves a turnaround plan of approximately four-to-five years, is to leverage its brand strength and high levels of customer satisfaction to create, over time, an efficient and profitable bank with a reduced overall risk profile, in terms of liquidity capital and day-to-day operations, and to reduce its risk-weighted assets.

This will require it to simplify and focus its Core Business on retail banking and SME customers where the Bank feels it has strong existing market credentials, customer relationships and expertise, whilst achieving significant operational efficiencies. The Bank is targeting a return on equity on its Core Business over a longer term period of low double digit per cent. The Bank currently expects to be in a position to seek controlled Core Business customer lending and deposit growth from 2015.

Those assets which are not consistent with the Bank's business strategy and classified as part of the Non-core Business will be actively managed to achieve the most appropriate asset value on an individual portfolio basis or targeted for run down or exit. The Bank intends to reduce Non-core Business net loans (meaning gross loans net of provisions) to less than £11.5 billion by 31 December 2014 and to continue deleveraging the Non-core Business thereafter at a slower pace. The Bank will also target the deleveraging of the Non-core Business in such a manner that the anticipated future losses from deleveraging do not materially exceed the capital that is released from the reduction in risk weighted assets, with the overall intention of achieving Non-core Business deleveraging that does not materially reduce the Common Equity Tier 1 Capital ratio of the Bank as a whole.

The successful implementation of the new strategy will be dependent on completion of the Liability Management Exercise which is the cornerstone of the Recapitalisation Plan

Strategy for the Core Business

To provide a compelling alternative in UK retail and SME banking, building on the Bank's co-operative brand strength and the Bank's high levels of customer satisfaction.

The Bank has a strong and differentiated brand with high levels of customer satisfaction. The Bank's core strategy is to build on the strengths of its brand and the recognition amongst its customers of being a fair, responsible and trusted bank, to deliver a proposition focused on core relationship banking in the UK retail and SME banking sectors.

To significantly improve its retail product mix and enhance returns through appropriate cross-selling of products and repricing of uneconomic products.

The Bank intends to significantly improve its retail offering through a rejuvenated set of retail banking product propositions. The Bank currently has a large number of products (including legacy products which it no longer offers but continues to service) and will seek to streamline its retail product offering to a less complex range of balance sheet products which are simple, transparent on fees and interest charged and

fairly priced, thereby also reinforcing the Bank's brand and customer loyalty. These will include mortgages, unsecured loans, credit cards, current accounts and savings accounts. The Bank will still continue to offer ancillary financial services products, such as insurance, through its distribution network, partnering with third party providers who adhere to the same standards and principles as the Bank.

The Bank intends to better leverage its brand and customer loyalty to improve cross-selling of its products to existing franchise customers (where appropriate for the customer), in particular products such as Bank-branded unsecured lending and residential mortgage lending. The Bank will also seek to restructure or exit from uneconomic legacy products and, where possible, move towards market pricing on products which have previously been priced below market, where consistent with its principle of fair pricing.

Introduce a simplified SME proposition focusing on building relationships with SME customers.

The Bank intends to focus on providing services to SMEs with turnover of typically up to £25 million. The Bank will support its SME customers by offering simple business banking products and services with some targeted growth in larger 'plain vanilla' lending to SME customers. The Bank will also seek to attract new customers by cross-selling its banking products and services (where appropriate) to customers and members of the wider Co-operative Group. The majority of the Bank's SME customers will be served primarily through self-service channels with a small number of relationship managers supporting the Bank's largest SME customers. Given the nature of its customer base, the Bank's SME business will remain deposit-oriented.

Cost saving programme orientated around targeted business simplification and improvements in operating efficiency.

Whilst maintaining the Bank's differentiated customer service proposition, the Bank plans to secure substantial long-term cost savings, targeting a cost-to-income ratio for the Core Business of less than 60 per cent. in the longer term through a significant cost saving programme. The Bank will seek to deliver these cost savings through (i) the simplification of the Bank's product offering, allowing for efficiency gains in the Bank's operations and IT functions; (ii) greater levels of self-service through the reorientation of the Bank's distribution model towards digital and other self-service channels; (iii) business process re-engineering (both IT and non-IT enabled) which will reduce middle and back office costs; (iv) delayering of management; and (v) full integration of Britannia within the Bank.

Significant reorientation of the Bank's distribution channels towards digital and self-service channels, improving the customer experience and reducing the Bank's service costs.

In line with customer demand and developments in the UK retail banking market, the Bank, in partnership with an established digital provider, will seek to significantly enhance its digital and self-service channels to allow its customers to access its products and services when and where they choose. It is expected that over time digital channels will be customers' preferred point of contact.

These enhancements are intended to allow the Bank to reduce its call centre and branch footprint whilst maintaining its market-leading levels of customer service. Between 30 June 2013 and the end of 2014, the Bank expects to significantly rationalise its branch network by at least 15 per cent. of its current estate (as at 30 June 2013) of 324 branches and migrate basic transactions onto a predominantly self-service basis, in particular through the digital channel. Similarly, the Bank expects to rationalise its network of corporate banking centres where it can be achieved without undue detriment to customer service, thereby mitigating the risk of attrition. Call centres will primarily support the digital service offering and the branch network will focus on providing face-to-face support to customers, allowing the Bank to maximise the value generated by its high levels of customer service. In the short term, the full integration of Britannia will remove existing duplication in the Bank's branch network, and the Bank also intends to close certain non-profitable branches. Customer needs will also continue to be met through alternative channels including via ATMs and limited service branch offerings in Co-operative Group stores to complement the network.

Significant re-engineering of the Bank's IT platform to support the Core Business strategy of the Bank.

As a result of historical under-investment (amongst other factors), a number of the Bank's IT systems now, or will soon, require their hardware and operating systems to be updated and improved. The Bank has

undertaken a review of its overall IT requirements and has agreed a new IT development plan which is to be executed in four phases (remediation, digital catch-up, simplification and strategic optimisation) and has been designed to meet the requirements of its Core Business strategy.

The primary focus for 2014 and 2015 will be remediation of the existing system issuer to ensure the Bank can meet its on-going commitments to regulators and customers and the creation of an IT platform which allows the Bank to provide new digital channel applications to enable appropriate online products, specifically web-based and mobile banking, and functionality for its customers. The execution of the Bank's turnaround plan will result in significant costs being incurred over the next three financial years and the Bank has currently budgeted in the region of £500 million in connection with the re-engineering of the Bank's IT platform to support the Core Business strategy of the Bank, its cost saving programme and the re-orientation of the Bank's distribution channels. Within this amount, total investment spend on transformation including IT remediation, digital catch-up and other IT initiatives in the next three years of approximately £400 million to £450 million is currently budgeted, of which approximately 40 to 45 per cent. is currently expected to be capitalised.

The Bank will seek to leverage opportunities from its relationship with Co-operative Group – Co-operative Group membership, its large store footprint and its broad product offering all present compelling and under developed opportunities.

The Bank will seek to deliver value to its customers and shareholders by better leveraging opportunities which are uniquely available to the Bank by virtue of its broad relationship with the wider Co-operative Group.

Co-operative Group membership is a significant pillar of the Bank's customer proposition, and the Bank will work alongside group companies within the wider Co-operative Group to target the membership and respective customer bases allowing members and customers to take advantage of opportunities and benefits provided by the Bank and the broader Co-operative Group.

The Bank will seek to further develop arrangements for it to benefit from Co-operative Group's physical footprint of over 4,800 stores across the UK to deliver banking services, such as ATMs and in-store Bank branches, to the Bank's customers. This will also enable the Bank to continue to deliver its market-leading level of customer service supplementing its physical network of branches and supporting its reorientation towards digital and self-service channels. The Bank's proposition may, in turn, include increased focus on introductions to products and services offered by Co-operative Group businesses, such as wills and funeral plans.

Strategy for the Non-core Business

The Non-core Business consists of those asset classes which are not consistent with the Bank's Core Business strategy and which are managed to achieve the most appropriate asset value on an individual portfolio basis or are targeted for run down or exit. The Bank's approach to achieving the most appropriate value on an individual portfolio basis means that these Non-core Assets will be managed to achieve optimal economic outcomes, after taking into consideration capital requirements, liquidity provisioning (both past and future), the nature of the assets, the underlying trends of value of such assets, returns and therefore the ability to improve economic outcomes over time by proactive management. Depending on the asset, this may involve the sale or refinancing of the asset or holding the asset until maturity. In the period from 30 June 2013 to 30 September 2013, £0.6 billion of Non-core Assets (consisting of Non-core Business loans) were deleveraged, through a combination of asset sales, run-off and managed repayments, net of new drawdowns.

The Non-core Assets contain a significant part of the Bank's impairment risk. Approximately 50 per cent. of the Non-core Assets relate to Optimum, a closed book of predominately interest-only, intermediary and acquired mortgage book assets. The Optimum portfolio, in line with the life of the book, will be run down over the longer term due to the nature of the assets. The key focus will be on arrears and default management, adhering to conduct standards whilst ensuring efficient use of funding and capital.

In support of this business strategy, the Bank is establishing an experienced team which will actively manage this business and oversee a controlled run-off and exit of the assets and intends to put in place a lean, agile

and cost efficient operational and governance structure with the focus on achieving deleveraging targets which are set on an annual basis and allow for future operating cost reductions in line with the asset run off.

4. HISTORY AND DEVELOPMENT OF THE BANK

The Bank was originally formed as the banking department of the Co-operative Wholesale Society Limited (**CWS**), the then Co-operative Group in 1872. CWS changed its name on 14 January 2001 to Co-operative Group (CWS) Limited. Co-operative Group (CWS) Limited changed its name to Co-operative Group Limited following the merger with United Co-operatives Limited on 29 July 2007.

The Bank as a separate legal entity was incorporated as The Co-operative Bank Limited in October 1970. In July 1971, the business formerly carried on by the banking department of Co-operative Group Limited was transferred to and vested in the Bank. This was followed, in June 1973, by the transfer of the business of the banking department of the former Scottish Co-operative Wholesale Society to the Bank.

The Bank obtained clearing bank status in 1975 and was granted recognised status by the Bank of England under the terms of the Banking Act 1979. In 1981, the Bank re-registered under the Companies Act 1980 as a public company and was re-registered on 10 January 1993 with its present name. On 19 June 2002, Co-operative Group transferred its entire shareholding in the Bank to Co-operative Financial Services Limited (now named Co-operative Banking Group Limited **(Banking Group)**), a newly incorporated Industrial and Provident Society. The ultimate parent of the Bank remained Co-operative Group. A summary of the structure of Banking Group is set out in paragraph 5 titled "*Business Overview*" of this Section 8 (*Description of the Bank*).

On 21 January 2009, the boards of Britannia and Banking Group jointly announced their proposal to merge (the **Merger**). The Merger became effective on 1 August 2009 through a transfer of the business, assets and liabilities of Britannia to the Bank under the Building Societies Act 1986. Prior to the Merger, Britannia was the UK's second largest building society in terms of total consolidated assets. At the date of this document, the retail residential lending and savings franchise transferred from Britannia and the pre-Merger businesses of the Bank, continue to trade as separate businesses under the "Britannia", "Co-operative Bank" and "smile" brand names respectively.

On 19 July 2012, Co-operative Group announced that non-binding heads of terms had been agreed with Lloyds Banking Group plc for the acquisition of 632 branches with an estimated 4.8 million banking customers (the **Verde Business**). On 24 April 2013, Co-operative Group announced that it had withdrawn from the process to acquire the Verde Business, after the boards of directors of both the Bank and Co-operative Group decided that it was not in the best interests of Co-operative Group's members to proceed with the acquisition.

On 17 June 2013, the boards of the directors of Co-operative Group and the Bank announced that they had completed a capital review of the Bank's capital position and concluded that the Bank required an additional £1.5 billion of aggregate Common Equity Tier 1 Capital. To meet the capital shortfall, Co-operative Group and the Bank announced the initial details of the Recapitalisation Plan which was intended to address this capital requirement. Further details of the Bank's capital position as at 30 June 2013 and the Bank's capital position as calculated in accordance with Basel III, together with an overview of the Bank's forecast capital position following the implementation of the Liability Management Exercise is set out in Section 13 (*Capital Adequacy*) and Section 16 (*Financial Information*).

On 21 October 2013, Co-operative Group and the Bank announced that they had been engaging with different bondholder constituents and seeking to balance the requirements and expectations of these parties. It was further announced that they expected that many elements of the Recapitalisation Plan would be materially different to the outline provided on 17 June 2013. The Recapitalisation Plan consists of the Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Bank's Existing Securities surrendered in the Liability Management Exercise. See Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*) and Section 6 (*Details of the Liability Management Exercise*) for further details of the Liability Management Exercise. At least £1

billion of Common Equity Tier 1 Capital will be generated in 2013 if the Liability Management Exercise is successful, with £333 million of Common Equity Tier 1 Capital being expected to be contributed by Banking Group under the 2014 Commitment.

Under the Recapitalisation Plan, Co-operative Group, which will hold 30 per cent. of the equity in the Bank, will remain the Bank's largest single shareholder by far, which will enable it to maintain significant influence over how the Bank operates.

The Bank has suffered a number of credit rating downgrades by Moody's and Fitch, most notably a six notch downgrade by Moody's on 9 May 2013 of the deposit and senior debt ratings to Ba3 from A3, taking the Bank below investment grade rating and in June 2013, the Bank's long-term credit rating was further downgraded by Fitch and Moody's. For further details, please see the paragraph titled "*Liquidity and Funding*" in Section 12 (*Operating and Financial Review*).

On 12 July 2013, Co-operative Group and the Bank announced the launch of an independent review, to be chaired by Sir Christopher Kelly, into the events that led to the recent announcement of the Recapitalisation Plan to address the Bank's £1.5 billion capital shortfall, the decision to merge the Bank with Britannia in 2009 and the proposed acquisition of the Verde Business (the **Kelly Review**). The Kelly Review will include an analysis of strategic decision making, management structures, culture, governance and accounting practices and aspects of the role of the Bank auditors. The intention is to present the findings of the Kelly Review to Co-operative Group's members at its annual general meeting in May 2014.

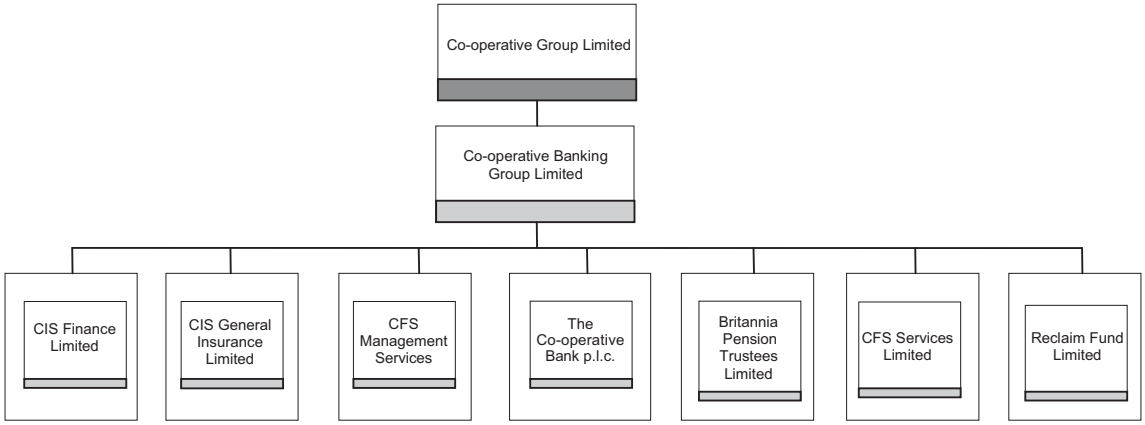
Since the Bank announced its Recapitalisation Plan, it has been undertaking a strategic review on improving its longer term financial and operational performance and has developed a strategy to return the Bank to profitability over the longer term. For further details please see paragraph 3 "*Strategy*" in this Section 8 (*Description of the Bank*).

Going forward, the Bank intends to explore the possibility with the UK Listing Authority of seeking a premium listing of the Ordinary Shares on the Official List within 12 months of completion of the Liability Management Exercise, subject to meeting the necessary eligibility criteria.

5. BUSINESS OVERVIEW

The Bank is currently a subsidiary of Banking Group and Co-operative Group is the ultimate holding entity of the Bank and Banking Group. The current structure of Banking Group is set out in the structure chart below:

Group Structure



A. The Core Business and the Non-core Business

Following the Merger, the Bank was initially organised into a structure with two key divisions, being (i) the retail division; and (ii) the corporate and markets division (**CAM**). CAM consisted of corporate banking, treasury, the Optimum portfolio (a closed book of predominately interest-only, intermediary and acquired

mortgage book assets), Platform (the Bank's intermediary mortgage brand) and business services. In 2011 the CAM division became the 'corporate and business banking' division (**CABB**).

During 2012, as part of the outcome of a strategic review, the Bank's management decided to undertake a transformational restructuring of the Bank and focus on strengthening its retail and business banking operations. As part of this initiative the Bank refined the operating segments on which it reported by separating its assets into core (being those assets consistent with the Bank's strategy and risk appetite) and non-core (being those assets not consistent with the Bank's strategy and risk appetite). More specifically, the Bank separated CABB into core and non-core segments and moved Platform from the CABB business into the 'Retail' business. The non-core assets were primarily a set of CRE exposures which were non-performing as well as a number of other assets acquired as part of the acquisition of Britannia, being the Optimum portfolio and Illius (a residential property company).

In 2013, as the strategy of the Bank developed to focus on serving retail and SME customers and as part of the Bank's plan to simplify and reshape itself as announced on 17 June 2013, the core and non-core business activities constituted in 2012 were redefined as:

(i) Retail and SME Banking (the **Core Business**); and

(ii) Co-operative Asset Management (the **Non-core Business**).

The newly constituted Core Business and Non-core Business activities came into effect during August 2013 and as a result, certain assets which were previously classified as part of the core business are now classified as part of the Non-core Business. Under the current core and non-core business segments (i.e. the Core Business and Non-core Business) the majority of corporate banking assets which were previously classified as part of the core business (pre-August 2013) are now classified as part of the Non-core Business and as such will be managed to achieve the most appropriate asset value on an individual portfolio basis or will be targeted for run-down or exit. A table setting out the key divisions used for managing the Bank between 1 January 2010 and 30 June 2013 (as described above) is set out below:

<table>
<tr><th>2010</th><th>2011</th><th>2012/H1 2013</th><th>H2 2013</th></tr>
<tr><td>Retail</td><td>Retail</td><td>Retail (incl Platform)</td><td rowspan="2">Retail Banking
BACB (Business and Commercial Banking)</td></tr>
<tr><td>CAM (Corporate and Markets)</td><td>CABB (Corporate and Business Banking)</td><td>CABB (Corporate and Business Banking)</td></tr>
<tr><td rowspan="2">Corporate
Optimum/Platform
Business Services
Treasury</td><td rowspan="2">Corporate (including Platform) Optimum</td><td rowspan="2">Optimum
Corporate non-core
Other CABB (non-core)</td><td>Treasury/other (including Unity Trust Bank)</td></tr>
<tr><td rowspan="2">CoAM
Corporate, Optimum, Illius</td></tr>
<tr><td>Treasury</td><td>Treasury</td></tr>
<tr><td>Other</td><td>Other</td><td>Other</td></tr>
</table>

Represents the Core Business

As at 30 June 2013, total segment assets in the old core and non-core business were £34,356.3 million and £9,829.9 million, respectively. For the same date, based on the newly constituted Core Business and Non-core Business, total segment assets in the Core Business and Non-core Business would have been £30,021.8 million and £14,164.4 million, respectively. Sixty-two per cent. of the Basel III final rules credit risk weighted assets of the Bank as at 30 June 2013 are now in the Non-core Business.

(a) ***The Core Business***

The Core Business represents lines of business that are consistent with the Bank's strategy and risk appetite. It continues to concentrate on supporting individual and business customers, where the Bank

has strong market credentials, customer relationships and expertise. These business areas of the Core Business are the Bank's:

(i) core retail banking business, which trades as "The Co-operative Bank", "Britannia" and "smile", together with the Bank's intermediary brand, "Platform", and includes retail secured and unsecured lending (**Retail Banking**);

(ii) core business and commercial banking business (**BACB**); and

(iii) treasury and the Unity Trust Bank (**Treasury/other**).

Each of the above areas is described in further detail below.

(b) ***The Non-core Business***

The Non-core Business consists of those asset classes which are not consistent with the Bank's business strategy, are managed to achieve the most appropriate asset value on an individual portfolio basis or are targeted for run down or exit, and contain a significant part of the Bank's impairment risk. These asset classes include non-core corporate banking assets, consisting of six asset classes, the Optimum portfolio, and the Illius portfolio. Each of these assets is described in further detail below.

(c) ***Certain financial information in respect of the Core Business and the Non-core Business***

The historical financial information of the Bank set out in this Section 8 (*Description of the Bank*) and Section 15 (*Segmental Financial and Other Information*), reflects the divisions of the Bank as presently managed, i.e. the Core Business and Non-core Business, which came into effect during August 2013. This financial information is unaudited and has been extracted from the Bank's internal management systems for the relevant periods.

The following table sets out certain unaudited financial information relating to the Core Business and the Non-core Business for the six months ended 30 June 2013.

Table 1: Segmentation of the Bank's activities for the six months ended 30 June 2013

	For the six months ended 30 June 2013 (unaudited)					
	Core Business					
	Retail Banking	*BACB*	*Treasury/ other*	*Total Core Business*	*Non-core Business*	*Total for the Bank*
	(£millions)					
Operating result	0.9	12.9	17.9	31.7	(489.3)	(457.6)
Gross loans and advances to customers	17,760.5	1,093.7	–	18,854.2	14,931.3	33,785.5
Segment assets	17,797.1	979.5	11,245.2	30,021.8	14,164.4	44,186.2
Customer deposits	28,132.8	4,655.3	–	32,788.1	1,485.6	34,273.7

B. Core Business

The Core Business represents activity consistent with the Bank's risk appetite and strategy. The Core Business is further split into three business areas: (i) Retail Banking; (ii) BACB; and (iii) Treasury/other.

Each of these areas is described in further detail below.

B.1 Core Business: Retail Banking

Retail Banking offers a range of financial products and services to individuals and households throughout the UK, trading as "The Co-operative Bank", "Britannia" and "smile" together with the Bank's intermediary brand "Platform".

The Bank has just over 4.6 million Retail Banking customers and is a clearing bank operating across multiple delivery channels with a range of current accounts and money transmission services, lending products and savings products. The Bank distributes its retail products through branches, call centres and via the internet and mobile banking. See paragraph (c) titled "*Distribution*" below for further details on the distribution of products.

As part of its business strategy, the Bank intends to introduce new products that are simple, transparent on fees and interest charged and fairly priced.

(a) Retail Banking Products

(i) ***Mortgage lending***

As at 30 June 2013, the Bank had a total outstanding mortgage portfolio of £14.2 billion issued under the Co-operative Bank brand and the Britannia brand and a total outstanding mortgage portfolio of £2.1 billion issued under the Platform brand. As at 30 June 2013, the Bank's total issued mortgage lending secured on residential property (excluding buy-to-let) was £15.2 billion and the total issued buy-to-let mortgage portfolio was £1.1 billion. The Bank's total mortgage lending of £16.3 billion represents an estimated 2.1 per cent. of total UK mortgage balances (as at 30 June 2013).

During the six months ended 30 June 2013, the Bank's gross new lending amounted to £1.5 billion (which includes further advances) and net new lending was £0.4 billion.

The majority of the Bank's mortgage lending portfolio consists of UK residential mortgage loans to individuals that are fully secured on a first priority basis on the residential property of the borrower on terms which allow for repossession and sale of the property if the borrower fails to comply with the terms and conditions of the loan. As a result, and in line with other residential mortgage lenders, the Bank's residential mortgage lending carries lower risk than many other types of lending.

The Bank's mortgage lending can take the form of either prime residential lending (where the borrower is the owner and occupier of the mortgaged property and meets the Bank's credit requirements for prime lending) or buy-to-let lending (which are loans advanced to borrowers who intend to let the mortgaged property). In addition, the Bank also has a stock of historical residential mortgage loans which were advanced to borrowers who self-certified their income and to other borrowers who do not meet the Bank's prime borrower credit requirements.

As at 30 June 2013, the percentage of the Bank's outstanding mortgage portfolio which comprises prime residential mortgages was 92.4 per cent. of the total portfolio.

The following table sets out a breakdown of the Retail Banking mortgage portfolio by type on a gross basis as at 30 June 2013.

Table 2: The Retail Banking mortgage portfolio by type as at 30 June 2013

	As at 30 June 2013 (unaudited)	
Product Type	*(£millions)*	*(percentages)*
Prime	15,068.3	92.4
Buy-to-let	1,086.5	6.7
Non-conforming and self-certified	150.4	0.9
Total	16,305.2	100.0

The following table sets out the geographical distribution of the Retail Banking mortgage loans on a gross basis as at 30 June 2013.

Table 3: Regional analysis of the Retail Banking mortgage loans as at 30 June 2013

	As at 30 June 2013 (unaudited)	
Region	*(£millions)*	*(percentages)*
London & South East	6,171.3	37.8
Northern England	3,097.3	19.0
Midlands & East Anglia	3,684.2	22.6
Wales & South West	2,087.6	12.8
Other	1,264.8	7.8
Total	16,305.2	100.0

The Bank's residential mortgage loans are currently generally granted for an average term of 22.5 years. However, the typical life of the Bank's residential mortgage lending (for a customer's initial mortgage with the Bank) is approximately 2.5 years after drawdown as a result of the volume of customer redemptions, with the volume of customer redemptions being a characteristic of the UK residential mortgage market affecting all UK mainstream residential mortgage lenders, together with the relative characteristics of the Bank's product mix, the volume of new mortgage lending by the Bank and general customer retention patterns. All of these factors influence the average life of the Bank's residential mortgage lending.

The Bank currently offers fixed rate and lifetime tracker rate mortgages. Fixed rate mortgages have a set rate for an initial set period, after which the rate reverts to the Bank's standard variable rates, which is set at the Bank's discretion.

The Bank's fixed rate mortgages currently offer a term of two, three, five or ten years, with the fixed rate charge determined by the loan-to-value ratio of the mortgage in question.

Lifetime tracker mortgages have a set methodology for determining a variable rate during the term of the mortgage, unlike the fixed rate mortgages which offer a set rate for an initial period. The Bank's lifetime tracker rate products bear interest at a variable rate that is a fixed percentage above the Bank of England's base rate.

To reduce the costs associated with early repayment of mortgages and to recover a portion of the costs of mortgage incentives, in line with its competitors, the Bank imposes early repayment charges on some of its mortgage products. The early repayment charges apply for repayment made prior to the expiration of the fixed or tracker rate for the particular product.

The following table sets out the breakdown of the Retail Banking mortgage portfolio by interest rate on a gross basis as at 30 June 2013.

Table 4: Breakdown of Retail Banking mortgages by interest rates product as at 30 June 2013

	As at 30 June 2013 (unaudited)	
Products	*(£millions)*	*(percentages)*
Fixed rate mortgages	7,419.5	45.5
Floating rate mortgages	8,885.7	54.5
Total	16,305.2	100.0

The Bank utilises an automated credit scoring system to assist in minimising credit risk on mortgage lending. The Bank's credit procedures for mortgage lending take into account the applicant's credit history, loan-to-value (**LTV**) ratio criteria, income multiples and an affordability calculation, or shock test, that tests the applicant's ability to service the loan at higher interest rates. The average LTV ratio of new mortgage lending during the six months ended 30 June 2013 was 65.0 per cent. The indexed LTV ratio for the Bank's entire mortgage portfolio was 44.3 per cent. at 30 June 2013 (based on the

latest property valuations available). Only 1.8 per cent. of the Bank's total mortgage book has an indexed LTV ratio in excess of 100 per cent., based on value of the property.

As at 30 June 2013, the Bank's buy-to-let mortgage portfolio was £1.1 billion or 6.7 per cent. of the Bank's total outstanding retail banking mortgage portfolio. The majority of the Bank's buy-to-let mortgages (88 per cent. as at 30 June 2013) comprise of interest-only mortgages. Other than buy-to-let mortgages, the Bank does not offer new customers interest-only mortgages. Rather, the Bank will typically require that new mortgages are repayment mortgages, where customers are required to repay the interest and part of the capital outstanding during the term of the loan. However, there are a number of historical mortgages within the Bank's residential mortgage portfolio which are structured on an interest-only basis and there may be circumstances where the Bank is required to allow existing customers to move onto another of the Bank's mortgage products on an interest-only basis. As at 30 June 2013, the proportion of interest-only mortgages in the Bank's mortgage portfolio was 22.7 per cent. or £3.7 billion out of £16.3 billion of outstanding mortgage balances.

Table 5 sets out the LTV and arrears information of the Retail Banking mortgage portfolio on a gross basis, broken down by product type as at 30 June 2013.

Table 5: LTV breakdown of Retail Banking's mortgage loans by product type as at 30 June 2013

	As at 30 June 2013 (unaudited)			
	Prime	*Buy-to-let*	*Non-conforming and self-certified*	*Total*
		(percentages)		
Average LTVs	43.4	61.7	50.9	44.3
New business LTVs	65.0	65.8	54.8	65.0
Book by indexed LTVs				
<= 50%	36.0	12.0	33.4	34.4
<= 75%	38.5	80.1	60.0	41.4
<= 100%	23.6	7.8	6.0	22.4
> 100%	1.9	0.1	0.6	1.8
Percentage of accounts with > 2.5% arrears	0.3	0	1.9	0.3
		(£ millions)		
Gross customer balances	15,068.3	1,086.5	150.4	16,305.2
New lending[1]	1,481.1	57.0	1.6	1,539.7

1 Excludes further advances for the period

The proportion of the Bank's Retail Banking mortgage accounts with greater than 2.5 per cent. in arrears was 0.3 per cent. as at 30 June 2013, as compared with the CML industry average of 1.40 per cent. as at 30 June 2013.

As part of the Bank's strategy, the Bank intends to offer a simple range of market aligned mortgage products (not interest-only products) without complex features, aimed at its relationship customers and consistent with its risk appetite and market conditions.

(ii) ***Unsecured lending***

The unsecured lending products offered by the Bank consist of personal unsecured loans, credit cards and overdraft facilities (as detailed below).

The following table sets out the Retail Banking unsecured lending balances on a gross (including credit commitments) basis split by product type, as at 30 June 2013.

Table 6: Breakdown of the Retail Banking unsecured lending balances (including credit commitments), split by product type as at 30 June 2013

	As at 30 June 2013 (unaudited)	
Product type	*(£millions)*	*(percentages)*
Personal unsecured loans	723.2	19.6
Credit cards	2,597.2	70.6
Overdrafts	362.7	9.8
Total unsecured lending balances	3,683.1	100.0

Personal unsecured loans

The majority of the Bank's personal unsecured lending portfolio comprises fixed rate lending either to customers who have an existing relationship with the Bank (classified as personal loans) or to customers with no broader relationship with the Bank (classified as direct loans). Direct loans can be sourced through one of the Bank's introducer or affinity relationships, including the Bank's affinity relationship with the Automobile Association, which generates a significant proportion of the Bank's direct loans. A majority of the Bank's new personal unsecured lending business is presently to customers holding a current account with the Bank.

The Bank's personal unsecured lending portfolio is composed of the following product types: personal loans, direct loans, career development loans, loans sourced by 'smile' and non-standard "advance" accounts and legacy flexible personal loans.

As at 30 June 2013, the Bank's total personal unsecured loans portfolio was £662.9 million (drawn balances) and comprised 121,000 customer accounts.

The table below sets out the Retail Banking personal unsecured loan portfolio on a gross basis, broken down by product type, as at 30 June 2013.

Table 7: Breakdown of the Retail Banking personal unsecured loan portfolio (including credit commitments) by product type as at 30 June 2013

	As at 30 June 2013 (unaudited)	
Product type	*(£millions)*	*(percentages)*
Personal and direct loans	607.5	84.0
Career development loans	76.7	10.6
'smile' personal loans	36.4	5.0
Non-standard advances and legacy flexible loans	2.6	0.4
Total	723.2	100.0

As with all unsecured personal lending, there is a greater risk of loss on unsecured personal lending as compared to residential mortgage lending because the Bank has no security if the borrower defaults on the loan. Accordingly, unsecured personal lending products bear higher interest rates than the Bank's residential mortgage products. In addition, the Bank uses an automated credit scoring system that is designed to evaluate a borrower's ability to repay the loan and imposes a maximum limit on the size of unsecured personal loans, and risk-based pricing is used in certain circumstances. The Bank presently has approximately 1.6 million current accounts, of which 0.09 million hold a personal loan with the Bank, which is approximately 5.6 per cent.

As part of its strategy, the Bank intends to reduce the number of direct loans and focus its unsecured personal lending on its existing primary banking customers and offer simple products that are priced in line with the UK market. The Bank intends to impose risk-based pricing capabilities to manage risk costs.

Credit cards

The Bank has approximately 699,000 credit card accounts of which 398,000 were active during the month of June 2013 (in that the relevant account recorded a debit or a credit during that month being sufficient to constitute activity for these purposes).

As at 30 June 2013, the Bank's credit card portfolio contained receivables of £548 million, with the proportion of such balances bearing interest being 65.5 per cent.

The characteristics of the Bank's current credit card product range are as follows:

(a) the platinum credit card is targeted at customers who value a fixed annual percentage rate (**APR**) and offers a fixed rate APR for a five year period;

(b) the clear credit card is targeted at customers who value one standard APR that applies to all transactions, including cash withdrawals, purchases and balance transfers;

(c) the 'think' credit card offers customers an ethical benefit and rewards customers for conducting transactions with the Bank's "think partners" with a low APR for a fixed period; and

(d) the members' credit card offers cashback to customers at a preferential rate when used in the Co-operative food stores (as compared to the rate offered on all other spend).

A majority of the new credit cards issued by the Bank are the clear credit card and the members' credit card.

In addition, the Bank's credit card portfolio includes a £111.5 million portfolio (including credit commitments) purchased from Northern Rock in 2003 which has been closed to new business since the end of 2007.

The table below sets out the Retail Banking credit card portfolio on a gross (including credit commitments) basis, broken down by product type, as at 30 June 2013.

Table 8: Breakdown of the Retail Banking credit card portfolio by product type as at 30 June 2013 (including credit commitments)

	As at 30 June 2013 (unaudited)	
Product type	*(£millions)*	*(percentages)*
Platinum	376.9	14.5
'Classic'	634.5	24.3
smile	274.5	10.6
Clear Card	202.4	7.8
Northern Rock	111.5	4.3
Affinity relationships	586.0	22.6
Gold	393.9	15.2
Variable rate loans	17.5	0.7
Total	2,597.2	100.0

The Bank markets and processes credit card applications itself (using its credit scoring system), and credit card holders receive differing credit limits, depending on their credit score. Credit limits are regularly reviewed in line with customer need and risk appetite.

Most of the debit activity on the Bank's credit card portfolio arises as a result of spending at merchants, with small elements of cash advance and balance transfer.

The Bank's credit card asset quality remains strong and is monitored constantly both for new and existing exposures. Its percentage of credit card balances one payment in arrears was 3.5 per cent. as at 30 June 2013, compared with an industry average benchmark of 4.0 per cent. (Source: FICO® Benchmark Reporting Service quarterly UK cards data). The Bank has a 2 per cent. market share of

the UK credit card market based on customers and a 1 per cent. UK market share of credit card outstanding balances with 50 per cent. of its credit card holders receiving other products from the Bank. As part of its strategy the Bank intends to further simplify its credit card proposition and re-price new accounts in line with the UK market and to take into account risk, focusing on growing its branded credit card portfolio (with a particular focus on sales to existing banking customers thereby deepening the core banking relationship).

Overdrafts

Overdrafts are offered to customers with current accounts with the Bank. In line with peers in the market, the Bank offers two types of overdraft; formal overdrafts and informal overdrafts. Formal overdrafts are where an overdraft is requested by the customer and agreed to in writing by the Bank. Informal overdrafts are where a customer, although not having formally requested an overdraft, may pay or withdraw money from their account in excess of the credit balance of the account or up to an agreed overdraft limit. Formal overdraft facilities are reviewed each year.

As at 30 June 2013, the Bank had aggregate formal and informal overdraft balances of approximately £62 million.

(iii) ***Savings and current accounts***

As at 30 June 2013, the Bank had approximately 680,380 primary current accounts (being accounts that on average turnover £800 or more per month) and £28.1 billion of retail customer deposit balances, representing an estimated 2 per cent. of total UK retail savings balances. The Bank's prime current account base has grown by 23 per cent., from 553,262 at the end of 2010 to 680,380 as at 30 June 2013, with growth being 8 per cent. in 2012 and 2.5 per cent. in the period ended 30 June 2013. The Bank offers a range of savings products and current accounts. The Bank offers a standard Current Account and a Current Account Plus. In addition, the Bank also offers a basic current account, called Cashminder directed at simple, in-credit banking and the Bank also maintains a book of historic packaged/fee-paying current accounts which are not presently part of the Bank's on-sale product range.

The Bank offers a range of savings products including term, limited access and easy access products, with or without an individual savings account (**ISA**) wrapper. The Bank's fixed rate savings accounts earn a fixed rate of interest for a chosen term and funds therein cannot be withdrawn until maturity.

The Bank's strategy is to simplify the range of current accounts and savings products with price varying by term, access and amount whilst addressing the needs of target customers. The Bank intends to migrate from expensive fixed-term deposits to variable rate funding. The Bank also intends to maintain competitive pricing of instant access and notice accounts to grow a short-term savings book. A compelling current account proposition with enhanced digital capability is planned to appeal to target customers. The Bank intends to leverage the broader Co-operative Group membership base to drive growth in current accounts.

The table below sets out deposits within the Retail Banking segment, broken down by deposit type, as at 30 June 2013.

Table 9: Breakdown of the Retail Banking deposits as at 30 June 2013

	As at 30 June 2013 (unaudited)	
Retail deposits	*(£millions)*	*(percentages)*
Current accounts	3,450.6	12.3
Term deposits	10,310.7	36.6
Instant access accounts	7,940.8	28.2
ISAs & others	6,430.7	22.9
Total	28,132.8	100.0

(b) ***Certain financial information in respect of the Retail Banking Segment***

Set out below is certain key financial information in respect of the Core Business's Retail Banking segment.

(i) ***Operating Results and Assets and Liabilities of the Retail Banking Segment***

The following table illustrates the financial performance of the Retail Banking segment, by setting out the operating results for Retail Banking for the six months ended 30 June 2013.

Table 10: Financial performance of the Retail Banking segment for the six months ended 30 June 2013

Retail Banking	*For the six months ended 30 June 2013 (unaudited) (£millions)*
Net interest income	203.5
Non-interest income	65.0
Total income	268.5
Operating costs	
Steady state	(235.0)
Strategic initiatives	(7.8)
	25.7
Impairment losses	(24.8)
Operating result	0.9

The following table sets out total assets, liabilities and risk-weighted assets of the Retail Banking segment as at 30 June 2013.

Table 11: Total assets, liabilities and risk-weighted assets of the Retail Banking segment as at 30 June 2013

Retail Banking	*As at 30 June 2013 (unaudited) (£millions)*
Gross loans and advances to customers	17,760.5
Net loans and advances to customers	17,583.9
Segment assets	17,797.1
Customer deposits	28,132.8
Segment liabilities	27,969.4
Risk-weighted assets (B2)	2,384.7
Risk-weighted assets (B3 final rules)	2,384.7

(ii) ***Key Performance Indicators of Retail Banking***

The following table provides a breakdown of the key performance indicators in relation to the Retail Banking segment, as at and for the six months to 30 June 2013.

Table 12: Breakdown of key performance indicators of the Retail Banking segment as at and for the six months ended 30 June 2013

	As at and for the six months ended 30 June 2013 (unaudited)
Retail Banking	
Net interest margin bps[(1)]	230
Cost-to-income ratio[(2)]	87.5%
Non-performing loans ratio[(4)]	2.2%
Non-performing loans coverage[(5)]	54.7%
Loan-to-deposit ratio[(6)]	63.1%

Notes:

(1) The net interest margin is calculated by dividing annualised net interest income by average segment assets.

(2) The cost-to-income ratio is calculated by dividing steady state costs by total income.

(3) The non-performing loans ratio is calculated by dividing impaired customer balances by gross customer balances.

(4) The non-performing loans coverage ratio is calculated by dividing total credit protection by impaired customer balances.

(5) The loan-to-deposit ratio is calculated by dividing gross customer loans by customer deposits.

(c) ***Distribution***

Overview

The Bank offers a broad multi-channel proposition to customers, covering branch, telephony, online, mobile, intermediary/broker (through Platform) and in-store throughout the wider Co-operative Group.

Branches

Branches remain important to the Bank's customers, and a branch presence is currently considered by the Bank to be a significant factor in maintaining the level of the Bank's brand awareness, consideration and advocacy with both the Bank's current customers and potential customers. In addition, branches are responsible for the acquisition of a proportion of the Bank's new current accounts and broader deposit-taking activity.

At the point of the merger with Britannia, the Bank's branch network was 345 branches (including four offshore and five in-stores) under the separate Co-operative Bank and Britannia brands. As at 30 June 2013, there were 324 branches with a target of rationalising by at least 15 per cent. of the Bank's branch network by the end of 2014 operating under a single high street brand (being the Co-operative Bank brand). In the short term, the full integration of Britannia will involve the removal of existing duplication in the Bank's branch network and the Bank also intends to close certain non-profitable branches.

Offshore branches include three branches located in the Isle of Man and a branch in Guernsey (supported by an agency arrangement in Jersey). Savings balances for each business as at 28 June 2013 were £892 million and £423 million respectively with a portfolio of mortgage assets totalling £171.0 million in Guernsey. As part of the Core Business's rationalisation programme, plans were announced in August 2013 to exit the Guernsey business.

Call centres

There are three primary call centre locations: Leek, Stockport and Skelmersdale. The call centres of the Bank (all of which are based in the UK) are open 24 hours a day and 7 days a week to service customers manage simple transaction requests and address customer needs across the full product range.

Internet

The Bank provides internet banking through the Co-operative Bank-branded and smile-branded websites. The Co-operative Bank-branded site is part of the Bank's multi-channel offer and has 1.17 million registered users with 0.71 million active users (unique users in the three months May 2013 to July 2013 inclusive). Internet banking, current accounts, unsecured loans, credit cards, mortgages and savings products are all available under the Co-operative Bank brand.

'Smile' was launched in 1999 as the UK's first full internet bank and as at 30 June 2013 had approximately 340,000 customers. In the period May 2013 to July 2013 (inclusive), there were 154,896 user log-ins. The 'smile' branded website continues to win consumer awards such as the Current Account Provider of the Year in 2013 (Consumer Money Facts Awards), joint top score for Best Overall Current Account (2013 uSwitch Current Account Awards) and Most Trusted Current Account Provider (2013 Moneywise Awards). Current accounts, saving products, unsecured loans, credit cards, and mortgages are all available under the 'smile' brand.

ATMs and in-store Bank branches

The Bank has over 2,700 ATMs, primarily located in Co-operative Group's food stores. These ATMs offer an important service to local communities and also allow the Bank a physical presence beyond the reach of its own branch network. A broader "in-store banking" concept is currently being trialled under various formats. There are at present seven such sites within Co-operative Group food stores where staff support customers with basic sales and transaction servicing; where appropriate this will supplement the traditional channel.

Platform

Intermediary remains an important channel to the Bank, in particular for mortgage origination, of which 12.9 per cent., being £2.1 billion out of £16.3 billion as at 30 June 2013, is sourced through the Bank's Platform brand in the broker market.

Platform is one of the few lenders operating a dedicated brand within the UK intermediary market. Platform has historically achieved approximately 1 per cent. share of total intermediary new business completions. The market competitiveness of the Bank's interest rates allows the Bank to drive new business volumes as required.

Launched in February 2003, Platform was created from the merger of Platform Home Loans and Verso, both subsidiaries of Britannia. Platform is focused on prime residential mortgages and buy-to-let intermediary lending. This offers flexibility to the Bank in terms of market participation, product and pricing and, given the specialist nature of the broker market, this approach enables the Bank to access segments of the mortgage market that would be harder to reach through the Co-operative Bank brand. Intermediaries range from large UK insurance companies (including Legal & General and Sesame Bankhall Group) to small independent mortgage advisers.

Distribution strategy

Whilst branches remain important to the Bank's customers, increasingly the value of other distribution routes – notably digital – is being observed in the UK market. Over the medium term, the Bank's strategy is to move towards a more digitally enabled offering that is less branch intensive, and facilitates broader customer self-service options for the Bank's customers' everyday transactional

needs, at the same time retaining the richness of the branch proposition to support important transactional milestones for customers with complex needs. In this future distribution model:

- the remote channels (internet and digital), which currently have limited functionality, will become the primary point of contact for the Bank's customers looking for information on their account, simple product queries, simple transactions and simple sales;
- the Bank's call centres will primarily support the remote channels (via callback facilities and appointment booking) and will cater for more complex queries (such as complaints) and emergency support. It will also provide simple transaction services and information to customers for whom digital is not an option, although operators' availability will be increasingly restricted;
- the Bank's branch network will provide face-to-face support for customers at critical moments, for example, during complex transactional decisions, when the Bank has made a mistake, when a life event causes financial problems or in emergencies. The branches' secondary role will be to help customers use the Bank's digital services and provide simple transaction services and information to customers for whom digital is not an option;
- Co-operative Group food stores and ATMs will also continue to provide self-service to customers for basic transactions and will be a source of account information; and
- the Bank's Platform brand will remain a key channel to the market and there will be continual selective usage of intermediary mortgages.

B.2 Core Business: BACB

BACB targets and services small and medium sized businesses which will typically (i) have a turnover of less than £25 million; (ii) have borrowing requirements of less than £5 million; and (iii) otherwise meet the Bank's risk appetite. In line with the strategy of the Core Business, BACB will have a particular focus on being a fair, responsible and trusted relationship bank and, hence, will continue to offer services on commercial terms, to charities, social businesses and co-operatives.

BACB does not offer banking services to certain sectors, customers and in respect of assets which (i) cannot be supported by the Bank's Core Business retail platform; (ii) fail to deliver a positive net interest margin for the Bank; or (iii) are non-performing or defaulting.

(a) ***BACB segments***

BACB is split into the following three sub-segments:

- business banking (**Business Banking**);
- relationship-managed banking (**Relationship-managed Banking**); and
- specialist banking (**Specialist Banking**).

The BACB segment is deposit rich in that deposits are materially higher than its loan portfolio. The Bank intends to simplify the services and products it offers so that they are more akin to retail products. The three sub-segments of the BACB are set out in further detail below.

(i) ***Business Banking***

This sub-segment of BACB offers banking services to small business customers and primarily targets those business customers with low physical cash/cheque needs and borrowing requirements. The service it offers includes access to branches and corporate banking centres, telephone banking and online services. Customers within this sub-segment do not, however, have a relationship manager. Products that are available to these customers include: (i) current accounts; (ii) savings accounts (fixed term, notice and instant access); (iii) bank cards; (iv) business overdrafts; and (v) small ticket term-lending of up to £100,000. The Business Banking sub-segment has approximately 93,367 customers.

(ii) ***Relationship-managed Banking***

The Relationship-managed Banking sub-segment of the BACB offers the following additional products to its customers: (i) larger secured and unsecured lending (including simple term unsecured financing of up to £5 million and products linked to government schemes); (ii) multiple accounts; and (iii) deposit accounts for larger amounts (instant access, notice, fixed term and treasury accounts).

One of the primary differences between the Business Banking and Relationship-managed Banking sub-segments is that Relationship-managed Banking customers are provided with a relationship manager. The Relationship-managed Banking sub-segment services has approximately 3,977 customers.

(iii) ***Specialist Banking***

The Specialist Banking sub-segment of the BACB services charities, co-operatives, public sector bodies and social businesses. The products and services it offers are consistent with those offered to customers within the Business Banking and Relationship-managed Banking sub-segments. The Specialist Banking sub-segment services has approximately 939 customers.

BACB had £4.7 billion of customer deposit balances and £1.1 billion loan portfolio amount on a gross basis as at 30 June 2013, as set out in the following table.

Table 13: Breakdown of BACB deposits and loan portfolio spilt by sub-segment as at 30 June 2013

	BACB deposits as at 30 June 2013 (unaudited)		*BACB Loan portfolio as at 30 June 2013 (unaudited)*	
	(£millions)	*(percentages)*	*(£millions)*	*(percentages)*
Business Banking	1,360.3	29.2	28.5	2.6
Relationship-managed Banking	2,142.2	46.0	804.1	73.8
Larger charities	772.9	16.6	61.3	5.6
Larger co-operatives	379.9	8.2	195.1	18.0
Total	4,655.3	100.0	1,089.0	100.0

As at 30 June 2013, BACB's total undrawn commitments were £0.6 billion.

(b) ***Certain financial information in respect of BACB***

Set out below is certain key financial information in respect of the Core Business's BACB segment.

(i) ***Operating Results and Assets and Liabilities of BACB***

The following table illustrates the financial performance of the BACB segment, setting out the operating results for the BACB for the six months ended 30 June 2013.

Table 14: Financial performance of the BACB segment for the six months ended 30 June 2013

BACB	*For the six months ended 30 June 2013 (unaudited) (£millions)*
Net interest income	34.4
Non-interest income	7.7
Total income	42.1
Operating costs	
Steady state	(25.3)
Strategic initiatives	(2.5)
	14.3
Impairment losses	(1.4)
Operating result	12.9

The following table sets out the total assets, liabilities and risk-weighted assets of the BACB segment as at 30 June 2013.

Table 15: Total assets, liabilities and risk-weighted assets of the BACB segment as at 30 June 2013

BACB	*As at 30 June 2013 (unaudited) (£millions)*
Gross loans and advances to customers	1,093.7
Net loans and advances to customers	1,083.2
Segment assets	979.5
Customer deposits	4,655.3
Segment liabilities	4,655.3
Risk-weighted assets (B2)	1,192.4
Risk-weighted assets (B3 final rules)	1,192.4

(ii) ***Key Performance Indicators of BACB***

The following table provides a breakdown of the key performance indicators in relation to the BACB segment as at and for the six months to 30 June 2013.

Table 16: Breakdown of the key performance indicators of the BACB segment as at and for the six months to 30 June 2013

BACB	*As at and for the six months ended 30 June 2013 (unaudited)*
Net interest margin bps[1]	685
Cost-to-income ratio[2]	60.1%
Non-performing loans ratio[3]	2.3%
Non-performing loans coverage[4]	41.3%
Loan-to-deposit ratio[5]	23.5%

Notes:

(1) The net interest margin is calculated by dividing annualised net interest income by average segment assets.

(2) The cost-to-income ratio is calculated by dividing steady state costs by total income.

(3) The non-performing loans ratio is calculated by dividing impaired customer balances by gross customer balances.

(4) The non-performing loans coverage ratio is calculated by dividing total credit protection by impaired customer balances.

(5) The loan-to-deposit ratio is calculated by dividing gross customer loans by customer deposits.

B.3 Core Business: Treasury/other

The core responsibilities for the Bank's Treasury department are to ensure a strong and stable liquidity base, provide diverse sources of wholesale funding to the Bank, manage market risk within risk appetite and deliver a strong financial performance on the investment portfolio. During the first half of 2013 the Bank has placed a significant focus on increasing its high quality liquid asset portfolio whilst at the same time reducing its non-investment portfolio where strategically appropriate. 'Other' comprises Unity Trust Bank, a subsidiary bank operating in the corporate banking and social economy sectors on behalf of trade unions.

The following table illustrates the financial performance of the Treasury/other segment, by setting out the operating results for the Treasury/other segment for the six months ended 30 June 2013:

Table 17: Financial performance of the Treasury/other segment for the six months ended 30 June 2013

Treasury/other	*For the six months ended 30 June 2013 (unaudited) (£millions)*
Net interest income	6.6
Non-interest income	28.3
Total income	34.9
Operating costs	
Steady state	(14.8)
Strategic initiatives	(1.5)
	18.6
Impairment losses	(0.7)
Operating result	17.9

The following table sets out the total assets, liabilities and risk-weighted assets of the Treasury/other segment as at 30 June 2013.

Table 18: Total assets, liabilities and risk-weighted assets of the Treasury/other segment as at 30 June 2013

Treasury/other	*As at 30 June 2013 (unaudited) (£millions)*
Segment assets	11,245.2
Segment liabilities	9,791.5
Risk-weighted assets (B2)	1,398.9
Risk-weighted assets (B3 final rules)	2,636.8

B.4 Certain financial information in respect of the Core Business

Set out below is certain key financial information in respect of the Core Business as a whole.

(a) ***Operating Results and Assets and Liabilities of the Core Business***

The following table illustrates the financial performance of the Core Business by setting out its operating results for the six months ended 30 June 2013.

Table 19: Operating results of the Core Business for the six months ended 30 June 2013

Core Business	*For the six months ended 30 June 2013 (unaudited) (£millions)*
Net interest income	244.5
Non-interest income	101.0
Total income	345.5
Operating costs	
Steady state	(275.1)
Strategic initiatives	(11.8)
	58.6
Impairment losses	(26.9)
Operating result	31.7

The following table sets out the total assets, liabilities and risk-weighted assets of the Core Business as at 30 June 2013.

Table 20: Total assets, liabilities and risk-weighted assets of the Core Business as at 30 June 2013

Core Business	*As at 30 June 2013 (unaudited) (£millions)*
Gross loans and advances to customers	18,854.2
Net loans and advances to customers	18,667.1
Segment assets	30,021.8
Customer deposits	32,788.1
Segment liabilities	42,416.2
Risk-weighted assets (B2)	4,976.0
Risk-weighted assets (B3 final rules)	6,213.9

(b) ***Key Performance Indicators of the Core Business***

The following table provides a breakdown of the key performance indicators in relation to the Core Business as at and for the six months ended 30 June 2013.

Table 21: Breakdown of key performance indicators of the Core Business as at and for the six months ended 30 June 2013

	As at 30 June 2013 (unaudited)
Core Business	
Net interest margin bps[(1)]	158
Non-interest income/Total income	29.2%
Cost-to-income ratio[(2)]	79.6%
Cost of risk bps[(3)]	29
Non-performing loans ratio[(4)]	2.2%
Non-performing loans coverage[(5)]	53.9%
Loans-to-deposit ratio	57.5%

Notes:

(1) The net interest margin is calculated by dividing annualised net interest income by average segment assets.

(2) The cost-to-income ratio is calculated by dividing steady state costs by total income.

(3) The cost of risk is calculated by dividing the annualised impairment charge by average assets.

(4) The non-performing loans ratio is calculated by dividing impaired customer balances by gross customer balances.

(5) The non-performing loans coverage ratio is calculated by dividing total credit protection by impaired customer balances.

C. Non-core Business

The Non-core Business consists of asset classes of the Bank that are not consistent with the Bank's Core Business strategy. In July 2013, Co-operative Asset Management (**CoAM**) was established by the Bank to oversee proactive management, disposal and run-off of these non-core asset classes in accordance with CoAM's strategic objective (the **Non-core Assets**). CoAM is the successor to the Bank's legacy CABB non-core segment (part of which used to be designated in the old core business) which was established in 2012. CoAM contains a significant part of the Bank's impairment risk.

C.1 CoAM

(a) ***CoAM's strategic objectives***

CoAM's principal objective is to optimise the realisation of the Non-core Assets over the medium term, with the Non-core Assets being managed to achieve the most appropriate asset value on an individual portfolio basis, or targeted for run down or exit.

In attempting to achieve this objective, CoAM aims to:

- achieve an exit from the Non-core Assets over the medium term, depending on the tenor and nature of each particular class of Non-core Asset;
- meet CoAM's capital usage targets for each year;
- avoid negative impacts on the Bank's Core Business strategy;
- minimise impact on the Bank's customers;
- maintain the Bank's wider reputation as being a fair, responsible and trusted bank; and
- manage conduct risk issues.

(b) ***CoAM's asset management strategy***

CoAM is the portfolio manager of the Non-core Assets, and has established specific management plans for each asset class. CoAM intends to use the full suite of asset management options at its

disposal, including (but not limited to): (i) single loan and portfolio sales; (ii) optimisation of funding structures utilising wholesale markets, central banks and capital markets; (iii) establishing joint ventures to share risk; and (iv) appointing third parties to work out certain types of assets, all to ensure that its objectives are achieved in the most efficient manner for the Bank. As a result of the focus on achieving the most appropriate asset value on an individual portfolio basis. CoAM does not intend to dispose of Non-core Assets in order to satisfy any short-term liquidity needs which may arise from time to time.

(c) ***CoAM's asset management expertise***

The Bank is assembling a team of experienced asset management professionals who will work together with the Bank's existing relationship teams and back office functions. The asset management professionals are split into the following five functions:

(i) a portfolio optimisation team focused on asset management strategies for each Non-core Asset class. Specific emphasis is placed on portfolio design and distribution, market solutions, quantitative analysis and deal execution. This team will also manage the Optimum portfolio on behalf of the workout teams;

(ii) a corporate specialist sectors team, which manages the relationship with CoAM's underlying customers on an industry sector basis;

(iii) a recoveries, workouts and restructuring team which manages Non-core Assets for the medium term once the decision has been made to place the asset into workout, which is a status that could be extended until maturity of the relevant asset;

(iv) a business management and operations team which manages CoAM's operations (including monitoring compliance with service level standards by service providers) and analyses performance of the Non-core Assets; and

(v) the Optimum residential mortgage management team which works in conjunction with Western Mortgage Services, who manage the platform for these assets. The Bank previously considered disposing of Western Mortgage Services; this is currently on hold.

(d) ***CoAM infrastructure***

The CoAM operating model is designed to run and manage the Non-core Assets by utilising the Bank's existing legacy IT infrastructure. However, CoAM may look to outsource the provision of certain services to third party providers, including general IT, loan primary servicing and data management, to improve CoAM's cost efficiency and reduce any potential impact caused by the Core Business' IT strategy (as outlined in paragraph 7 below) such as CoAM requiring systems that are no longer supported by the Core Business.

The Bank has been conducting a data remediation exercise for the purpose of improving CoAM's ability to monitor, analyse and manage the Non-core Assets, by improving the quality and accuracy of the Bank's data on its existing loan stock. This remediation exercise will deliver a dataroom covering all asset classes, and centrally collate all facilities, collateral and derivative documentation and is expected to complete by the end of the first quarter of 2014.

(e) ***Funding***

The Non-core Business is funded by a combination of deposits of the Non-core Business and by the Core Business. The Non-core Business' total deposit portfolio as at 30 June 2013 was £1,485.6 million, comprising deposits from corporate (£495.2 million), deposits from the public sector (£641.2 million) and others (£349.2 million).

C.2 Non-core Assets

The Non-core Assets are identified on the basis of the following criteria:

- assets which cannot be supported by the Bank's Core Business retail platform. These include assets which are (i) lending assets which are not aligned with the Core Business' retail and SME focus going forward; (ii) corporate assets where the borrower typically has a turnover in excess of £25 million; (iii) customers that require more complex banking support for transactions (eg guarantees or letters of credit); or (iv) lending assets with a loan to value ratio of greater than 80 per cent.;
- assets which fail to deliver a positive net interest margin for the Bank including liquidity costs and/or a return on capital above the cost of capital;
- non-performing or defaulting assets; or
- assets with a risk weighted asset of greater than 60 per cent.

The Non-core Assets comprise eight asset classes with total outstanding loans of £15.0 billion with a net carrying value of £14,048 million and fair value of £11,040.4 million as at 30 June 2013.

The table below sets out a breakdown of the Non-core Business' total outstanding loan portfolio on a gross basis as at 30 June 2013.

Table 22: Non-core Business loan portfolio as at 30 June 2013

	As at 30 June 2013	*(unaudited)*
Non-core Business	*(£millions)*	*(percentage)*
Optimum	7,281.4	48.7
Corporates	1,681.6	11.2
CRE	3,462.4	23.1
PFI	1,055.6	7.1
Housing associations	930.7	6.2
Local authorities	25.8	0.2
REAF	524.9	3.5
Total gross customer balances	14,962.4	100.0

As at 30 June 2013, local authorities portfolio of the Non-core Business had risk weighted assets (on a Basel II and III basis) of £11 million.

The table below sets out the maturity profile of the Non-core Business' loan portfolio as at 30 June 2013.

Table 23: Non-core Business loan portfolio maturity profile as at 30 June 2013

	As at 30 June 2013 (unaudited)			
Maturity profile (£millions):	*<1 year*	*1-3 years*	*3-5 years*	*>5 years*
Optimum	53.4	167.2	236.8	6,824.0
Corporates	292.8	446.3	438.7	503.8
CRE	713.6	1,038.6	645.8	1,064.3
PFI	15.1	6.5	–	1,034.0
Housing associations	17.5	7.5	11.7	894.1
Local authorities	6.6	16.1	–	3.1
REAF	2.6	9.4	0.5	512.4
Total	1,101.6	1,691.6	1,333.5	10,835.7

CoAM also has exposure to £1.4 billion of undrawn balances. This is a mixture of revolving credit facilities and stage drawdown primarily in the Corporates, REAF, PFI and CRE portfolios.

In the period from 30 June 2013 to 30 September 2013, £0.6 billion of Non-core Assets (consisting of Non-core Business loans) were deleveraged, through a combination of asset sales, run-off and managed repayments, net of new drawdowns.

C.3 Non-core Asset Classes

(a) ***Optimum***

Optimum was created following the merger with Britannia and is a closed book of non-prime intermediary and acquired mortgage book assets including non-prime residential mortgages (both income verified and self-certified), buy-to-let and other non-conforming mortgages. The Optimum gross customer balances as at 30 June 2013 stood at £7.3 billion.

The management of the Optimum portfolio is the subject of significant work to devise an appropriate asset management strategy. The current status on the portfolio is:

- as at 30 June 2013, the Optimum portfolio comprised 28.9 per cent. buy-to-let mortgages, 35.1 per cent. non-conforming, 26.7 per cent. self-certified and 9.3 per cent. specialist prime. As at 30 June 2013, 24 per cent. of the Optimum portfolio by value has a loan-to-value ratio of greater than 100 per cent. (23,505 accounts), (equivalent to £3.2 billion) and 16.5 per cent. of the portfolio is currently in arrears (by any amount/possession) (equivalent to £1.2 billion), which is a significantly greater level relative to the 0.9 per cent. for the Core Business retail mortgage portfolio;
- the Optimum portfolio is predominantly an interest-only mortgage book (78 per cent. of the Optimum portfolio is comprised of interest-only mortgages);
- many customers are reluctant to redeem their residential mortgages or are unable to redeem due to a high loan-to-value or because the interest rate offered is favourable relative to those currently available in the market. In addition, 85.9 per cent. of the Optimum portfolio are variable rate mortgages which track the Bank of England base rate or LIBOR. This therefore prevents the Bank from passing any increases in its cost of funding to these customers. As a result of these and other factors, 83.4 per cent. of the portfolio (equivalent to £6 billion) is classified by the Bank as not in line with current risk policy and is likely to be non-rebankable at the current time and is being proactively managed on an amortising basis where possible;
- the run-off profile of the Optimum portfolio is typical for a residential mortgage book of its vintage;
- the weighted average maturity for the Optimum book is seven years. The Bank's strategy with regard to the Optimum book is based upon a natural amortisation of the book;
- over 60 per cent. of the Optimum portfolio is encumbered; as a result the ability of CoAM to sell or otherwise dispose of the Optimum portfolio is severely restricted prior to the run-off of these notes;
- Calico is a second-loss trade on approximately 24 per cent. of the total book nominal value. This transaction provides second-loss protection on a loan-by-loan basis on a pool of approximately £1.8 billion of assets;
- As at 30 June 2013, 16.5 per cent. of the portfolio were non-performing, coverage ratio was 12.4 per cent., risk weighted assets were £3,842.9 million (calculated on a Basel II and Basel III basis). The Optimum portfolio of loans had a fair value and carrying value was £5,384.8 million and £7,115.3 million respectively, as at 30 June 2013. As at 30 June 2013, the Optimum portfolio of loans had a undrawn commitment was £nil million. As at 30 June 2013, the risk-weighted asset ratio of the Optimum portfolio was the equivalent of 72 per cent. without taking into account the impact of the Calico second-loss trade; and

- the Optimum portfolio may present a significant credit risk on a single risk shock factor (interest rate rise) or on a multiple stress basis. There may also be conduct risks inherent in the book that may result in additional provisions. See the risk factor titled "*Worsening economic and market conditions and/or increasing interest rates could result in increased mortgage and unsecured loan losses which would adversely impact the Bank's financial and operational performance*" in Section 2 (*Risk Factors*).

CoAM's ultimate objective is to exit the Optimum portfolio. However, as large-scale asset sales are unlikely, the Bank expects to have to hold a significant proportion of the Optimum portfolio for many years in run-off, with natural amortisation of the portfolio taking place.

As a result, CoAM's priorities are to manage the credit and conduct risk associated with the Optimum portfolio as effectively as possible, to deleverage the unencumbered portfolio where this meets CoAM's strategic objectives and to transform the operational effectiveness of the management of the portfolio by implementing a cost effective and efficient operating model, which may include appropriate outsourcing arrangements, such as outsourcing to Western Mortgage Services.

As at 30 June 2013 the Optimums outstanding loan portfolio on a gross basis was £7,281.4 million. The table below sets out a breakdown of the Optimum outstanding loan portfolio as at 30 June 2013.

Table 24: Optimum portfolio by type as at 30 June 2013

	As at 30 June 2013 (unaudited)	
	(£millions)	*(percentages)*
Non-conforming	2,553.7	35.1
Buy-to-let	2,107.6	28.9
Self-certificated	1,944.9	26.7
Prime	675.2	9.3
Total	7,281.4	100

The following table sets out the geographical distribution of the Optimum portfolio as at 30 June 2013.

Table 25: Geographical distribution of the Optimum portfolio as at 30 June 2013

	As at 30 June 2013 (unaudited)	
Optimum Region	*(£millions)*	*(percentages)*
London & South East	3,276.7	45.0
Northern England	1,507.2	20.7
Midlands & East Anglia	1,252.4	17.2
Wales & South West	844.6	11.6
Other	400.5	5.5
Total	7,281.4	100.0

The following table sets out the LTV ratio of the Optimum portfolio, broken down by type as at 30 June 2013.

Table 26: LTV breakdown by product of the Optimum portfolio as at 30 June 2013

			As at 30 June 2013 (unaudited)		
Optimum	*Non-conforming*	*Buy-to-let*	*Self-certificated*	*Prime*	*Total*
			(percentages)		
Average LTVs	80.9	79.1	76.9	77.9	79.2
Book by indexed LTVs					
<= 50%	5.8	5.7	7.8	7.4	6.5
<= 75%	16.7	28.1	22.8	11.4	21.2
<= 100%	44.6	51.7	49.8	49.1	48.3
> 100%	32.9	14.5	19.6	32.1	24.0
Percentage of accounts with >2.5% arrears	4.5	0.2	1.9	1.9	2.3
Gross customer balances (*£ million*)	2,553.7	2,107.6	1,944.9	675.2	7,281.4

(b) ***Illius***

Illius is a £0.2 billion diverse portfolio of 1,364 repossessed properties managed through Co-operative Group Property. The portfolio is geographically diverse, making it inefficient to manage, and is under-maintained. Less than 17 per cent. of the properties in the Illius portfolio are located in the South East region of the UK. Many of the properties have historically not been maintained to a high standard.

Illius was established in the second quarter of 2008 as a vehicle to mitigate losses from the Britannia buy-to-let mortgage book. The underlying strategy was to buy-in at arm's length and market value repossessed properties with the intention that they would be held and sold at a higher value at a future date.

As at 30 June 2013, the carrying value of the Illius assets was estimated to be £16 million higher than the value of the portfolio if it was sold as an entire portfolio and an adjustment was booked for this in accordance with accounting policies. Illius' total risk weighted assets as at 30 June 2013 were £153.0 million (calculated on a Basel II basis and on a Basel III basis).

It is intended for the Illius portfolio to be disposed of over the next three to four years.

(c) ***Corporates***

Corporates is a £1.7 billion portfolio made up of leveraged, syndicated and relationship connections. A significant proportion of deleveraging activity since 30 June 2013 has been from this portfolio, totalling £0.5 billion. Further deleveraging is expected, with an immediate focus on expired or nearly-expired facilities, customers with a greater perceived ability to refinance and developing strategies for the large non-performing exposures. Large undrawn exposures will be reviewed in order to identify where limits can be removed. This portfolio along with certain CRE relationships are part of CoAM rebanking exercise where the relationship benefit is expected to generate a near-par disposal, whereas an outright sale of the financial asset may deliver a sub-par outcome.

As at 30 June 2013, the portfolio had gross loans of £1,701.6 million and net loans of £1,518.2. 32.9 per cent. of the portfolio is non-performing with 48.9 per cent. non-performing loans coverage ratio. It also has exposure to £625.2 million of undrawn commitments (as at 30 June 2013). Total risk-weighted assets were £1,450.8 million (calculated on a Basel II basis) and £1,460.6 million (calculated on a Basel III basis).

(d) ***CoAM CRE***

As at 30 June 2013, this portfolio had gross loans of £3.5 billion (and net loans of £2.9 billion). Approximately £3.4 billion is drawn across 799 borrowers and 1,340 loans. Approximately 57 per cent. of the portfolio is non-performing with 37.5 per cent. non-performing loans coverage ratio. The weighted average maturity of the portfolio is 4.2 years and approximately £2.1 billion will either mature in less than one year (£418 million) or is already in default (£1,638 million) based on drawn balances. Relative to other portfolios of the Non-core Assets, this portfolio consumes significant capital with risk weighted assets of £2.1 billion (on a Basel II basis) and £2.3 billion (on a Basel III basis) as at 30 June 2013. As at 30 June 2013, the portfolio had exposure of £135 million of undrawn commitments.

The strategy for the non-performing part of this portfolio is to identify and execute exit options on a case-by-case basis by means of, for example, a refinancing, restructuring, enforcement or consensual sale. This commenced with a strategic asset review in August 2013 and will continue until the end of the year.

The following table sets out the geographical distribution of the CoAM CRE portfolio on a gross basis as at 30 June 2013.

Table 27: Regional analysis of CoAM CRE portfolio as at 30 June 2013

	As at 30 June 2013 (unaudited)	
CoAM CRE portfolio Region	*(£millions)*	*(percentages)*
London & South East	1,190.7	33.1
Midlands & East Anglia	550.4	15.3
North West	787.8	21.9
Wales & South West	269.8	7.5
Northern England	384.9	10.7
Other	413.7	11.5
Total	3,597.3	100.0

The following table sets out the industry segments of the CoAM CRE portfolio on a gross basis as at 30 June 2013.

Table 28: Analysis of CoAM CRE portfolio by industry sector as at 30 June 2013

	As at 30 June 2013 (unaudited)	
CoAM CRE portfolio Industry	*(£million)*	*(percentages)*
Retail	1,054.0	29.3
Office	809.4	22.5
Industrial	456.9	12.7
Residential	586.4	16.3
Other	690.6	19.2
Total	3,597.3	100.0

The following table sets out the LTV coverage information relating to the CoAM CRE portfolio by property type as at 30 June 2013.

Table 29: LTV coverage information relating to the CoAM CRE portfolio by property type as at 30 June 2013[1]

CoAM CRE portfolio	*As at 30 June 2013 (unaudited)*				
	Average LTV		*Provision & FV*	*Collateral*	*Expected performance*
Property type	*(£millions)*	*(percentages)*		*(£millions)*	
Commercial development	268.7	101.7	18.8	79.5	10.2
Residential investment	363.4	82.0	45.6	155.4	0.5
Commercial investment	2,897.0	110.2	571.3	967.7	48.7
Hotels	68.2	76.4	1.6	15.5	–
Total	3,597.3	106.0	637.3	1,218.1	59.4

Note:

(1) The sum of the provision and fair value, collateral, and expected performance columns in this table equal the amount of impaired loans and therefore shows how the impaired balances are covered.

(e) ***Project Finance Initiatives and Project Finance (PFI)***

This is a £1.1 billion portfolio of predominantly low margin, long-dated loans to finance public private partnership, project finance initiatives, such as schools, universities and hospitals and roads.

As at 30 June 2013, the portfolio had gross loans £1,068.1 million and net loans of £1,055.7 million. 2.3 per cent. of the portfolio is non-performing with 51.2 per cent. non-performing loans coverage ratio. It also has exposure to £194.4 million of undrawn commitments (as at 30 June 2013). Total risk-weighted assets were £1,125.6 million (calculated on a Basel II basis and Basel III basis).

The portfolio faces certain challenges including legislative constraints and the general market downturn. The sale of these non-core assets is likely to have an adverse impact on capital given the low market pricing. Therefore, these non-core assets will be considered for disposal on a case-by-case basis so that only those assets whose disposal is capital neutral are selected for disposal, with other assets planned to be held in maturity. Additional strategies are being considered, such as securitisation on or creating specific servicing solutions (outsourcing).

(f) ***Housing Association***

This is a £0.9 billion portfolio across long-dated (the average life of the loans is 20 years), predominantly low margin and high credit quality assets.

As at 30 June 2013, the portfolio had loans (gross and net) of £941.7 million. It has no non-performing loans. It also has exposure to £153.3 million of undrawn commitments (as at 30 June 2013). Total risk-weighted assets were £525.8 million (calculated on a Basel II and Basel III basis).

There is limited opportunity to refinance the portfolio and a sale of the portfolio would be at a significant loss and capital destructive. These long-dated assets are planned to be held to maturity to reflect the expected loss and capital impact on sale. Additional strategies are being considered such as securitisation.

(g) ***Renewable Energy and Asset Finance (REAF)***

This is a £0.5 billion portfolio of specialised energy lending, mainly relating to wind farms, as well as combined heat and power and hydro.

As at 30 June 2013, the portfolio had gross loans £531.2 million and net loans of £518.8 million. 1.8 per cent. of the portfolio is non-performing with 133.3 per cent. non-performing loans coverage

ratio. It also has exposure to £115.3 million of undrawn commitments (as at 30 June 2013). Total risk-weighted assets were £615.8 million (calculated on a Basel II and Basel III basis).

The REAF portfolio has low yields and approximately a third of its projects are still in the development phase.

A portfolio sale is deemed to be the optimum exit strategy for these assets. This will take the form of a standalone renewable business through a fund structure which may include REAF staff in the on-going management. The Bank is advancing a fund structure in this regard.

C.4 Certain financial information in respect of the Non-core Business

Set out below is certain key financial information in respect of the Non-core Business as a whole.

(a) ***Operating Results and Assets and Liabilities of the Non-core Business***

The following table illustrates the financial performance of the Non-core Business by setting out operating results for the six months ended 30 June 2013.

Table 30: Operating results for the Non-core Business as at 30 June 2013

Non-core Business	*For the six months ended 30 June 2013 (unaudited) (£millions)*
Net interest income	4.5
Non-interest income	5.8
Total income	10.3
Operating costs	
Steady state	(28.0)
Strategic initiatives	(2.5)
	(20.2)
Impairment losses	(469.1)
Operating result	(489.3)

The following table sets out the total assets, liabilities and risk-weighted assets of the Non-core Business as at 30 June 2013.

Table 31: Assets and liabilities of the Non-core Business as at 30 June 2013

Non-core Business	*As at 30 June 2013 (unaudited) (£millions)*
Gross loans and advances to customers	14,931.3
Net loans and advances to customers	14,048.8
Segment assets	14,164.4
Customer deposits	1,485.6
Segment liabilities	1,485.6
Risk-weighted assets (B2)	9,782.0
Risk-weighted assets (B3 final rules)	10,032.9

(b) ***Key Performance Indicators of the Non-core Business***

The following table sets out key performance indicators for the Non-core Business as at and for the six months to 30 June 2013.

Table 32: Key performance indicators for the Non-core Business as at 30 June 2013

	As at 30 June 2013 (unaudited)
Non-core Business	
Net interest margin bps[(1)]	6
Non-interest income/Total income	56.3%
Cost-to-income ratio[(2)]	271.8%
Cost of risk bps[(3)]	628
Non-performing loans ratio[(4)]	25.0%
Non-performing loans coverage[(5)]	31.2%
Loans-to-deposit ratio	1,005.1%

Notes:

(1) The net interest margin is calculated by dividing annualised net interest income by average segment assets.

(2) The cost-to-income ratio is calculated by dividing steady state costs by total income.

(3) The cost of risk is calculated by dividing the impairment charge by average assets.

(4) The non-performing loans ratio is calculated by dividing impaired customer balances by gross customer balances.

(5) The non-performing loans coverage ratio is calculated by dividing total credit protection by impaired customer balances.

6. INVESTMENT PLAN

The Bank will be required to make significant levels of investment to execute its turnaround plan. A high percentage of these investments will be IT related to make its platform fit-for-purpose and provide the minimum levels of functionality required by the strategy. These investments are expected to contribute to cost savings and revenue uplift.

These investments can be classified into three categories according to level of criticality:

- Mandatory: investments critical for the on-going business. This includes investments in regulatory compliance, risk remediation, resilience activities and management information. Of the three categories, this requires the largest amount of investment;
- Enablement of the strategy: investments critical to allow the Bank to be able to deliver its strategic plan. This includes investments in digital catch-up, improving product pricing and credit decisioning, branch closure and non-IT related process optimisation; and
- Delivery of the strategy: investments required in executing the strategic plan. This includes investments in systems rationalisation, channel optimisation and integration, enabling customer self-service and automating processes and workflow.

The execution of the Bank's turnaround plan will result in significant costs being incurred over the next three years, and the Bank has currently budgeted in the region of £500 million in connection to the re-engineering of the Bank's IT platform to support the Core Business strategy of the Bank, its cost saving programme, and the reorientation of the Bank's distribution channels. Within this amount, total investment spent on transformation, including IT remediation, digital catch-up and other IT initiatives in the next three years of approximately £400 to £450 million is currently budgeted, of which approximately 40 to 45 per cent. is currently expected to be capitalised.

See the section below for more details on the Bank's plans with regards to IT.

7. TECHNOLOGY/IP/IT

IT Systems and Infrastructure

The core of the Bank's information technology (**IT**) systems architecture is IBM's mainframe technology, which supports current, savings and loan account processing for the Bank's customers.

Midrange platforms, which are primarily provisioned on versions of IBM AIX, Solaris and Wintel, support additional services such as payments, fraud monitoring and finance, as well as savings account processing for Britannia customers and the teller and call centre applications. The Bank's credit card, mortgage and ATM systems are externally hosted using industry recognised third parties such as First Data Corporation, Wincor Nixdorf Limited and Sopra Group Limited.

IT Organisation and Suppliers

The IT team consists of approximately 400 people. The team manages, oversees and controls the existing IT for the Bank and any changes to the Bank's IT. The primary areas covered by the IT team are service, IT development, and IT security and risk management. The IT team's staff provide primary points of contact for the Bank for service management and business and IT change, and are accountable for service, IT security and risk management, and change and innovation.

Co-operative Group provides IT support to the Bank pursuant to a services agreement dated May 2013. This support includes the provision of data centres, hardware (computers), networks, supplier management and programme office resources and IT support for business areas shared with Co-operative Group (such as finance, human resources, marketing and IT). See paragraph 8 titled "*Separation*" of this Section 8 (*Description of the Bank*) and paragraph 20.1(a) titled "*IT Services Agreement*" in Section 20 (*Additional Information*) for details of which of these services Co-operative Group may cease to provide under the New IT Services Agreement (as defined in paragraph 20.1(a) titled "*IT Services Agreement*" in Section 20 (*Additional Information*).

The majority of the Bank's software is supported by a third party, Steria Limited (**Steria**). The Bank also uses Steria for application development and project management. These out-sourcing arrangements are regularly reviewed with the focus being on reducing cost and improving delivery certainty. This supervision takes the form of weekly service reviews, monthly governance forums that formally review performance and annual reviews of key obligations and commercials.

Security

The security of the Bank's IT systems is an area of importance, with an internal team responsible for all IT security build-and-run activities. There have been and continue to be challenges in IT security similar to those experienced by industry peers. These relate to areas of control weakness such as identity and access management and the reliance on legacy security infrastructure, in addition to a continually evolving cybersecurity-threat landscape.

These issues have been assessed by the Bank, documented and are well understood. This has resulted in the Bank spending £4.7 million on security technologies during 2013, investing in identity and access management, firewall refresh, security monitoring and addressing legacy security infrastructure. These phased programmes of work will continue into 2014 and aim to address critical risks, including strengthening the internal IT security team and aligning policy and supporting controls to industry standards eg ISO27001 and PCI-DSS. While there have been tangible improvements in security controls, the need for continued investment to further remediate the risks to appropriate levels and maintain them within risk appetite has been recognised.

The Bank is also working towards full compliance with the Payment Card Industry Data Security Standard, which is a common set of security standards developed by the major card providers to ensure that payment card data is processed, stored and transmitted securely.

Business Continuity

Co-operative Group provides management of business continuity and disaster recovery arrangements, and provision of work area recovery sites.

The Bank has business continuity plans for each operational area, reviewed on a quarterly basis, in line with internal control standards and risk policy requirements. Each operational area completed a business impact analysis and call cascades. Testing includes work-area recovery testing and scenarios testing supported by education and awareness.

Work-area recovery for the Bank predominantly consists of syndicated third party work-area recovery at a number of recovery sites. This is supplemented by a combination of cross-site agreements to allow priority areas to move to an alternate major occupancy, and contact centres have the ability to transfer customer servicing activities to alternative locations. Treasury has a dedicated work-area recovery capability.

Business continuity plan owners are supported by co-ordinators within each business unit who facilitate plan updates and testing and liaise with Co-operative Group.

The business continuity framework is under review to deliver the required level of confidence in the Bank's ability to continue priority operations during and post any major incidents. This includes:

- Resourcing the Bank with incident management and business continuity colleagues with appropriate skills and experience.
- Agreeing the strategy for business continuity management and the risk appetite for business continuity.
- Reviewing the business impact analysis and business continuity plans.
- Establishing a formal action plan and governance to ensure delivery of improvements.

The Bank currently receives IT disaster recovery services from Co-operative Group through the Existing IT Service Agreement which includes an annual schedule for testing the IT disaster recovery of the systems, services and third party provisions. A number of approaches are adopted; including technical testing at a component level, business end-user testing and live proving of contingency infrastructure. This service is expected to be brought back into the Bank.

A review of the Bank's disaster recovery provision was undertaken in 2013 and concluded that the current approach provides limited assurance of the ability to recover services in the event of a full disaster recovery invocation.

As a result, a remediation programme has been initiated to review and update the strategy, policies, procedures and technical recovery plans to ensure they are aligned to business recovery objectives and where appropriate, identify technology for remediation.

Intellectual Property

The information and processes the Bank uses may be protected by patents, copyrights in software or other materials, rights in databases, rights in confidence or other intellectual property rights owned by third parties. The Bank seeks to obtain such licences or consents in respect of any intellectual property rights owned by third parties that it identifies as necessary to its business.

Recent Developments and Current Position

Recent developments include (i) the launch of a new credit card platform, (ii) new fraud and financial crime management systems, (iii) improved security systems, including two factor authentication (which requires the customer to authenticate himself using credentials generated by a chip and pin card reader) and (iv) a new credit decision making engine (which manages credit checks used in, for example, the account opening process).

The Bank continues to comply with on-going regulatory changes, such as Faster Payments transfers (**Faster Payments**) and Seven Day Account Switching (**Seven Day Account Switching**). Faster Payments is the

transfer of funds between clearing banks, typically within a 15 second timeframe, moving from the previous three-day BACS cycle. Seven Day Account Switching provides for the ability to transfer customer accounts between banks, including all direct debits and standing orders, within seven days.

Since 2012, two new IBM Z196 mainframes have been installed to run the core banking systems, and during 2011 and 2012 a new telephone call centre system was implemented using Avaya and Genesys technologies.

As a result of historical underinvestment (amongst other factors), the Bank's digital offerings significantly lag behind its competitors and a number of the Bank's IT systems now, or will soon, require both hardware and operating systems to be refreshed. The existing IT systems have a number of known resilience-related risks (which are under active management). These fall broadly into the categories of: disaster recovery, design of IT systems and single points of failure, end of life technology and third party suppliers. There are also issues with the Bank's ability to quickly launch new products on its platform. It had previously been intended to replace key IT systems (including the existing core banking platform, and the applications that support the branch, internet and call centre channels) with a new core software platform which was being developed or, had the planned acquisition of the Verde Business gone ahead, the IT systems used by Lloyds TSB. The Bank subsequently decided to cease the implementation of these IT plans and following that decision reported a write-down on its IT assets of £148.4 million in its interim accounts for the six months ended 30 June 2013. Since then, the Bank has undertaken a review of its overall IT requirements against the backdrop of its new business strategy, and has agreed a new IT development plan which is to be exercised in phases and has been designed to meet the requirements of the Core Business strategy of the Bank, as outlined below.

Future Plans

To meet the requirements of the Core Business strategy and address the issues outlined above, the Bank has adopted a strategy of 'incremental build' which involves progressive re-engineering of the existing IT platform. This includes: introduction of new digital channel applications with improved capabilities; enhancements to the core mainframe platform to allow for simpler product development and management; installing an enterprise data warehouse; delivering improved reporting and analytics; and improved security, process and workflow automation. The re-engineering will be combined with simplification of IT systems in order to reduce operating costs; for example, the rationalisation of existing savings and mortgage platforms.

The Bank's IT team recognises that the delivery of this plan will require engagement with industry-leading third parties to assist it with the implementation of this strategy.

In parallel to the enhancement of the core platform, the Bank shall continue to support its non-core operations, which may, whilst it deleverages its Non-core Assets, impact its ability to drive savings from the rationalisation of its IT systems.

8. SEPARATION

8.1 Separation of Services

Current Position

Certain functions of the Bank are centralised and carried out by Co-operative Group. There are currently two key arrangements in place pursuant to which the Bank receives the supply of services, assets and/or personnel:

Project Unity

Between 2011 and 2013 the Bank transferred a number of functions and a substantial number of personnel to Co-operative Group and entered into arrangements pursuant to which Co-operative Group would provide certain services to the Bank. This project is known within the Bank as "Project Unity" (**Project Unity**). In connection with Project Unity, Co-operative Group, CFSMS and the Bank entered into two key agreements:

- the Existing IT Services Agreement, dated 5 July 2012, in relation to the provision by Co-operative Group of certain IT services to the Bank and other members of Banking Group; and
- a Professional Services Master Services Agreement, dated 14 February 2013, pursuant to which the same parties entered into a number of individual service contracts in relation to the provision of certain other services by Co-operative Group to the Bank and other members of Banking Group.

The Unity Agreements were negotiated on an arm's-length basis, although taking into account that services provided under the Unity Agreements are provided, on an "at cost" or "pass-through" basis, with no margin added by Co-operative Group.

CFSMS Arrangements

References to **CFSMS Arrangements** relate to arrangements between CFSMS (an indirect subsidiary of Co-operative Group) and the Bank regarding the provision of services, personnel and on-supply of certain third party services and assets to the Bank. CFSMS was established as a direct 100 per cent. subsidiary of Banking Group in 2005, to enable economies of scale through the sharing of employees and sourcing of third party services across Banking Group, including the Bank, Reclaim Fund Limited, CIS General Insurance and Co-operative Life Insurance and Asset Management.

CFSMS also holds a significant proportion of the fixed assets of Banking Group and is the primary counterparty to a large proportion of third party contracts for the provision of services to, and licences used by, Banking Group. Ownership of those assets and the benefit of and obligations under those arrangements currently remain with CFSMS. In addition, many of the Bank's personnel are employed or engaged by CFSMS and seconded to, and are under the control of, the Bank and CFSMS also procures and provides assets and services for the benefit of the Bank.

The Bank is therefore highly dependent on CFSMS to provide personnel and services to conduct its day-to-day activities. CFSMS's obligations to Bank in relation to its provision of assets and personnel are governed by an agreement dated 16 February 2006. Under that agreement, the Bank provides CFSMS with an indemnity for all liabilities, losses, damages, costs and expenses of any nature incurred as a result of CFSMS entering into and performing the agreement in respect of the assets, services and personnel provided to the Bank.

Proposed changes

Since the announcement of the Bank's recapitalisation plan on 17 June 2013 (the **17 June Plan**), the Bank and Co-operative Group have been working to amend certain provisions of the Project Unity and CFSMS Arrangements to ensure those arrangements were suitable for the circumstances of a listing of the Bank on the London Stock Exchange with Co-operative Group as a significant majority shareholder. Those updated arrangements were close to finalisation prior to the announcement on 21 October by Co-operative Group that it was in discussions with bondholders and that many elements of any recapitalisation plan for the Bank would be materially different to the outline provided on 17 June 2013.

As described in this document, under the terms of the Liability Management Exercise, Co-operative Group will retain a 30 per cent. interest in the Bank. This change to the 17 June Plan has required the Bank and Co-operative Group to revisit, in a very short timeframe, the appropriateness of Project Unity and the CFSMS Arrangements as an operating structure for the Bank as there would be significant adverse cost impacts if the Project Unity and CFSMS Arrangements were to continue in the form envisaged for the 17 June Plan following completion of the Liability Management Exercise, principally arising from VAT becoming payable in respect of the services, as the Bank and Co-operative Group will no longer be in the same VAT group. In addition, as CFSMS is a wholly-owned, indirect subsidiary of Co-operative Group, the Bank does not consider it appropriate for the provision of personnel or supply of certain third party services and assets to the Bank to be housed in an entity that, on completion of the Liability Management Exercise, will cease to be in the same group as Bank. In the time available it has not been possible for the Bank and Co-operative Group to finalise the basis

on which the services currently provided by CFSMS and Co-operative Group will be provided to the Bank following completion of the Liability Management Exercise.

As a result, the Bank and Co-operative Group have agreed certain high level principles (the **Separation Principles**) that will govern future discussions between the Bank and Co-operative Group regarding the separation arrangements between the Bank and Co-operative Group. The parties intend to document arrangements to resolve certain separation matters in a manner consistent with the Separation Principles. The Separation Principles include an overarching agreement to act in good faith and, amongst other things:

- A commitment that, until appropriate alternative arrangements for Project Unity and the CFSMS Arrangements are agreed, Co-operative Group will continue to provide services to the Bank under the same terms that such services are currently provided.
- For those costs allocated by Co-operative Group in its sole discretion, the Bank and Co-operative Group will take reasonable steps to avoid the Bank incurring costs incremental to those it currently incurs.
- Co-operative Group and the Bank will mitigate costs arising for Co-operative Group or the Bank from (i) Co-operative Group being a less than 50 per cent. shareholder of the Bank or (ii) agreed steps taken in connection with the separation process (acknowledging that the Bank shall be under no obligation to accept the transfer of any assets or liabilities that are not wholly or predominantly related to the continuing business of the Bank).
- An additional mark-up (of no more than 20%) may be charged by Co-operative Group for services provided under Project Unity after completion of the Liability Management Exercise but not in respect of the first 12 months in respect of all services. The following exceptions apply to the 12 month general arrangement: (i) pension administration services, and (ii) IT services (where no mark-up shall be applied for the first 24 months).
- Costs will be allocated between the Bank and Co-operative Group on an equitable basis.
- A working group consisting of representatives from the Bank and Co-operative Group will be established to address and oversee the separation work-stream.

Consistent with the Separation Principles, Co-operative Group and the Bank have also agreed the following basis on which Project Unity and the CFSMS Arrangements will be unwound, with the intention that as many of the steps as possible will be implemented, without undue prejudice to either party, prior to the completion of the Liability Management Exercise:

(a) ***Project Unity***

(i) *Back to Bank*

The scope of services to be provided under the Existing IT Services Agreements and the Professional Services Master Services Agreement will be amended such that the significant majority of these services will be taken back into the Bank. Certain services, such as in relation to pensions and IT, may be provided for a longer period although the details of the scope of such services and the relevant time periods remain under discussion between Co-operative Group and the Bank. The longest of these time periods is likely to be in relation to IT services, the separation of which is estimated will take between one and three years. It is anticipated that the Bank will require membership services to continue to be provided by Co-operative Group under the Bank's proposed new ownership structure.

(ii) *Interim arrangements*

It is still intended that the amendments to the Unity Agreements contemplated for the 17 June Plan will be made to ensure that those services which have not be taken back into the Bank before completion of the Liability Management Exercise are provided on

appropriate terms, and the service contracts will be updated accordingly to reflect the detailed services that are no longer required. The parties have agreed that, following completion of the Liability Management Exercise, an additional mark-up (of no more than 20 per cent.) may be charged by Co-operative Group for services provided under the Unity Agreements, but not in respect of the first 12 months in respect of all services. The following exceptions apply to the 12 month general arrangement: (i) pension administration; (ii) IT Services (where the 20 per cent. mark-up shall not be applied for the first 24 months). A summary of the current Project Unity agreements, together with the proposed amendments to them as contemplated for the 17 June Plan, is set out in paragraph 20.1 titled "*Project Unity*" in Section 20 (*Additional Information*). The Bank and Co-operative Group are considering whether any additional amendments (including to the scope of the services and key terms) are required to the Project Unity agreements to reflect that Co-operative Group will be a minority shareholder in the Bank following completion of the Liability Management Exercise.

(iii) *Costs*

It is not possible for the Bank to predict exactly which of the services will have been returned to the Bank by the time of completion of the Liability Management Exercise. However, if no change were made to the current arrangements, other than the changes envisaged for the 17 June Plan, then the incremental costs to Bank for those services would be in the region of £8 to £12 million per annum, arising principally as a result of VAT charges.

(b) ***CFSMS Arrangements***

(i) *Back to Bank*

The continuation of the CFSMS Arrangements contemplated for the 17 June Plan would be materially prejudicial to Bank and the Bank and Co-operative Group have agreed, in principle, that alternative arrangements are required to be put in place which may involve the transfer of assets, third party contracts, and employees from CFSMS to the Bank or of CFSMS itself to the Bank. The Bank is in on-going discussions with Co-operative Group regarding the precise structure of these alternative arrangements (which may involve the provision of services from Co-operative Group to the Bank or from the Bank to Co-operative Group).

(ii) *Interim arrangements*

In contemplation of the 17 June Plan, the Bank and CFSMS agreed that:

- CFSMS will establish a small dedicated management team to deal with contract management following Banking Group's disposal of insurance subsidiaries; and
- the CFSMS management team will manage CFSMS' supplies to the Bank (comprising services seconded employees, and third party services and assets) to ensure these meet the requirements of the CFSMS-Bank 2006 Agreement.

The Bank and CFSMS also agreed to replace the CFSMS-Bank 2006 Agreement with a new agreement (the **CFSMS-Bank Framework Agreement**).

As with the Project Unity arrangements described above, it is still intended by the Bank that the CFSMS-Bank Framework Agreement contemplated for the 17 June Plan will be finalised between the parties and, to the extent that the arrangements described in paragraph (b)(i) above cannot be implemented before completion of the Liability Management Exercise, will be entered into between the Bank and CFSMS.

The CFSMS-Bank Framework Agreement will be based on the form of the Unity Agreements (as amended) and will address the current arrangements in respect of

personnel of the Bank who are employed or engaged by CFSMS, the provision of services by CFSMS and the on-supply by CFSMS of third party supplies of assets and services. In addition, the agreement will address the following further areas: governance of the allocation of charges between the Bank and all other entities receiving services from CFSMS; allocation of personnel who provide services both to the Bank and other Co-operative Group entities, detailed audit rights; the ability of the Bank to direct CFSMS to take action against third party suppliers and the governance arrangements for CFSMS' supplies to the Bank. A summary of the proposed CFSMS-Bank Framework Agreement is set out in paragraph 20.2 titled "*CFSMS – Framework Agreement*" in Section 20 (*Additional Information*). The Bank and Co-operative Group are considering whether any additional amendments are required to the CFSMS-Bank Framework Agreement to reflect that Co-operative Group will be a minority shareholder in the Bank following completion of the Liability Management Exercise.

(iii) *Costs*

It is not currently possible for the Bank to confirm whether the arrangements described in paragraph (b)(i) can be implemented by the time of completion of the Liability Management Exercise. However, if no change were made to the CFSMS Arrangements, other than the changes envisaged for the 17 June Plan (including the entry into of the CFSMS-Bank Framework Agreement), then the incremental costs to Bank for those services would be in the region of £50 to £60 million per annum, arising principally as a result of VAT charges.

8.2 **Other Separation Arrangements**

Since Co-operative Group will own 30 per cent. of the Bank, rather than the significant majority interest identified in the 17 June Plan, there are a number of other areas of the relationship between the Bank and Co-operative Group which will, over time, require further discussions.

However, in light of the ownership structure of the Bank that will exist assuming successful completion of the Liability Management Exercise, as referred to above, the Bank and Co-operative Group have agreed a number of pensions matters as detailed in paragraph 20.10 titled "*Pensions Undertaking*" in Section 20 (*Additional Information*). In addition, the Bank and Co-operative Group have agreed certain high level principles that will govern the future discussions on other areas of separation and seek to assist in ensuring that the interests of both parties (and of other stakeholders in the respective organisations) are protected. These principles, which have been developed to ensure that the Bank's Recapitalisation Plan can, if successful, be completed before 31 December 2013, include, among other things, an agreement to act in good faith; appropriate mitigation of avoidable costs whilst balancing the other commercial interests of the parties; and the preservation of relationships with shared third party suppliers.

9. DIVIDEND POLICY

The Directors intend to focus on and prioritise returning the Bank to health in the future. The Bank is in the early stages of being turned around and will continue to be impacted by legacy issues for some time, and as such, the Directors do not expect the Bank to pay dividends in the near future. In any event, the Bank has agreed with the PRA not to make any dividend payments until further notice without the prior consent of the PRA.

Notwithstanding the above, the Directors will reconsider the Bank's dividend policy as appropriate as the Bank continues to develop and implement its strategy, taking into account such factors as the Bank's capital and financial position, cash requirements and liquidity and profits available as well as, in particular, the Bank's regulatory outlook, capital position, regulatory requirements, investment needs and principal relevant risk factors subsisting at the time.

The Bank can give no assurance that it will pay any dividends in the future, nor, if a dividend is paid, what the amount of such dividend will be.

9
DIRECTORS, SENIOR MANAGEMENT, EMPLOYEES AND CORPORATE GOVERNANCE

DIRECTORS, SENIOR MANAGEMENT, EMPLOYEES AND CORPORATE GOVERNANCE

1. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

1.1 DIRECTORS

The following table lists the names, positions and ages with respect to current Directors.

Name	Position	Age
Richard Pym	Chairman	64
Niall Booker	Chief Executive Officer	55
Rodney Jensen Bulmer	Executive Director, Core Business and Deputy Chief Executive	43
John Richard Coates	Non-Executive Director	62
Anne Margaret Gunther	Non-Executive Director	58
Richard Graeme Barclay Hardie	Non-Executive Director	52
Merlyn Vivienne Lowther	Non-Executive Director	59
Euan Angus Sutherland	Non-Executive Director	44
Bennett Lyle Edward Reid	Non-Executive Director	59
William Gennydd Thomas	Non-Executive Director	53
Kathrine Bancroft	*Company Secretary*	

Richard Pym – Chairman

Richard joined the Board as Chairman in June 2013. He is a Chartered Accountant, has over 21 years' experience in financial services and has held a series of senior roles, including Group Chief Executive of Alliance & Leicester plc. He is currently Chairman of UK Asset Resolution Limited, Bradford & Bingley plc, Northern Rock (Asset Management) plc, Brighthouse Group plc and Nordax Finans AB (publ).

Niall Booker – Chief Executive Officer

Niall joined the Board in June 2013. He has held a variety of senior roles at HSBC in a career of more than 30 years spanning retail and corporate banking. Most recently, he was group managing director and chief executive officer of HSBC North America Holdings Inc. In this role he had responsibility for working through the issues in HSBC Finance Corporation, where he was chief executive officer, including working closely with the regulators of HSBC North America Holdings.

The terms of Niall's employment with the Bank are not yet finalised.

Rodney Jensen Bulmer – Executive Director, Core Business and Deputy Chief Executive

Rodney joined the Board in May 2013. Rodney has 21 years' experience in the industry. He joined Banking Group in October 2007 and became Sales Director in July 2008. Following the merger with Britannia Building Society in August 2009, Rodney became Managing Director Retail. He joined Banking Group from Santander UK plc where he held the position of director of retail direct. Rodney is currently a director of Mutualplus Limited, The Co-operative Academy of Manchester and Co-operative Bank Financial Advisers Limited.

Rodney has resigned from the Bank and announced his intention to leave the business and step down from the Board of the Bank no earlier than 31 March 2014. Until his departure Rodney will continue to play an important role in the running of the business and in particular the detailed work being undertaken by the Bank in relation to the LME.

John Richard Coates – Non-Executive Director

Richard joined the Board in January 2013. He has over 25 years' experience in the retail financial services sector. Richard was a senior partner at KPMG from 1985 to 2003 in its retail financial services practice. He

joined Northern Rock plc as a non-executive director in August 2008 and chaired its audit committee from January 2010 until its acquisition by Virgin Money in January 2012. He is currently a non-executive director of the Police Mutual Assurance Society.

Anne Margaret Gunther – Non-Executive Director

Anne joined the Board in September 2011. She has 35 years' experience in a range of financial services environments. She was chief executive of Standard Life Bank and then chief executive of Norwich and Peterborough Building Society, securing its merger with the Yorkshire Building Society. Anne is chair of the Warwick Business School and is a non-executive director of MBNA Limited and of the North, East and West Devon NHS Clinical Commissioning Group.

Richard Graeme Barclay Hardie – Non-Executive Director

Graeme joined the Board in May 2013. He was previously managing director of NatWest retail bank and executive director, retail banking at Abbey National Bank plc. He was a senior adviser, retail markets at the Financial Services Authority (as it was known) and non-executive director at Metro Bank (UK) Limited. He is currently a non-executive director of FNZ (UK) Ltd and is a director of Northpoint Consultancy Services Limited.

Merlyn Vivienne Lowther – Non-Executive Director

Merlyn joined the Board in September 2011. She was Chief Cashier of the Bank of England from 1999 to 2004 and a non-executive director of Schroders plc from 2004 until 2013 where she chaired its audit and risk committee from 2010 until 2013. She is currently a trustee of the Winston Churchill Memorial Trust and The Henry Smith Charity.

Euan Angus Sutherland – Non-Executive Director

Euan joined the Board in August 2013. He is currently Group Chief Executive of Co-operative Group. He was formerly group chief operating officer of Kingfisher plc and was previously chairman of B&Q and chief executive officer of Kingfisher UK & Ireland. He is currently a non-executive director of Super Group plc.

Euan is on the Board of the Bank as a nominee director of Co-operative Group, and is intended to constitute a nominee director for the purposes of the Articles of Association of the Bank, which will be proposed for approval at a general meeting of the Bank to be held on 15 November 2013.

Bennett Lyle Edward Reid – Non-Executive Director

Ben joined the Board in June 2009. He has spent over 30 years in the mutual societies sector becoming Chief Executive of The Midcounties Co-operative in 2006. He became a director of Co-operative Group in May 2000. He is a Fellow of the Chartered Association of Certified Accountants and Institute of Co-operative Directors, the Chair of the Walsall Healthcare NHS Trust and was recently appointed to the Board of Governors of the University of Wolverhampton.

Ben is on the Board of the Bank as a nominee director of Co-operative Group, and is intended to constitute a nominee director for the purposes of the Articles of Association of the Bank, which will be proposed for approval at a general meeting of the Bank to be held on 15 November 2013.

William Gennydd Thomas – Non-Executive Director

Bill joined the Board of Bank in October 2013. He is a former senior vice President of HP Enterprise Services and was on the main board of EDS Finance Limited as executive-vice president. He has IT expertise and is an experienced leader and general manager with a track record in leading major change in large organisations. He has extensive commercial and operational experience, working domestically and internationally with both public and private sector organisations. Bill is chair of the advisory board at Cranfield University School of Management and is on the management and board of Leeds University Business School. He is currently a non-executive independent director of XChanging plc, GFI SA and Balfour Beatty plc.

1.2 SENIOR MANAGEMENT

In addition to the Executive Directors, the current members of the senior executive management team with responsibility for day-to-day management of the Bank's business are:

John Baines – Chief Financial Officer

John has been providing his services as Chief Financial Officer to the Bank since April 2013 under a contract for the provision of services. He was most recently chief financial officer of Aldermore Bank plc, having spent the previous eight years at RBS where he was initially chief financial officer of the wealth management division, being appointed as chief executive officer of the division in 2006. John qualified as a chartered accountant 25 years ago and, prior to RBS, held a number of senior finance roles in investment banks, including spending six years at each of UBS and JP Morgan.

Grahame McGirr – Chief Risk Officer and Head of CoAM

Grahame has been providing his services as Chief Risk Officer to the Bank since 1 February 2013 under a contract for the provision of services. Grahame has 16 years' experience in the industry. Prior to joining Banking Group, Grahame had a career with Barclays, where he was Head of Portfolio Trading, and Investec. Following the financial crisis, Grahame was part of the team that restructured Northern Rock, followed by a period at The Royal Bank of Scotland.

Liam Coleman – Treasurer

Liam has been providing his services as treasurer to the Bank since June 2013 and has 25 years' experience in the industry. Previously Liam was deputy group treasurer and group head of capital management at RBS from February 2011 to June 2013 and he worked at Nationwide Building Society from 1996 to 2011 ultimately as group director, treasury where he had responsibility for all of the treasury activities of the Society. Earlier in his career, Liam worked at NatWest in corporate banking and at Hambros and Bank of Tokyo-Mitsubishi in corporate and structured finance. Liam is currently a non-executive director of Great Western Hospitals NHS Foundation Trust.

Julie Harding – HR Director

Julie has been providing her services as HR Director to the Bank since October 2013 under a contract for the provision of services. She has had both a domestic and international career in banking with HSBC in the commercial and retail sectors and brings to the Bank extensive experience of leading major change programmes. Julie has leadership experience in Australia, Brazil and the UK.

Robert Rickert – Chief Operating Officer

Robert joined the Bank as the Chief Operating Officer in October 2013. He is tasked with bringing technology and operations under one accountability, that of the Chief Operating Officer. The intention behind combining these two functions is to improve process efficiency, customer experience, effective controls, provide a tighter risk framework and clearer end-to-end customer focused processes. Robert has over 25 years of leadership experience with more than 15 years focused on technology and operations and he has a track record across a number of different industries primarily in financial services.

Robert has held senior leadership roles most recently with UBS, where he was Head of Group Operations Technology, and Barclays and DTZ.

1.3 PERSONNEL

Number of personnel

The number of people providing services to the Bank (either as employees of the Bank or its subsidiaries, or via secondment arrangements) on a full-time equivalent basis, by the main category of activity, as at 30 June 2013 and in each of the three years ended 31 December 2012, 2011 and 2010 is set out below:

	Number of personnel on a full-time equivalent basis			
	As at 30 June	*As at 31 December*		
Area	*2013*	*2012*	*2011*	*2010*
IT	790	850	1,150	990
Operations & Support	2,930	2,950	2,390	2,690
Corporate & Business Banking	450	400	430	590
Finance	290	360	410	570
Human Resources	200	190	300	370
Miscellaneous	40	10	–	–
Retail Banking	2,650	2,690	3,390	3,990
Risk	210	330	460	360
Total	7,560	7,780	8,530	9,560

Note: The figures in the table above are approximate. The allocation of employees to Bank activity is the Bank's best view based on records available from internal management information systems.

The breakdown of the employing entities of the personnel on a full-time equivalent basis as at 30 June 2013 and in each of the three years ended 31 December 2012, 2011 and 2010 is shown below:

	Number of personnel on a full-time equivalent basis			
	As at 30 June	*As at 31 December*		
Employing Entity	*2013*	*2012*	*2011*	*2010*
CFSMS	5,530	5,600	6,130	6,920
The Bank	1,630	1,710	1,910	2,070
Platform Home Loans Limited	20	40	90	130
Western Mortgage Services Limited	300	340	360	400
Britannia International Limited	30	40	40	40
Co-operative Group	50	50	0.0	0.0
Total	7,560	7,780	8,530	9,560

Note: The figures in the table above are approximate. The allocation of employing entity shown is the Bank's best view based on the records available from internal management information systems.

It is standard practice for all new employees to be engaged on CFSMS contracts of employment (except for staff employed in the Isle of Man who are employed by Britannia International Limited). Approximately 73.0 per cent. on a full-time equivalent basis of personnel who work on Bank activity are engaged on CFSMS contracts of employment. The people employed by CFSMS who provide services to the Bank are seconded to, and are under the control of, the Bank. Further details on the role and arrangement with CFSMS, and the proposals to change the current arrangements, can be found in (i) paragraph 8 titled "*Separation*" in Section 8 (*Description of the Bank*) and (ii) paragraph 20.2 titled "*CFSMS-Bank Framework Agreement*" in Section 20 (*Additional Information*). Those individuals shown in the table above as being employed by Co-operative Group provide services to the Bank pursuant to the Unity Agreements. In addition to these individuals, a number of people provide services to the Bank in addition to providing services to other members of Co-operative Group pursuant to the Unity Agreements. These persons are not included in the figures in this paragraph 1.3. Further details on the Unity Agreements can be found in paragraph 20.1 titled "*Project Unity*" in Section 20 (*Additional Information*).

Certain Banking Group employees are historically employed on Bank contracts. Not all Bank employees are fully dedicated to Bank activities due to the shared service model used across Banking Group.

During the six months to 30 June 2013, the Bank had on average approximately 2,620 employees working on a temporary or part-time basis (490 of whom were on a temporary basis and 2,130 permanent employees who worked part-time).

2. CORPORATE GOVERNANCE

The UK Corporate Governance Code, published by the Financial Reporting Council in September 2012 (the **UK Corporate Governance Code**), sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders. The UK Corporate Governance Code recommends that at least half the board of directors (excluding the Chairman) should comprise "independent" non-executive directors. The UK Corporate Governance Code states that the board should determine whether a director is independent in character and judgement and whether there are any relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement.

The Directors support high standards of corporate governance. As at the date of this Prospectus and on completion of the Liability Management Exercise, the Bank will comply with the UK Corporate Governance Code, except as set out further below. The Bank's Board of Directors currently comprises two Executive Directors (including the Chief Executive Officer) and eight Non-Executive Directors (including the Chairman). The Bank regards John Richard Coates, Anne Margaret Gunther, Richard Graeme Barclay Hardie, Merlyn Vivienne Lowther and William Gennydd Thomas as independent Non-Executive Directors, within the meaning of "independent" as defined in the UK Corporate Governance Code.

A number of appointments to the Board and senior management are required. Following completion of the Liability Management Exercise, the Bank intends to appoint a finance director to the Bank's Board. Grahame McGirr is currently both head of CoAM and CRO; following completion of the Liability Management Exercise the expectation is that a new CRO will be appointed allowing Grahame McGirr to focus solely on CoAM. In addition, as Rodney Bulmer, the current Deputy Chief Executive Officer of the Bank and the Executive Director responsible for the Bank's Core Business, has given notice to terminate his contract and is expected to leave the Bank no earlier than March 2014, a replacement will need to be found for him and executive representation on the Board will need to be considered.

In order to further strengthen the Bank's Board of Directors and its independence, recruitment is underway to appoint a further two independent non-executive directors one of whom is intended to be from a commercial banking background and one from a human resources background. Following this recruitment, and on the assumption that there will be no other changes to the composition of the Board, there are expected to be seven independent non-executive directors on the Board resulting in a Board which is compliant with the UK Corporate Governance Code.

The UK Corporate Governance Code also recommends that a board should appoint one of its independent non-executive directors to be the senior independent director (the **SID**). The SID should be available to shareholders if they have concerns that the normal channels of Chairman, Chief Executive Officer or other executive directors have failed to resolve, or for which such channel of communication is inappropriate. The Bank does not currently have a SID as at the date of this Prospectus. It is intended that the prospective independent non-executive director who is intended to be recruited from a commercial banking background be appointed as the SID following his/her appointment to the Bank's Board of Directors.

2.1 Nominee Directors

As referred to in the Relationship Agreement, for so long as it remains a bona fide co-operative society, the Articles of Association of the Bank, which will be proposed for approval at a general meeting of the Bank to be held on 15 November 2013, provide Cooperative Group with the right to appoint and, once appointed, remove (i) up to two persons to the Board provided that Co-operative Group controls directly or indirectly 25 per cent. or more of the voting rights exercisable at a general meeting of the Bank; or (ii) one person to the Board provided that Cooperative Group controls directly or indirectly 20 per cent. or more, but less than

25 per cent., of the voting rights exercisable at a general meeting of the Bank. A summary of the Articles of Association of the Bank is set out in paragraph 12, titled "*Summary of the Bank's Articles of Association*" in Section 20 (*Additional Information*) of this Prospectus. It is intended that Euan Angus Sutherland and Bennett Lyle Edward Reid will constitute the first such nominees of Co-operative Group for the purposes of the Articles of Association.

Subject to certain conditions, the Relationship Agreement also provides a mechanism for the appointment of up to two persons (in each case, after having been identified for such purpose by the Purchasers): (i) nominated by the holders of the Dated Notes at or around the time of the Scheme Meeting; and (ii) to the extent the holders of the Dated Notes have not so nominated, approved by the shareholders other than Co-operative Group or Banking Group (and for these purposes, a person is 'approved' if less than 25 per cent. of relevant votes disapprove of the relevant person within a specified timeframe).

2.2 **Roles and responsibilities of the Board**

The Board has collective responsibility for the long-term success of the Bank. Its role is to provide entrepreneurial leadership of the Bank within a framework of prudent and effective controls which enables risk to be assessed and managed. The Board sets the Bank's values and standards and ensures that its obligations to its shareholders and others are understood and met.

The Board sets the Bank's strategy and approves plans presented by management for the achievement of the strategic objectives it has set. It determines the nature and extent of the significant risks it is willing to take in achieving its strategic objectives and is responsible for ensuring maintenance of sound risk management and internal control systems.

Implementation of the strategy set by the Board and the management and day-to-day running of the Bank is delegated to the Chief Executive Officer with the exception of the matters reserved to the Board. Such reserved matters include decisions on strategic and long-term objectives, the approval of published financial statements, major acquisitions and disposals, significant investments and other capital expenditure and risk management policies.

2.3 **Board Committees**

In addition to those matters reserved to the Board, the Board has established Audit, Remuneration, Nomination and Risk Committees to complement the Board's activities and to ensure the Bank follows best practice in corporate governance matters including compliance with the UK Corporate Governance Code. All committees are compliant with the UK Corporate Governance Code.

A further board committee has been established in connection with the Recapitalisation Plan, namely the Values and Ethics Committee. The Articles of Association of the Bank set out the purpose and composition of the committee and it will play an important role in relation to the Bank's commitment (as set out in the Articles of Association) to promote and conduct its business to the extent practicable in a manner informed by the established values of the co-operative movement, having regard to the highest standards of ethical principles and with the idea of being recognised as a good corporate citizen and contributing to building a stronger and sustainable society. The Bank will promote and conduct its business in such manner in relation to:

(a) how it relates to, communicates with, balances the interests of, and otherwise deals with, its stakeholders; and

(b) how it applies the profits of the Bank, in accordance with the dividend policy set out in its Articles of Association.

A summary of the Articles of Association is set out in paragraph 12, titled "*Summary of the Bank's Articles of Association*" Section 20 (*Additional Information*) of this Prospectus.

Further details of the committees are set out below.

(a) **Audit Committee**

In accordance with the requirements of the UK Corporate Governance Code, the Audit Committee is made up of at least three members who are all independent non-executive directors and includes at least one member with recent and relevant financial experience. Membership shall include at least one member of the Risk Committee. The Audit Committee currently comprises Richard Graeme Barclay Hardie, Merlyn Lowther and Anne Margaret Gunther and is chaired by John Richard Coates, all of whom are independent non-executive directors. The Audit Committee will meet at least six times a year. The Audit Committee has responsibility for, amongst other things, the monitoring of the integrity of the financial statements of the Bank. It focuses in particular on compliance with accounting standards and the rules of the FCA and ensuring that an effective system of internal financial control is maintained. The ultimate responsibility for reviewing and approving the annual report and accounts, and the half-yearly reports, remains with the Board.

The terms of reference of the Audit Committee cover such issues as the membership and frequency of meetings, as mentioned above, together with requirements of any quorum for, and the right to attend, meetings. The duties of the Audit Committee covered in the terms of reference are: financial reporting, internal controls, internal audit, external audit and reporting responsibilities. The terms of reference also set out the authority of the Audit Committee to carry out its duties.

(b) **Remuneration Committee**

In accordance with the requirements of the UK Corporate Governance Code, the Remuneration Committee is made up of at least three members who are all independent non-executive directors. The Remuneration Committee is chaired by Anne Gunther, an independent non-executive director, and its other members are Richard Graeme Barclay Hardie and John Richard Coates. When the prospective independent non-executive director with the human resources background is appointed, it is intended that they shall take over the role of chair. The Remuneration Committee, which meets at least twice a year, has responsibility for the establishment, implementation and maintenance of the Bank's policy on all aspects of remuneration for the Executive Directors and certain senior executives of the Bank, and shall determine, within the terms of the agreed policy and in consultation with the Chairman and/or Chief Executive Office of the Bank, as appropriate, the specific remuneration packages for each of the Executive Directors, the Chairman of the Bank and certain senior executives of the Bank, including pension rights and any compensation payments and the implementation of any incentive arrangements. It is also responsible for setting and recommending to the Board the overarching principles and parameters of the remuneration policy across the Bank to ensure an overall coherent approach to remuneration in respect of all employees. Further, the Remuneration Committee has responsibility for ensuring compliance with all regulatory requirements in respect of remuneration.

The terms of reference of the Remuneration Committee cover such issues as membership and frequency of meetings, as mentioned above, together with the requirements for quorum and the right to attend meetings. The duties of the Remuneration Committee covered in the terms of reference relate to the following: setting the principals and parameters for the overall remuneration policy for the Bank, determining and monitoring policy on and setting level of remuneration for Executive Directors and certain senior executives, including: contracts of employment, performance-related pay, pension arrangements, remuneration reporting and disclosure, incentive schemes and remuneration consultants. The terms of reference also set out the reporting responsibilities and the authority of the Remuneration Committee to carry out its duties.

(c) **Nomination Committee**

In accordance with the requirements of the UK Corporate Governance Code, the Nomination Committee is made up of at least three members, the majority of whom are independent non-executive directors and currently comprises Richard Graeme Barclay Hardie, John Richard Coates and is chaired by Richard Pym. The Nomination Committee will meet at least twice a year.

The Nomination Committee is responsible for considering and making recommendations to the Board in respect of appointments to the Board and the Board Committees (in consultation with the chairs of those committees). It is also responsible for keeping the structure, size and composition of the Board under regular review, and for making recommendations to the Board with regard to any changes necessary. The Nomination Committee also considers succession planning for Executive Directors, non-executive directors and certain senior executives, taking into account the challenges and opportunities facing the Bank, and the skills and expertise that will be needed on the Board in the future and keeps under review the leadership needs of the organisation.

The terms of reference of the Nomination Committee cover such matters as membership and frequency of meetings as stated above together with the quorum requirements for, and the right to attend, meetings. The duties of the Nomination Committee covered in the terms of reference relate to reviewing and recommending the Board composition, succession planning for Executive Directors, non-executive directors and certain senior executives, keeping up to date on strategic issues and commercial changes affecting the Bank, identifying and nominating candidates for Board vacancies and evaluation of candidates for the Board. The terms of reference also set out the authority of the Nomination Committee to carry out its duties.

(d) **Risk Committee**

The Risk Committee is responsible for the risk management framework and for providing oversight and advice to the Board in relation to current and potential future risk exposures of the Bank and future risk strategy, reviewing and approving various formal reporting requirements, and promoting a risk awareness culture within the Bank.

The Risk Committee is currently made up of four members who are all independent non-executive directors and is chaired by Richard Graeme Barclay Hardie. The other members are Merlyn Lowther, Anne Gunther and John Richard Coates. It is expected that the Chief Financial Officer and the Chief Risk Officer will normally be invited to attend all or part of each meeting. The Risk Committee will normally meet at least four times a year.

The terms of reference of the Risk Committee cover such issues as membership and frequency of meetings, together with the requirements for quorum for, and the right to attend, meetings. The duties of the Risk Committee covered in the terms of reference are in relation to: reviewing and challenging the design and implementation of the risk management framework, risk profile, risk appetite, management's risk mitigation and control remediation actions, challenging and exercising oversight of capital and liquidity management policy, and the management and control of all significant risks. The terms of reference also set out the authority of the Risk Committee to carry out its duties.

(e) **Values and Ethics Committee**

The Values and Ethics Committee (the **V&E Committee**) is constituted by the Articles of Association of the Bank. It comprises a minimum of five and a maximum of seven members, of whom: (A) the majority must be independent Directors; and (B) at least five must be Directors. The chairman is an independent director specifically appointed for the role. Co-operative Group has the right to appoint and remove one of the members of the committee (who must be a Director) while it indirectly or directly holds 20% or more of the Ordinary Shares in the Bank.

The V&E Committee shall recommend to the Board for its approval and adoption the co-operative values and ethical policies of the Bank and shall represent, monitor, and advise the Board on matters concerning all stakeholders in their dealings with the Bank in line with the commitment of the Bank to promote and conduct its business to the extent practicable in a manner informed by the established values of the co-operative movement under the Bank's Articles of Association. For so long as Co-operative Group remains both a bona fide co-operative society and holds directly or indirectly 20% or more of the Ordinary Shares of the Bank, the articles concerning the V&E Committee may be amended or repealed only with the prior written consent of Co-operative Group in addition to the passing of a special resolution approving such changes. The V&E Committee shall meet at least twice

in any one financial year of the Bank and shall prepare an annual report for approval by the Board which, subject to such approval, shall be included in the annual report and accounts of the Bank.

The terms of reference of the V&E Committee covers such issues as membership and frequency of meetings, together with the requirements for quorum for, and the right to attend, meetings. The responsibilities of the V&E Committee covered in the terms of reference involve monitoring and reporting to the board on:

(i) customer satisfaction levels (with a focus on service levels and on the product offering in the light of the Bank's ethical policies, in each case assessed by reference to relevant customer metrics);

(ii) alignment of treatment of the Bank's customers with its values and ethical policies;

(iii) alignment of employee training and culture with its values and ethical policies;

(iv) corporate social responsibility, community investment, environmental and other projects and activities of the Bank;

(v) the establishment of a clear 'ethical' policy and 'ethical' strategy informed by customer consultation that aligns with the commercial strategy and is reviewed annually;

(vi) the extent to which executive remuneration policies are consistent with the Bank's values and ethical policies;

(vii) provision of products and services to sectors/organisations with clear social justice or community benefit purpose;

(viii) the development of products and services with 'ethical' features;

(ix) the Bank's approach to improving the social and environmental impacts of the Bank's own operations; and

(x) the choice of suppliers, partners and third party relationships which should be informed by the Bank's 'ethical' policy.

The V&E Committee's chairman shall attend the Bank's annual general meeting to answer any shareholder questions on the V&E Committee's activities and on the report of the V&E Committee in the Annual Report and Accounts of the Bank. All members of the V&E Committee shall also attend the annual general meeting.

10
CAPITALISATION AND INDEBTEDNESS

CAPITALISATION AND INDEBTEDNESS

The following table sets out a summary of the Bank's capitalisation as at 30 June 2013, extracted from the audited Interim Financial Information.

Capitalisation

	As at 30 June 2013 (£ millions)
Shareholders' equity	
Share capital	418.8
Other reserves	30.7
Retained earnings	532.0
Total capitalisation	981.5(1

Notes:

1 There has been no material change to the Bank's capitalisation since 30 June 2013.

Indebtedness

The following table sets out the Bank's net indebtedness as at 31 August 2013, extracted from the Bank's accounting records and is unaudited.

	As at 31 August 2013 (£millions)
Cash and balances with central banks	4,672.7
Loans and advances to banks	53.6
Trading securities	–
Liquidity	4,726.3
Current Financial Receivable	–
Current – deposits by banks	(2,079.8)(
Current – customer accounts and capital bonds	(30,814.8)
Current – debt securities in issue	(96.3)
Current – other borrowed funds	(178.1)
Current – amounts owed to other Co-operative Group undertakings	(60.2)
Current Financial Debt	(33,229.2)
Net Current Financial Indebtedness	(28,502.9)
Non-current – deposits by banks	(879.5)
Non-current – customer accounts and capital bonds	(4,217.4)
Non-current – debt securities in issue	(4,341.4)
Non-current – other borrowed funds	(1,157.0)
Non-Current Financial Indebtedness	(10,595.3)
Net Financial Indebtedness	(39,098.2)
Indirect and Contingent Indebtedness:	
Guarantees and irrevocable letters of credit	119.9
Documentary credits and short-term trade-related items	1.5
Forward asset purchases and forward deposits placed	136.2
Undrawn formal standby facilities, credit lines and other commitments to lend (including revocable and irrevocable commitments)	3,878.1(2

Notes:

(1) Includes £1,984.3 million secured on investment securities sold under sale and repurchase agreements.

(2) Undrawn loan commitments include revocable commitments which are unused credit card limits of £2,268.2 million.

11
SELECTED FINANCIAL INFORMATION

Consolidated income statement of the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013 and 2012

	Financial year ended 31 December			*Six months ended 30 June*	
	2012	*2011*	*2010*	*2013*	*2012 (Unaudited)*
		(£millions)		*(£millions)*	
Income	771.2	817.6	821.8	355.8	385.1
Operating costs – steady state	(568.2)	(548.2)	(555.5)	(303.1)	(282.8)
Operating costs – strategic initiatives	(14.8)	(13.4)	(26.0)	(14.3)	(9.2)
	188.2	256.0	240.3	38.4	93.1
Impairment losses	(468.7)	(114.9)	(95.8)	(496.0)	(91.9)
Operating result	(280.5)	141.1	144.5	(457.6)	1.2
Significant items	(85.1)	(53.3)	(55.5)	(34.6)	(39.3)
Intangible asset impairment	(150.0)	–	–	(148.4)	–
Customer redress (including PPI)	(149.7)	(90.0)	(4.3)	(163.0)	(40.0)
Share of post-tax profits from joint venture	1.2	0.2	0.7	0.3	0.6
Financial Services Compensation Scheme levies	(24.8)	(14.5)	(11.5)	0.1	(0.8)
Fair value amortisation	15.2	86.3	(14.2)	(8.2)	19.7
Profit (loss) before taxation and distributions	(673.7)	69.8	59.7	(811.4)	(58.6)
Profit-based payments to members of Co-operative Group	–	(15.6)	(10.8)	–	–
Profit (loss) before taxation	(673.7)	54.2	48.9	(811.4)	(58.6)

Consolidated balance sheet of the Bank and its subsidiaries as at 31 December 2012, 2011 and 2010 and as at 30 June 2013

	As at 30 June	*As at 31 December*		
	2013	*2012*[1]	*2011*	*2010*
	(£millions)		*(£millions)*	
Assets				
Loans and advances to customers	32,932.9	33,693.7	34,132.3	35,144.1
Cash and balances at central banks	5,402.1	5,433.0	6,696.6	1,735.6
Loans and advances to banks	1,737.5	1,904.1	2,006.5	2,394.1
Investment securities	5,082.6	6,889.8	4,571.0	4,903.1
Derivative financial instruments	804.3	818.8	975.8	975.6
Other assets	672.9	834.0	573.4	428.8
Total assets	46,632.3	49,573.4	48,955.6	45,581.3
Liabilities				
Amounts owed to customers	34,922.3	36,772.5	36,420.4	34,114.7
Wholesale liabilities	3,517.8	3,612.0	3,302.7	2,938.6
Debt securities in issue	4,610.0	4,713.7	4,164.8	4,212.2
Derivative financial instruments	662.7	967.6	1,087.9	702.4
Other liabilities	656.7	398.8	447.9	564.9
Other borrowed funds	1,248.1	1,258.6	1,258.8	975.4
Total liabilities	45,617.6	47,723.2	46,682.5	43,508.2
Total equity	1,014.7	1,850.2	2,273.1	2,073.1
Total liabilities and equity	46,632.3	49,573.4	48,955.6	45,581.3

1 Note: On 29 August 2013, the Bank published its interim financial report for 2013. The 2012 balance sheet comparatives contained in the interim financial report were represented to reflect that certain deferred tax liabilities could not be offset against the deferred tax assets. As a result, the 'Other assets', and 'Total assets', 'Other liabilities', 'Total liabilities' and 'Total liabilities and equity' each increased by £121.4 million.

Consolidated cash flow statement of the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013 and 2012

	Financial year ended 31 December			*Six months ended 30 June*	
	2012	*2011*	*2010*	*2013*	*2012*
		(£millions)		*(£millions)*	
Net cash flows from operating activities	805.2	3,470.2	(1,333.5)	(1,978.9)	(1,654.5)
Net cash flows from investing activities	(2,344.7)	831.9	2,220.6	1,842.2	(194.2)
Net cash flows from financing activities	(34.7)	183.1	128.8	(47.2)	(51.2)
(Decrease) increase in cash and cash equivalents	(1,574.2)	4,485.2	1,015.9	(183.9)	(1,899.9)
Cash and cash equivalents at the beginning of the period	7,888.4	3,403.2	2,387.3	6,314.2	7,888.4
Cash and cash equivalents at the end of the period	6,314.2	7,888.4	3,403.2	6,130.3	5,988.5

Key performance indicators for the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013 and 2012

The following table sets out selected consolidated financial information which is unaudited but which has been derived from the Bank's consolidated financial statements for the financial years ended 31 December 2012, 2011 and 2010, and the Bank's interim financial information for the six months ended 30 June 2013 and 2012.

	Financial year ended 31 December			*Six months ended 30 June*	
	2012	*2011*	*2010*	*2013*	*2012*
Net interest margin (bps)[2]	111	123[1]	135	104	103
Non-interest income/Total income	29.2%	24.3%	23.1%	30.0%	35.3%
Cost-to-income ratio[3]	73.7%	67.0%	67.6%	85.2%	73.4%
Cost of risk (bps)[4]	139	35	28	146	28
Non-performing loans ratio[5]	10.9%	8.4%	8.4%	12.3%	9.6%
Non-performing loans coverage[6]	28.6%	27.1%	27.1%	33.8%	24.1%
Core Tier 1 ratio	8.8%	9.6%	9.6%	4.9%	9.6%
Loans-to-deposit ratio	91.6%	93.9%	102.5%	94.3%	100.5%

Notes:

(1) Excluding £37.2 million of Treasury/other profits.

(2) The net interest margin is calculated by dividing annualised net interest income by average segment assets.

(3) The cost-to-income ratio is calculated by dividing steady state costs by total income.

(4) The cost of risk is calculated by dividing the impairment charge by average assets.

(5) The non-performing loans ratio is calculated by dividing impaired customer balances by gross customer balances.

(6) The non-performing loans coverage ratio is calculated by dividing total credit protection by impaired customer balances.

12
OPERATING AND FINANCIAL REVIEW

OPERATING AND FINANCIAL REVIEW

The following discussion which relates to the Bank's results of operation for the financial periods ended 30 June 2013 and 2012 is based on and should be read in conjunction with the Interim Financial Information, which is set out in "*Part A*" in Section 16 (*Financial Information*).

The Interim Financial Information has been prepared in accordance with the requirements of the Prospectus Directive and the Listing Rules and in accordance with IFRS as adopted by the EU and the basis of preparation included in note 1 in the Interim Financial Information. The historical financial information set out in this Section 12 (*Operating and Financial Review*) reflects the segments of the business in place during the six-month period ended 30 June 2013, and the core and non-core businesses as then constituted. See below for a description of the core and non-core businesses, and see Section 21 (*Important Legal Information*) for further information.

Prospective investors should read the following discussion together with the whole of this Prospectus, including Section 2 (*Risk Factors*) and the Interim Financial Information (including the related notes) and should not rely solely on the information set out in this Section 12 (*Operating and Financial Review*).

The operating and financial review of the Bank for the years ended 31 December 2012, 2011 and 2010 can be found on pages 6 to 9 of the financial statements of the Bank for the year ended 31 December 2012, pages 5 to 7 of the financial statements of the Bank for the year ended 31 December 2011, and pages 5 to 8 of the financial statements of the Bank for the year ended 31 December 2010, respectively, which have been incorporated by reference into this document. Such reviews reflect the segments of the business as operated during the relevant reporting periods.

The following discussion includes certain forward-looking statements that, although based on assumptions that the Bank's management considers to be reasonable, are subject to risks and uncertainties that could cause actual events or conditions to differ materially from those expressed or implied in this Section 12 (*Operating and Financial Review*). Among the important factors that could cause the Bank's actual results, performance or achievements to differ materially from those expressed in such forward-looking statements are those factors that are discussed in Section 21 (*Important Legal Information*) and Section 2 (*Risk Factors*) in this Prospectus. In addition, certain regulatory issues also affect the Bank's results of operations and are described in Section 17 (*Supervision and Regulation*). All statements other than statements of historical fact, such as statements regarding the Bank's future financial position and risks and uncertainties related to the Bank's business, plans and objectives for future operations, are forward-looking statements.

OVERVIEW

The Bank's strategy, which involves a four to five year turnaround plan, is to de-risk the Bank by becoming a commercial bank focused on retail and SME franchise businesses in the UK, built around the Bank's existing brand and franchise strength. The Bank is differentiated from other banks within the UK market as it is recognised by its customers as being a fair, responsible and trusted bank. These positive attributes are underpinned by the values of the co-operative movement, with which the Bank is associated. As at 30 June 2013, the Bank has approximately 4.7 million customers, of which just over 4.6 million are retail and 0.1 million are business customers, and operates through a network of 324 branches, 22 corporate banking centres and 3 primary call centres, over 2,700 ATMs, the internet and other digital channels.

In the six-month period to 30 June 2013, the Bank was managed through two distinct divisions:

- Core – The 'core' business represented activity consistent with the strategy and risk appetite for the Bank. This includes the retail, core corporate and business banking and treasury/other segments. Core corporate and business banking (**CABB**) comprised corporate banking, business banking and business services, and effectively consisted of all the key business-to-business elements of the Bank. The Retail Banking business (trading as The Co-operative Bank, Britannia and 'smile') offered a range of financial products and services to individuals and households throughout the UK. Retail also included Platform (the intermediary mortgage business). Included in the Treasury/other segment were the results of the treasury activities of the business and the results of Unity Trust Bank.

- Non-core – Non-core business lines included activities not congruent with the then strategy of the Bank, which were targeted for run-down or exit. These non-core lines contain the majority of the impairment risk for the Bank, and predominately included the Corporate non-core businesses, Optimum (a closed book of predominantly interest-only, intermediary and acquired mortgage book assets) and Illius (the residential property company) both of which originated from the non-member Britannia business prior to merger.

The Bank had total assets of £46,632.3 million as at 30 June 2013 (£49,694.8 million as at 31 December 2012).

KEY FACTORS AFFECTING RESULTS OF OPERATIONS

The Bank is going through a difficult period. It has incurred significant losses for the six months ended 30 June 2013, primarily arising from significant additional impairment charges, intangible asset impairment and customer redress provisions, and has announced a regulatory capital shortfall of £1.5 billion that the Bank intends to address by the end of 2014 through a Recapitalisation Plan discussed in further detail below. In addition, the Bank has suffered a number of credit rating downgrades by Moody's and Fitch, most notably a six notch downgrade by Moody's on 9 May 2013 to Ba3 from A3, taking the Bank below investment grade rating. These factors, together with general economic conditions in the UK and increasing regulatory capital and liquidity requirements, have had, and will continue in the short to medium term to have, a significant impact on the Bank's results of operations.

The launch of the Recapitalisation Plan

On 17 June 2013, following the conclusion of the Bank's review of its capital position and discussions with the PRA, it was stated in the June Announcement that the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion, of which at least £1 billion is expected to be contributed pursuant to the Liability Management Exercise in 2013 and, conditional on completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is to be contributed by Banking Group in 2014 pursuant to the 2014 Commitment of which £170 million must be satisfied at the latest by 30 June 2014 (with £70 million of this contribution to be paid before 31 January 2014), and the remaining £163 million by 31 December 2014).

On 17 June 2013, the PRA made the following statement:

"The PRA's current assessment is that the Co-operative Bank needs to generate an additional £1.5 billion in Common Equity Tier One capital in order to absorb potential losses over coming years. We will hold the Co-operative Group to the delivery of its plans. In relation to the Co-operative Bank this action will deliver the Financial Policy Committee's recommendation to the PRA in March regarding the capital position of the banking system."

On 29 August 2013, the PRA reconfirmed its assessment of the Bank's capital shortfall of £1.5 billion of Common Equity Tier 1 Capital following the announcement of the Bank's interim results for the six month period ended 30 June 2013. The PRA also reconfirmed that this requirement remained unchanged following the announcement by the Bank on 21 October 2013 of an expectation of an increase in its overall provisions of approximately £103 million relating to customer redress. The Liability Management Exercise is intended to generate at least £1 billion of the required £1.5 billion of Common Equity Tier 1 Capital by the end of 2013. Successful completion of the Liability Management Exercise is conditional upon the entire principal amount of all Existing Securities being exchanged pursuant to the Liability Management Exercise.

The contributions that a successful Liability Management Exercise would provide by the end of 2013 would increase the Bank's Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9 per cent. but above the regulatory minimum requirement" by the end of 2013, including after taking into account the impact of the impairment charges of £496.0 million incurred for the six month period ended 30 June 2013 and potential impairment charges for the remainder of the Bank's financial year ending 31 December 2013.

The Recapitalisation Plan

The key objective of the Recapitalisation Plan is to strengthen significantly the Bank's Common Equity Tier 1 Capital base and to refocus the Bank's strategy around its strength in core relationship retail banking providing current accounts, residential mortgages and savings products to retail customers and SMEs. The Liability Management Exercise forms a critical element of the Recapitalisation Plan. The Liability Management Exercise is intended to generate at least £1 billion of the £1.5 billion of Common Equity Tier 1 Capital required by the Bank. The Liability Management Exercise will generate Common Equity Tier 1 Capital in two ways:

- first, to the extent that the Bank exchanges Dated Notes for New Ordinary Shares and issues Additional New Ordinary Shares pursuant to the Scheme, the amount of such New Ordinary Shares and Additional New Ordinary Shares issued will constitute Common Equity Tier 1 Capital for the Bank; and

- second, to the extent that Existing Securities are exchanged or issued for New Securities at a discount to the Bank's book value of those Existing Securities (i.e. by imposing a discount on the Existing Securities through the Liability Management Exercise), the amount of that discount will also be recognisable as Common Equity Tier 1 Capital (on the basis that the Bank will reduce a liability for less than the book value of that liability in the Bank's accounts).

The offers in respect of the Preference Shares and Perpetual Subordinated Bonds are being conducted by way of exchange offers (the **Exchange Offers**) and certain proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds (the **Proposals**). The offer in respect of the Dated Notes is being conducted by way of the Scheme. The Liability Management Exercise will only be successfully completed if the entire principal amounts of the Existing Securities are exchanged pursuant to the Liability Management Exercise.

The Scheme will also provide that 62,500,000 Additional New Ordinary Shares will be made available to Holders of the Dated Notes for subscription on the terms of the Scheme as described in the Explanatory Statement (the **Additional New Ordinary Shares Offer**).

The Exchange Offers, the Proposals and the Scheme are collectively referred to in this Prospectus as the Liability Management Exercise. In addition, as part of the Liability Management Exercise, a proportion of the New Ordinary Shares issued in exchange for Existing Securities will be delivered to Co-operative Group in exchange for the issue by Cooperative Group to the Holders of certain of the Existing Securities (being Preference Shares and 13% Bonds) of a Final Repayment Notes and/or Instalment Repayment Notes (the **Group Notes**). Each such Holder will have the opportunity to choose whether it would prefer to receive Final Repayment Notes and/or Instalment Repayment Notes (if the Liability Management Exercise is successfully completed) or a combination of the two, each to be issued by Co-operative Group pursuant to the Group Notes.

In addition, the Bank expects that capital created through interest savings on the Existing Securities surrendered in the Liability Management Exercise net of any coupon payments on the New Securities should contribute an additional amount of Common Equity Tier 1 Capital towards the Recapitalisation Plan, beyond that created as a result of the Liability Management Exercise. The Bank currently estimates that net interest savings should result in allowable Common Equity Tier 1 Capital in the region of £40 million during the course of 2014.

2014 Commitment

Under the Recapitalisation Plan, Banking Group has agreed to contribute £333 million of Common Equity Tier 1 Capital during 2014 (the **2014 Commitment**). On 4 November 2013 (being the date of the launch of the Recapitalisation Plan), Banking Group entered into a legally binding and irrevocable undertaking to pay (the **Undertaking to Pay**) in favour of the Bank in consideration for the issuance of 54,058,442 New Ordinary Shares immediately prior to the completion of the Liability Management Exercise (the **2014 Commitment Agreement**). Banking Group's obligations under the 2014 Commitment and the Undertaking to Pay are conditional only upon the successful completion of the Liability Management Exercise.

As announced on 17 June 2013, Banking Group is expecting to satisfy the 2014 Commitment from the net proceeds of the sale by Banking Group of Royal London (CIS) Limited (formerly known as Co-operative Insurance Society Limited) and Royal London Asset Management (CIS) Limited (formerly known as The Co-operative Asset Management Limited) (together **Co-operative Life Insurance and Asset Management**) and the net proceeds of the proposed sale of CIS General Insurance Limited (CIS General Insurance) (together the **Insurance Proceeds**). The sale of Co-operative Life Insurance and Asset Management to The Royal London Mutual Insurance Society Limited (**Royal London**) completed on 31 July 2013. The total consideration for the sale is £219.0 million, of which £39.0 million has already been paid to Banking Group. Payment of the remaining £180 million (as deferred consideration) is subject to the approval of the court under a transfer of the life insurance fund of Co-operative Life Insurance Society Ltd (now named RL (CIS) Ltd) into Royal London under Part VII of FSMA. There is no certainty as to timing or outcome of the court process and therefore no certainty as to when the deferred consideration may be received by Banking Group or if it will be received at all. In respect of the disposal of CIS General Insurance, the Bank has been told that, whilst Co-operative Group is currently in discussions with various interested parties to sell CIS General Insurance, as at the date of this Prospectus, no legally binding agreement to sell CIS General Insurance has been entered into and any such agreement may, when entered into, be subject to various conditions precedent.

To provide support to Banking Group's obligations under the Undertaking to Pay should the Insurance Proceeds not materialise or be insufficient to satisfy the Undertaking to Pay, Banking Group has entered into an intra-group loan with Co-operative Group and the Bank (the **Intra-group Loan**). The Intra-group Loan allows Banking Group to draw down sufficient amounts to satisfy the Undertaking to Pay taking into account Banking Group's existing cash resources and is intended to be unconditional before 2014 (see paragraph 20.6 titled "*Intra-group Loan*" in Section 20 (*Additional Information*) for further details of the small number of customary conditions precedent)). Banking Group, under the terms of the Intra-group Loan is obliged to pay any amounts drawn down under that loan to the Bank in satisfaction of the Undertaking to Pay.

Co-operative Group has informed the Bank that it has appropriate arrangements in place to satisfy the discharge of its obligations under the Intra-group Loan from alternative resources in the event that the Insurance Proceeds are not sufficient to satisfy the amount of the 2014 Commitment or otherwise not received in time to satisfy the PRA's required timing to satisfy the 2014 Commitment. For further details, see the risk factor titled "*The commitment by Banking Group to contribute £333 million of Common Equity Tier 1 Capital during 2014, in addition to being solely conditional upon the successful completion of the Liability Management Exercise, is subject to the ability of Banking Group and/or Co-operative Group to fund the commitment, which is dependent on certain actions, some of which are partially outside the control of Co-operative Grou*p" in Section 2 (*Risk Factors*).

The Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Bank's Existing Securities are together referred to in this Prospectus as the **Recapitalisation Plan**.

Structure of the 2014 Commitment

The 2014 Commitment has been structured as follows:

(a) The 54,058,442 New Ordinary Shares to be issued to Banking Group against the Undertaking to Pay will be issued immediately following the implementation of the Scheme in accordance with its terms (including the subscription of Additional New Ordinary Shares to Holders of Dated Notes in accordance with the Scheme). The New Ordinary Shares issued in consideration for the Undertaking to Pay will be fully paid up for the purposes of the Companies Act and will be freely transferable (subject to the lock-up restrictions imposed under the 2014 Commitment Agreement, which are to be superseded by the lock-up restrictions imposed in the Relationship Agreement between Banking Group, Co-operative Group and the Bank once this comes into force (as described in paragraph 20.3 "*Relationship Agreement*" in Section 20 (*Additional Information*)) and fungible with all other Ordinary Shares. The New Ordinary Shares issued against the Undertaking to Pay, which will be issued in the same exchange ratio as the New Ordinary Shares to be issued to Holders of the Dated Notes pursuant to the Liability Management Exercise, will represent 21.6 per cent. of the Ordinary Shares in issue at completion of the Liability Management Exercise.

(b) The Undertaking to Pay does not generate Common Equity Tier 1 Capital of the Bank until such time as the cash proceeds of the undertaking are received by the Bank.

(c) The 2014 Commitment requires Banking Group to deliver the cash proceeds to discharge the relevant proportion of the Undertaking to Pay by such dates as to satisfy the PRA's timing requirements. The PRA has stipulated that the 2014 Commitment must be satisfied in two tranches, with £170 million payable by 30 June 2014 and £163 million payable after 30 June 2014 but not later than 31 December 2014. In the 2014 Commitment Agreement, Banking Group has agreed to contribute the 2014 Commitment and satisfy the Undertaking to Pay in a number of tranches, with (i) £20 million payable by no later than 31 December 2013; (ii) £50 million by no later than 31 January 2014; (iii) £100 million by no later than 30 June 2014; and (iv) £163 million by no later than 31 December 2014. In addition, following receipt by Banking Group of the Co-operative Life Insurance and Asset Management Deferred Consideration or the net proceeds of the disposal of CIS General Insurance, Banking Group is required to apply such proceeds as soon as reasonably practicable following receipt of such proceeds in satisfaction of the Undertaking to Pay (in part or in full as the case may be).

See the paragraph 20.4 titled "*2014 Commitment Agreement*" in Section 20 (*Additional Information*) for more details of the 2014 Commitment.

(d) The Intra-group Loan allows Banking Group to draw down sufficient amounts to satisfy the Undertaking to Pay taking into account Banking Group's existing cash resources and is intended to be unconditional before 2014 (and is only subject to a small number of customary conditions precedent – see the paragraph 20.6 titled "*Intra-group Loan*" in Section 20 (*Additional Information*) for further details). Banking Group, under the terms of the Intra-group Loan is obliged to pay any amounts drawn down under that loan to the Bank in satisfaction of the Undertaking to Pay.

Assuming the Liability Management Exercise is completed and therefore at least £1 billion of Common Equity Tier 1 Capital is raised in respect of the Exchange Offers, Proposals and the Scheme, and £125 million is in 2013 raised pursuant to the Additional New Ordinary Shares Offer under the Scheme, the Bank expects to report, for the end of 2013, a Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9% but above the regulatory minimum requirement". Taking into account the benefit of the additional Common Equity Tier 1 Capital to be provided by Banking Group to satisfy the 2014 Commitment and a reduction in RWAs, partially offset by expected losses in the Bank in 2014, it is currently expected that the Bank's Common Equity Tier 1 Capital ratio will remain broadly stable, improving only modestly from this level in the coming years. The Bank expects to achieve a leverage ratio above the regulatory minimum by the end of 2014.

The uncertainty around the implementation of the Recapitalisation Plan constitutes a material uncertainty which casts significant doubt on the Bank's ability to continue as a going concern. The Interim Financial Information, therefore, includes an "emphasis of matter" as to the Bank's ability to continue as a going concern (see note 3 to the Interim Financial Information for further details of the going concern position of the Bank). Failure to implement the Recapitalisation Plan would likely result in the Bank ceasing to be able to continue as a going concern. Please see risk factor titled "*The implementation of the Liability Management Exercise is subject to a number of significant risks. Should the Liability Management Exercise not be implemented, the Bank is likely to be the subject of a resolution procedure under the Banking Act 2009*" in Section 2 (*Risk Factors*). In such circumstances, holders of existing securities could potentially lose some, substantially all, or the entire amount of their investment in the Existing Securities.

Deleveraging the Non-core Business asset portfolio

The Non-core Business consists of those asset classes which are not consistent with the Bank's Core Business strategy and which are managed to achieve the most appropriate asset value on an individual portfolio basis or are targeted for run down or exit. As at 30 June 2013 the Non-core Business had total segment assets of £14.2 billion constituting 32.1 per cent. of the Bank's total segment assets. The Bank intends to reduce Non-core Business net loans to less than £11.5 billion by 31 December 2014, and to continue deleveraging the Non-core Business thereafter at a slower pace. The Bank will also target the deleveraging of the Non-core Business in such a manner that the anticipated future losses from deleveraging

do not materially exceed the capital that is released from the reduction in RWAs, with the overall intention of achieving Non-core Business deleveraging that does not materially reduce the Common Equity Tier 1 Capital ratio of the Bank as a whole.

Approximately 50 per cent. of the Non-core Business relates to Optimum (as at 30 June 2013, £7.3 billion), a closed book of predominately interest-only intermediary and acquired mortgage book assets. The Optimum portfolio, in line with the life of the book, will be run down over the longer term due to the nature of the assets. Optimum, being a portfolio of predominantly interest-only residential mortgages, is particularly sensitive to changes in interest rates.

The management of arrears and defaults, the running-down of the Non-core Assets and the use of funding will each impact on the Bank's capital position, its cash resources and liquidity, the Core Business and the Bank's operating results and financial position. In support of this business strategy, the Bank is also putting in place an operational and governance structure in respect of the Non-core Business which the Directors believe will allow for future cost reductions in line with the Non-core Asset run-down.

Cost management and operating efficiencies

The Bank has a high cost-income ratio relative to other financial institutions. For the six month period ended 30 June 2013, its cost-to-income ratio was 85.2 per cent. The high cost base and operational inefficiencies continue to impact on the Bank's profitability, and reducing the Bank's cost base is and will continue to be a priority for the business following a successful completion of the Liability Management Exercise.

In particular, the Bank plans to secure substantial long-term cost savings and to target a cost-to-income ratio of less than 60 per cent. in the longer term through a significant cost savings programme. These cost-savings are intended to be delivered through (i) the simplification of the Bank's product offering, allowing for efficiency gains in the Bank's operations and IT functions; (ii) greater levels of self-service through the reorientation of the Bank's distribution model towards digital and other self-service channels; (iii) business process re-engineering (both IT and non-IT enabled) which will remove middle and back office costs; (iv) delayering of management and (v) full integration of Britannia within the Bank.

Investment

The Bank will be required to make significant levels of investment to execute its turnaround plan. A high percentage of these investments will be IT related to make its platform fit-for-purpose and provide the minimum levels of functionality required by the strategy. These investments are expected to contribute to cost savings and revenue uplift.

These investments can be classified into three categories according to level of criticality:

- Mandatory: investments critical for the on-going business. This includes investments in regulatory compliance, risk remediation, resilience activities and management information. Of the three categories, this requires the largest amount of investment;
- Enablement of the strategy: investments critical to allow the Bank to be able to deliver its strategic plan. This includes investments in digital catch-up, improving product pricing and credit decisioning, branch closure and non-IT related process optimisation; and
- Delivery of the strategy: investments required in executing the strategic plan. This includes investments in systems rationalisation, channel optimisation and integration, enabling customer self-service and automating processes and workflow.

The execution of the Bank's turnaround plan will result in significant costs being incurred over the next three years, and the Bank has currently budgeted in the region of £500 million in connection to the re-engineering of the Bank's IT platform to support the Core Business strategy of the Bank, its cost saving programme, and the reorientation of the Bank's distribution channels. Within this amount, total investment spend on transformation, including IT remediation, digital catch-up and other IT initiatives in the next three years of approximately £400 to £450 million is currently budgeted, of which approximately 40 to 45 per cent. is currently expected to be capitalised.

Impairment losses on loans and advances to customers

The Bank's impairment charge on loans and advances for the six months ended 30 June 2013 was £496.0 million, up from £94.6 million for the six months ended 30 June 2012. This impairment charge is made up of £165.5 million in the core business (principally retail banking (£24.8 million) and CABB (£140.0 million)) and £330.5 million in the Non-core Business (non-core corporate £294.3 million and Optimum £36.2 million). These credit impairments are the principal reason for the level of operating loss for the six months ended 30 June 2013.

There are a number of causes of the increase in the overall impairment charge which go to explaining the change in position from the impairment charge recognised at 31 December 2012:

(a) First, the Bank has targeted Non-core Assets for run-down and exit. In the six months to 30 June 2013, the Bank has continued to review its corporate loan book on an asset-by-asset basis and change the work-out approach on a significant number of assets to ensure it complies more closely with industry and regulator standards. This has resulted in a reduction in expected future recoveries in respect of such assets and consequential impairment charges. This reduction in expected future recoveries has contributed approximately half of the overall impairment charge of £496.0 million for the six month period ended 30 June 2013.

(b) Second, there have been further improvements in the Bank's credit risk management approach and improvements in the data upon which impairment assessments are made (constituting approximately 25 per cent. of the overall impairment charge for the six months ended 30 June 2013). In respect of the Bank's retail loans, changes in impairment provisions have resulted from a management review of (i) the probability of possession given default (status level has changed to 180 days past due for non-forborne customers and all customers that are on a forbearance plan from the previous state of possession), (ii) the treatment of forbearance, timing of impairment recognition and length of emergence periods (which have been extended to 12 months) and (iii) the formalisation of a charge-off policy (accounts that are in arrears for over 180 days are now treated as charge-off). The review took into account the continuing impacts of the corporate real estate environment, prolonged real wage deflation and the lower apparent crystallisation of losses whilst the Bank of England base rate continues to be low. The change in the credit risk management approach was the primary driver behind the increase in impairments to the core and non-core retail books in the six months ended 30 June 2013.

(c) Third, impairments continue to be incurred in the ordinary course of business in both the core and non-core businesses due to changes in customer circumstances. New defaults (21 per cent.) and deterioration (4 per cent.) comprise the rest of the overall impairment charge for the six month period ended 30 June 2013.

In light of the significance of the impairment charges recognised in the Interim Financial Information, the Board has also carried out several independent reviews on the Bank's impairment charges, including the impairment charges recognised in the Interim Financial Information, which concluded that it was appropriate for such impairments not to have been recognised in the 2012 Accounts, given the information which was available at the time of such accounts and that the change in methodologies applied in preparing the Interim Financial Statement is considered to be a change in accounting estimate.

The impairment charges at 31 December 2012 and 30 June 2013 were consistent with the credit information available and the prevailing workout and provisioning approach employed by the business at the relevant times.

A number of factors may result in further impairment charges in the future. See paragraphs titled "*Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in increased residential mortgage and unsecured loan losses which would adversely impact the Bank's financial and operational performance*" and "*Worsening economic and market conditions could result in increased commercial loan losses beyond what the Bank has already provided for, which would adversely impact the Bank's financial and operational performance*" in Section 2 (*Risk Factors*) for further details.

Fair values

The fair value disclosures in the Interim Financial Information and on page 128 of the 2012 Accounts show a decrease in the fair value of the Bank's customer assets from £33.2 billion as at 31 December 2012 to £29.0 billion as at 30 June 2013.

As explained in note 34 of the Interim Financial Statements the Bank has significantly better data now, not least connected with its programme of disposals, and has been able to apply a different and improved methodology to its fair value assessment. The disclosures made in each set of financial statements were consistent with the information available and the methodology employed at the relevant time.

Impairment of the investment made in the replacement banking IT platform

The Bank has previously invested in developing a replacement of its core banking IT platform. Following the change in the Bank's strategy, the directors concluded that the replacement platform being developed was inconsistent with the new strategy, and would no longer be implemented. This resulted in an impairment charge of £136.4 million for the period ended 30 June 2013. In addition, an impairment review has been undertaken of the remaining intangible assets. Following that review, a further impairment of £12.0 million has been made against the assets in use, resulting in a remaining book value as at 30 June 2013 of £24.4 million. The write-off of intangible assets in the six months ended 30 June 2013 is therefore £148.4 million (HY 2012: nil).

Customer redress provisions

The Bank's provision for customer redress is reflected in charges of £166.7 million (£163.0 million significant item charge and £3.7 million relating to interest payments included in the results before significant items) in the six month period ended 30 June 2013, which includes provisions for potential customer compensation claims relating to past sales of payment protection insurance (**PPI**), alleged failings relating to the introduction of third-party sales of card and identity protection products, arrears charges and the processing of first payments on certain mortgages, the mis-selling of interest rate swaps and an additional provision following identification of a technical breach of the CCA.

Impact of general economic conditions in the UK and elsewhere

Since mid-2008, the global economy and the global financial system, and the Eurozone in particular, have experienced a period of significant turbulence and uncertainty. The severe dislocation of the financial markets around the world that began in August 2007 and significantly worsened in mid-2008 triggered widespread problems at many commercial banks, investment banks and other financial and related institutions in the UK and around the world. The dislocation severely impacted general levels of liquidity, the availability of credit and the terms on which credit is available.

Governments and central banks have responded by lowering interest rates and injecting liquidity into the financial system and taking other forms of action relating to financial institutions, including bank recapitalisations and the provision of government guarantees for certain types of funding, aimed at both supporting the sector and providing confidence to the market. Interest levels in the UK have now fallen to their lowest level since the Bank of England was founded. The Bank primarily derives its income from the UK, and therefore is directly and indirectly affected by the general economic conditions in the UK.

These market dislocations were also accompanied by recessionary conditions and trends in the UK and other countries in which the Bank has exposure. This dislocation adversely affected, among other things, consumer confidence, levels of unemployment, salary levels, the state of the housing market, the commercial real estate sector, bond markets, equity markets, counterparty risk, inflation, the availability and cost of credit, transaction volumes in wholesale and retail markets, the liquidity of the global financial markets and market interest rates, which in turn had, and continue to have, a material adverse effect on the Bank's business and operating results.

Although there have been periods where market conditions have generally improved, recent developments, particularly in the Eurozone, have demonstrated that there continues to be significant uncertainty. Discussion on the risks associated with the UK economy can be found in "*The Bank's business and financial*

performance have been and may continue to be affected by general economic conditions in the UK, and adverse developments in the UK or global financial markets could cause the Bank's earnings and profitability to decline" in Section 2 (*Risk Factors*), respectively.

Among other factors:

- increased unemployment has led to some borrowers being unable to service their loan payments as they become due resulting in increased arrears in the Bank's secured residential mortgage portfolios and in the unsecured consumer loan portfolios, which has resulted in higher impairment charges and doubtful debt provisions in these portfolios;
- house prices have fallen since their peak in 2007, reducing the amount of collateral in the impaired residential mortgage loan portfolio and therefore, in certain cases, increased the actual losses upon loan default. According to the seasonally adjusted Halifax House Price Index, average house prices in the UK peaked in the third quarter of 2007 at almost £200,000 before falling steadily until the end of the first quarter 2008 to £158,000. Average house prices then remained stable before recovering to £167,000 in the three quarters to 30 June 2013;
- commercial property prices fell sharply in late 2008 and early 2009, although they have stabilised since then, reducing the amount of collateral in the commercial real estate loan portfolio and therefore, in certain cases, increased the actual losses upon loan default;
- the low base rate environment and the higher cost of funding arising from increased competition for retail and commercial deposits have resulted in a reduced net interest margin, otherwise known as margin compression, which has resulted in reduced net interest income in retail and corporate banking; and
- the Bank earns non-interest income on its Treasury investment portfolio which is held for liquidity and longer term purposes. This income is sensitive to interest rates and bond yields.

Net interest income

The Bank's net interest margins and, consequentially, earnings are affected by the size and mix of the Bank's lending portfolio, the pricing on its loans, and the costs and sources of its funding, including the repricing and maturity profile of the Bank's interest-earning assets and liabilities, net of any interest rate hedging applied.

The Bank's net interest margins have been squeezed by a number of factors which have negatively impacted on the pricing of its loans and the cost of its funds, including:

- Interest margin as margins achievable on mortgages are typically lower in times of low base rates. The Bank of England base rate has remained at 0.5 per cent. since March 2009, having fallen from 5.75 per cent. in July 2007 through eight consecutive cuts of between 0.25 per cent. and 1.0 per cent. In the 30 years preceding July 2007, the lowest level of the base rate was 3.5 per cent. The very low level of the Bank of England base rate presently has resulted in lower net interest margins as the cost of funding has increased.
- The Funding for Lending Scheme is considered to have lowered the overall cost of funding as retail deposit rates have fallen, due to lower demand, notably for fixed term deposits. Notwithstanding this, competition for the highest quality mortgages remains intense and is likely to continue, putting downward pressure on returns available for the lowest risk-weighted mortgage assets.
- The Bank's high level of surplus liquidity.

So long as interest rates stay relatively low by historic standards, the Directors believe that the cost of funds margin will remain higher than if rates rose.

The credit rating downgrades by Moody's and Fitch, most notably a six notch downgrade by Moody's on 9 May 2013 to Ba3 from A3, taking the Bank below investment grade rating, has had an adverse impact on

the Bank's ability to source capital and a consequential impact on the Bank's funding costs. Further detail on funding is included in "*Liquidity and Funding*" below.

Net interest income is the largest component of the Bank's total income representing 94 per cent. of operating income for the six months ended 30 June 2013 (HY 2012: 74 per cent.). Net interest margin for the Bank has fallen to 104 bps as at 30 June 2013 from 111 bps as at 31 December 2012.

Capital adequacy and liquidity requirements

The Bank is subject to capital adequacy and liquidity requirements. Effective management of the Bank's capital and liquidity positions is critical to the implementation of the Recapitalisation Plan and the Bank's ability to operate its businesses and achieve its new strategy. For further details of the UK regulatory requirements, including capital adequacy and liquidity, and proposed changes in legislation see Section 17 (*Supervision and Regulation*).

A number of factors may impact on the Bank's regulatory capital and liquidity positions, and these therefore need to be carefully managed. In particular, the run-off and exit of the Non-core Assets and their impact on the amount and timing of impairment provisions and risk weighted assets, now and going forwards, will have an effect on the Bank's Common Equity Tier 1 Capital and leverage ratios. The Bank's regulatory capital and liquidity may also be impacted by a number of other factors, including (i) reductions in profits and retained earnings as a result of credit losses, write-downs or otherwise, (ii) increases in risk weighted assets (which are pro-cyclical under the existing regime promulgated by the Basel Committee, resulting in risk weighting increasing in economic downturns), (iii) loss of deposits and (iv) the inability to raise finance through wholesale markets as a result of the Bank's situation, market conditions or otherwise.

The introduction of increased capital requirements will constrain the Bank's ability to support risk assets, thereby constraining lending levels. Furthermore, the introduction of new rules on the size of liquidity buffers may affect the Bank by increasing the size of its low-yielding liquid asset portfolio, thereby potentially reducing its non-interest income. The introduction of a leverage ratio could also impact the Bank's performance as it may constrain the growth of its loan portfolios, thereby reducing future profitability.

For risks relating to the Bank's regulatory requirements, see paragraphs titled "*The Bank operates in highly regulated industries and the Bank's business and results may be significantly affected by the laws and regulations applicable to it. In particular, the Bank may face legal and regulatory proceedings*" and "*Bank's business, operating results, financial position and/or its ability to implement its strategy may be adversely impacted by it not maintaining adequate regulatory capital and by future changes to its regulatory capital requirements*" in Section 2 (*Risk Factors*).

CURRENT TRADING

Consistent with the statements made when the Bank's unaudited interim results for the period ended 30 June 2013 were announced on 29 August 2013, the short term outlook for the Bank continues to be challenging.

Monthly revenue and cost trends since 30 June 2013 have remained consistent with those observed in the first half of the year. The average monthly level of impairment charges in July and August has fallen as compared to average monthly levels for the first half of the year. In the period from 30 June 2013 to 30 September 2013, £0.6 billion of Non-core Assets (consisting of Non-core Business loans) were deleveraged, through a combination of asset sales, run-off and managed repayments, net of new drawdowns and the Bank raised £1.5 billion of secured wholesale funding. As at 30 September 2013, the encumbrance ratio was 29.8 per cent.

The Bank's capital position has not materially changed since 30 June 2013 and the Bank remains dependent on the successful completion of the Liability Management Exercise.

LOSS FORECAST

The Bank's unaudited interim results for the six months ended 30 June 2013 contained the following statement:

"Clearly there are lessons to be learned from the last few years but it is vital that the new management team focuses on navigating the short-term issues and building the strategy that is targeted at returning the business to health in the future. We have already taken a number of actions but it is clear that we are in the early stages of turning the bank around. Indeed, we do not expect to be profitable for some years and legacy issues will continue to have an impact on the Bank for some time."

The statement above regarding profitability represents a profit forecast under the Prospectus Rules. The Directors have considered the above statement and continue to believe that it is valid, based on the assumptions below as the Bank will not be profitable in 2013 and 2014 and can give no assurance that the Bank will generate a profit for some years thereafter.

Basis of preparation and principal assumptions

This profit forecast is based on the interim results for the six months ended 30 June 2013, the unaudited management accounts for eight months ended 31 August 2013, management's forecast for the remaining four months ending 31 December 2013 and management's latest available projections for the financial years ending 31 December 2013 and 2014.

The principal assumptions on which the profit forecast is based comprise:

- Assumptions that are within management's control including:
  - Deleveraging of Non-core Business will be underwritten in such a manner that the anticipated future losses from deleveraging do not materially exceed the capital released from the reduction in risk-weighted assets; and
  - There will be no material variation to the assumed level of cost reductions and to the assumption that the cost-to-income ratio for the Core Business, of not less than 60 per cent. is only achieved in the longer term.
- Assumptions that are not within management's control including:
  - There will be no material change in legislation or regulatory capital and liquidity requirements impacting the Bank's operations;
  - There will be no material change in the accounting standards applicable to the Bank;
  - There will not be any material change in interest rates affecting the Bank from those currently applicable to the Bank;
  - There will not be any material improvement in the economic and general trading environment currently prevailing in the UK; and
  - There will be no material change to the competitive environment which impacts on consumer preferences.

The profit forecast has been properly compiled on the basis of the stated assumptions and using accounting policies which are in accordance with IFRS and consistent with those used by the Bank in the six months ended 30 June 2013 and which will be applicable for the financial years ending 31 December 2013 and 2014. Please see Part E: "*Accountants Report on Loss Forecast Report*" in Section 16 (*Financial Information*) for further details.

RESULTS OF OPERATIONS

The table below presents the Bank's results of operations for the six months ended 30 June 2013 and 2012.

	Six months ended 30 June 2013		
	Before significant items	*Significant items*	*After significant items*
		(£ millions)	
Interest receivable and similar income	715.6	(39.0)	676.6
Interest expense and similar charges	(470.8)	–	(470.8)
Net interest income	244.8	(39.0)	205.8
Fee and commission income	116.2	(94.0)	22.2
Fee and commission expense	(36.2)	–	(36.2)
Net fee and commission income	80.0	(94.0)	(14.0)
Net trading income	1.1	–	1.1
Other operating income	26.0	–	26.0
Operating income	351.9	(133.0)	218.9
Operating expenses	(321.7)	(213.0)	(534.7)
Financial Services Compensation Scheme levies	0.1	–	0.1
Impairment losses on loans and advances	(496.0)	–	(496.0)
Impairment gains on investments	–	–	–
Operating (loss)/profit	(465.7)	(346.0)	(811.7)
Share of post-tax profits from joint ventures	0.3	–	0.3
(Loss)/profit before taxation	(465.4)	(346.0)	(811.4)
Income tax	(41.0)	80.4	39.4
(Loss) for the period	(506.4)	(265.6)	(772.0)

	Six months ended 30 June 2012 (unaudited)		
	Before significant items	*Significant items (£ millions)*	*After significant items*
Interest receivable and similar income	744.7	–	744.7
Interest expense and similar charges	(473.5)	–	(473.5)
Net interest income	271.2	–	271.2
Fee and commission income	128.0	(40.0)	88.0
Fee and commission expense	(41.2)	–	(41.2)
Net fee and commission income	86.8	(40.0)	46.8
Net trading income	9.3	–	9.3
Other operating income	39.8	–	39.8
Operating income	407.1	(40.0)	367.1
Operating expenses	(294.3)	(39.3)	(333.6)
Financial Services Compensation Scheme levies	(0.8)	–	(0.8)
Impairment losses on loans and advances	(94.6)	–	(94.6)
Impairment gains on investments	2.7	–	2.7
Operating (loss)/profit	20.1	(79.3)	(59.2)
Share of post-tax profits from joint ventures	0.6	–	0.6
(Loss)/profit before taxation	20.7	(79.3)	(58.6)
Income tax	(6.1)	19.4	13.3
(Loss)/profit for the period	14.6	(59.9)	(45.3)

The Bank incurred a loss before taxation (after significant items) of £811.4 million for the six months ended 30 June 2013 compared with a loss before taxation of £58.6 million for the six months ended 30 June 2012.

The increased losses in the six months ended 30 June 2013 as compared with the six months ended 30 June 2012 arose primarily as a result of a substantial increase in the Bank's impairment provisions on loans and advances. The Bank's impairment provision increased from £94.6 million for the six months ended 30 June 2012 to £496.0 million for the six months ended 30 June 2013, representing an increase of £401.4 million. High operating costs continue to be a significant factor impacting the profitability of the Bank. Cost-to-income ratio for the six months ended 30 June 2013 was 85.2 per cent.

In addition, the losses in the six months ended 30 June 2013 were also driven by a number of significant items:

- £148.4 million resulting from a write-down of IT assets previously under development to replace the core banking platform;
- £163.0 million of additional customer redress provisions, including: a £10.0 million provision for potential customer redress relating to past sales of interest rate swaps (HY 2012: nil); a £53.0 million provision for potential customer redress relating to past sales of payment protection insurance, primarily covering increased operating and ombudsman costs (HY 2012: £40.0 million); a £26.0 million provision for potential customer redress relating to alleged failings in the introduction of third party sales of card and identity protection insurance products (HY 2012: nil); a provision of £30.0 million (HY 2012: £nil) for potential customer redress relating to the processing of first payments on certain mortgages; a provision of £29.0 million (HY 2012: £nil) made for potential

customer redress following identification of a technical breach of the CCA, a provision of £15.0 million (HY 2012: £nil) for potential customer redress relating to arrears charges;

- £10.0 million of costs incurred in connection with the bid for the Lloyds Banking Group branches (HY 2012: £20.0 million);
- £14.7 million of costs incurred on a programme of investment and integration (HY 2012: £19.3 million); and
- £9.9 million impairment in respect of property, plant and equipment (HY 2012: nil).

The table below presents the Bank's net interest income and its components for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June 2013	
	Before significant items (£millions)	*After significant items (£millions)*
Interest receivable and similar income:		
On loans and advances to customers	643.1	614.1
On loans and advances to banks	15.4	15.4
On investment securities	75.3	75.3
Net expenses on financial instruments hedging assets	(59.4)	(69.4)
Net interest income on financial instruments not in a hedging relationship	41.2	41.2
Total interest receivable and similar income	715.6	676.6
Interest expense and similar charges:		
On customer accounts	255.3	255.3
On bank and other deposits	127.5	127.5
On subordinated liabilities	40.1	40.1
On perpetual subordinated debt	20.8	20.8
Net interest expense on financial instruments hedging liabilities	9.5	9.5
Net interest expense on financial instruments not in a hedging relationship	17.6	17.6
Total interest expense and similar charges	470.8	470.8
Net interest income	244.8	205.8

	For the six months ended 30 June 2012 (unaudited) (£millions)
Interest receivable and similar income:	
On loans and advances to customers	693.6
On loans and advances to banks	15.7
On investment securities	77.3
Net expenses on financial instruments hedging assets	(63.1)
Net interest income on financial instruments not in a hedging relationship	21.2
Total interest receivable and similar income	744.7
Interest expense and similar charges:	
On customer accounts	268.2
On bank and other deposits	121.4
On subordinated liabilities	39.6
On perpetual subordinated debt	16.8
Net interest expense on financial instruments hedging liabilities	9.2
Net interest expense on financial instruments not in a hedging relationship	18.3
Total interest expense and similar charges	473.5
Net interest income	271.2

In the six months ended 30 June 2013, net interest income (before significant items) was £244.8 million, a decrease of £26.4 million from net interest income (before significant items) of £271.2 million for the six months ended 30 June 2012.

The main reason for the reduction in net interest income (before significant items) relates to the unwind of fair value adjustments which arose on the merger with Britannia: a £4.2 million charge in the six months to 30 June 2013 compared to income of £22.0 million in the six months to June 2012. £33.6 million of the reduction in the fair value unwind is in respect of customer balances where fair value adjustments are unwinding in the ordinary course of business as these loans are nearing the end of their re-pricing period. This reduction has been partially offset by a £10.2 million increase in fair value unwind relating to investment securities arising in the normal course of business. The significant item for the six months ended 30 June 2013 was a provision for potential customer redress of £39.0 million (HY 2012: £nil) relating to past sales of interest rate swaps and potential redress following identification of a technical breach of the CCA.

The table below presents the Bank's fee and commission income for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June 2013		
	Before significant items	*Significant items (£millions)*	*After significant items*
Fee and commission income:			
On items not at fair value through income or expense	116.0	(94.0)	22.0
On trust or fiduciary activities that result from holding or investing in assets on behalf of others	0.2	–	0.2
Total fee and commission income	116.2	(94.0)	22.2
Fee and commission expense:			
On items not at fair value through income or expense	34.3	–	34.3
On items at fair value through income or expense	1.9	–	1.9
Total fee and commission expense	36.2	–	36.2
Net fee and commission income	80.0	(94.0)	(14.0)

	For the six months ended 30 June 2012 (unaudited)		
	Before significant items	*Significant items (£millions)*	*After significant items*
Fee and commission income:			
On items not at fair value through income or expense	127.9	(40.0)	87.9
On trust or fiduciary activities that result from holding or investing in assets on behalf of others	0.1	–	0.1
Total fee and commission income	128.0	(40.0)	88.0
Fee and commission expense:			
On items not at fair value through income or expense	35.0	–	35.0
On items at fair value through income or expense	6.2	–	6.2
Total fee and commission expense	41.2	–	41.2
Net fee and commission income	86.8	(40.0)	46.8

In the six months ended 30 June 2013, net fee and commission income (before significant items) was £80.0 million, a decrease of £6.8 million from net fee and commission income (before significant items) of £86.8 million for the six months ended 30 June 2012.

The Bank's fee and commission income for the six months ended 30 June 2013 was £116.2 million (before significant items), down from £128.0 million for the six months ended 30 June 2012. The primary reason for the reduction in fee and commission income was a reduction in business levels, including as a result of the Bank's decision to stop new lending to larger corporate customers. The significant item for the six months ended 30 June 2013 was provision for potential customer redress of £53.0 million (HY 2012: £40.0 million) relating to past sales of payment protection insurance, £26.0 million (HY 2012: £nil) for potential customer redress relating to alleged failings in the introduction of third party sales of card and identity protection products, and £15.0 million (HY 2012: £nil) of provisions made for potential customer redress relating to arrears charges.

The table below presents the Bank's operating costs and its components for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June 2013		
	Before significant items	*Significant items (£millions)*	*After significant items*
Staff costs:			
Wages and salaries	93.7	1.2	94.9
Social security costs	7.2	0.4	7.6
Pension costs – defined benefit plans	0.1	–	0.1
Pension costs – defined contribution plans	13.6	0.4	14.0
Other staff costs	16.9	4.3	21.2
Total staff costs	131.5	6.3	137.8
Administrative expenses	158.7	166.8	325.5
Depreciation of property, plant and equipment	6.0	–	6.0
Amortisation of intangible fixed assets	3.0	–	3.0
Impairment of intangible fixed assets	2.0	–	2.0
Profit on sale of property, plant and equipment	–	–	–
Impairment of property, plant and equipment	–	9.9	9.9
Operating lease rentals	15.6	–	15.6
Property provisions for liabilities and charges provided in the period	3.6	–	3.6
Property provisions for liabilities and charges released during the period	(0.4)	–	(0.4)
Other provisions for liabilities and charges provided in the period	–	30.0	30.0
Other provisions for liabilities and charges released during the period	(0.1)	–	(0.1)
Direct expenses from investment properties that generated rental income in the period	1.7	–	1.7
Direct expenses from investment properties that did not generate rental income in the period	0.1	–	0.1
Total operating expenses	321.7	213.0	534.7

	For the six months ended 30 June 2012 (unaudited)		
	Before significant items	*Significant items (£millions)*	*After significant items*
Staff costs:			
Wages and salaries	97.3	7.3	104.6
Social security costs	7.5	0.6	8.1
Pension costs – defined benefit plans	0.1	-	0.1
Pension costs – defined contribution plans	18.5	0.7	19.2
Other staff costs	14.7	8.3	23.0
Total staff costs	138.1	16.9	155.0
Administrative expenses	128.9	22.4	151.3
Depreciation of property, plant and equipment	7.8	–	7.8
Amortisation of intangible fixed assets	3.0	–	3.0
Impairment of intangible fixed assets	–	–	–
Profit on sale of property, plant and equipment	(0.4)	–	(0.4)
Impairment of property, plant and equipment	–	–	–
Operating lease rentals	14.7	–	14.7
Property provisions for liabilities and charges provided in the period	1.0	–	1.0
Property provisions for liabilities and charges released during the period	(0.3)	–	(0.3)
Other provisions for liabilities and charges provided in the period	0.1	–	0.1
Other provisions for liabilities and charges released during the period	–	–	–
Direct expenses from investment properties that generated rental income in the period	1.4	–	1.4
Direct expenses from investment properties that did not generate rental income in the period	–	–	–
Total operating expenses	294.3	39.3	333.6

The Bank's relatively high operating costs continue to impact its profitability.

The primary reason for the increase in administrative expenses is increased costs in the running of the Retail segment distribution platform. A significant part of this cost is a one-off provision of £13.9 million relating to a change in ATM rateable values in respect of ATMs situated outside of Co-operative stores. This is an issue which is common across the retail industry.

The significant items for the six months ended 30 June 2013 relate to £14.7 million (HY 2012: £19.3 million) of costs incurred on a programme of investment and integration, £10.0 million (HY 2012: £20.0 million) of costs incurred as a result of the bid for Lloyds' branches, £148.4 million (HY 2012: £nil) of recharged costs relating to impairment of intangible fixed assets, £9.9 million (HY 2012: £nil) of impairment of property, plant and equipment and £30.0 million (HY 2012: £nil) of provisions for potential customer redress relating to the processing of first payments on certain mortgages.

The table below presents the Bank's impairments for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June	
	2013 (audited)	*2012 (unaudited)*
	(£millions)	
Core business:		
Retail banking	24.8	18.2
CABB	140.0	17.5
Treasury/other	0.7	(2.2)
Total core business	165.5	33.5
Non-core business:		
Corporate non-core	293.4	56.9
Other non-core	36.2	1.5
Total non-core business	330.5	58.4
Total impairment losses	496.0	94.6

The Bank's impairment losses for the six months ended 30 June 2013 was £496.0 million up from £94.6 million for the six months ended 30 June 2012. The impairment losses are made up of £165.5 million in the core business (principally retail banking (£24.8 million) and CABB (£140.0 million)) and £330.5 million in the non-core business (non-core corporate £293.4 million and Optimum £36.2 million). These credit impairments are the main driver behind the level of operating loss for the six months ended 30 June 2013.

The impairment losses for the six months ended 30 June 2013 are stated net of a £12.4 million credit fair value unwind. The credit fair value unwind adjustment arose as a result of the merger with Britannia. As at 30 June 2013, the total credit fair value adjustment remaining was £55.2 million.

Segmental analysis

The Bank's business was separated into two business areas: the 'core' business includes the retail, CABB and the Treasury/other segments, while the 'non-core' business comprises the corporate non-core, Optimum (a closed book of predominantly interest-only, intermediary and acquired mortgage book assets) and Illius (the residential property company).

The table below presents the Bank's segmental presentation for the six months ended 30 June 2013 and 2012. Revenues are attributed to the segment in which they are generated. Transactions between the reportable segments are on normal commercial terms and internal charges and transfer pricing adjustments have been reflected in each segment.

	For the six months ended 30 June 2013 (audited)							
	Core business				*Non-core business*			
	Retail	*CABB*	*Treasury/ other*	*Total Core*	*Corporate banking*	*Other non-core*	*Total Non-core*	*Total*
	(£ millions)							
Interest margin	203.5	58.4	6.6	268.5	(8.9)	(10.6)	(19.5)	249.0
Non-interest income	65.0	23.8	28.3	117.1	1.0	(11.3)	(10.3)	106.8
Operating income	268.5	82.2	34.9	385.6	(7.9)	(21.9)	(29.8)	355.8
Operating expenses	(242.8)	(43.7)	(16.3)	(302.8)	(2.6)	(12.0)	(14.6)	(317.4)
Impairment losses on loans and advances	(24.8)	(140.0)	(0.7)	(165.5)	(294.3)	(36.2)	(330.5)	(496.0)
Operating profit/(loss)	0.9	(101.5)	17.9	(82.7)	(304.8)	(70.1)	(374.9)	(457.6)

	For the six months ended 30 June 2012 (unaudited)							
	Core business				Non-core business			
	Retail	CABB	Treasury/ other	Total Core	Corporate banking	Other non-core	Total Non-core	Total
	(£ millions)							
Interest margin	196.6	54.0	7.1	257.7	(11.5)	3.0	(8.5)	249.2
Non-interest income	68.4	32.2	26.0	126.6	1.2	8.1	9.3	135.9
Operating income	265.0	86.2	33.1	384.3	(10.3)	11.1	0.8	385.1
Operating expenses	(214.8)	(38.6)	(13.1)	(266.5)	(2.8)	(12.6)	(15.4)	(281.9)
Impairment losses on loans and advances	(18.2)	(17.5)	(0.5)	(36.2)	(56.9)	(1.5)	(58.4)	(94.6)
Impairment losses on investments	–	–	2.7	2.7	–	–	–	2.7
Operating profit/(loss)	32.0	30.1	22.2	84.3	(70.0)	(3.0)	(73.0)	11.3
Group recharges	(8.2)	(1.1)	(0.3)	(9.6)	(0.1)	(0.4)	(0.5)	(10.1)
Operating profit/(loss) after reallocating group recharges	23.8	29.0	21.9	74.7	(70.1)	(3.4)	(73.5)	1.2

Retail and SME

Retail

The table below presents the retail segment for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June		
	2013 (audited)	2012 (unaudited)	Change
	(£ millions)		
Interest margin	203.5	196.6	6.9
Non-interest income	65.0	68.4	(3.4)
Operating income	268.5	265.0	3.5
Operating expenses	(242.8)	(223.0)	(19.8)
Impairment losses	(24.8)	(18.2)	(6.6)
Operating profit/(loss)	0.9	23.8	(22.9)

The retail operating result for the six months ended 30 June 2013 was a profit of £0.9 million (HY 2012: profit of £23.8 million). Whilst operating income was broadly stable, operating costs have increased by £19.8 million, mainly relating to the running of the distribution platform. A significant part of this cost is one-off in nature, being a provision for additional rates payable on ATMs situated outside stores (£13.9 million), an issue common across the retail banking industry.

There have been further improvements to the credit risk management approach, improving the data on which impairment assessments are made. This is the primary driver behind the increase in retail impairments to £24.8 million for the six-month period ended 30 June 2013 from £18.2 million in the six month period ended 30 June 2012.

Corporate and business banking

The table below presents the Bank's CABB segment for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June		
	2013	*2012*	
	(audited)	*(unaudited)*	*Change*
		(£ millions)	
Interest margin	58.4	54.0	4.4
Non-interest income	23.8	32.2	(8.4)
Operating income	82.2	86.2	(4.0)
Operating expenses	(43.7)	(39.7)	(4.0)
Impairment losses	(140.0)	(17.5)	(122.5)
Operating profit/(loss)	(101.5)	29.0	(130.5)

The core CABB operation delivered an operating loss of £101.5 million during the six months ended 30 June 2013 (HY 2012: profit of £29 million), reflecting significant impairment of £140.0 million for the six months ended 30 June 2013 (HY 2012: £17.5 million).

Interest margin, at £58.4 million, increased by £4.4 million mainly as a result of improved asset margins partially offset by increased costs of fixed-term deposits. The reduction in non-interest income from £32.2 million for the six months ended 30 June 2012 to £23.8 million for the six months ended 30 June 2013 is due to the decision to stop new lending to larger corporates.

Treasury/other businesses

The table below presents the Bank's treasury operation for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June		
	2013	*2012*	
	(audited)	*(unaudited)*	*Change*
		(£ millions)	
Interest margin	6.6	7.1	(0.5)
Non-interest income	28.3	26.0	2.3
Operating income	34.9	33.1	1.8
Operating expenses	(16.3)	(13.4)	(2.9)
Impairment gains/losses	(0.7)	2.2	(2.9)
Operating profit/(loss)	17.9	21.9	(4.0)

During the six months ended 30 June 2013, significant focus was placed on increasing liquidity whilst at the same time reducing the non-liquidity buffer investment portfolio where strategically appropriate. This resulted in £40.4 million profit from asset sales in the period (HY 2012: £10.7 million). In the six months ended 30 June 2013, the Bank accessed the Bank of England 'Funding for Lending Scheme', drawing £900 million.

Non-core Business

Corporate non-core

The table below presents the corporate non-core segment for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June		
	2013	*2012*	
	(audited)	*(unaudited)*	*Change*
		(£ millions)	
Interest margin	(8.9)	(11.5)	2.6
Non-interest income	1.0	1.2	(0.2)
Operating income	(7.9)	(10.3)	2.4
Operating expenses	(2.6)	(2.9)	0.3
Impairment losses	(294.3)	(56.9)	(237.4)
Operating profit/(loss)	(304.8)	(70.1)	(234.7)

Corporate non-core operation delivered an operating loss of £304.8 million during the six months ended 30 June 2013 (HY 2012: operating loss of £70.1 million), reflecting significant impairment of £294.3 million for the six months ended 30 June 2013 (HY 2012: £56.9 million).

The table below presents the other non-core segment for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June		
	2013	*2012*	
	(audited)	*(unaudited)*	*Change*
		(£ millions)	
Interest margin	(10.6)	3.0	(13.6)
Non-interest income	(11.3)	8.1	(19.4)
Operating income	(21.9)	11.1	(33.0)
Operating expenses	(12.0)	(13.0)	1.0
Impairment losses	(36.2)	(1.5)	(34.7)
Operating profit/(loss)	(70.1)	(3.4)	(66.7)

Other non-core includes Optimum and Illius. Other non-core delivered an operating loss of £70.1 million during the six months ended 30 June 2013 (HY 2012: operating loss of £3.4 million), reflecting significant impairment of £36.2 million for the six months ended 30 June 2013 (HY 2012: £1.5 million).

The Optimum portfolio delivered a loss of £50.6 million (HY 2012: loss of £2.2 million). This reflected increased provisions for loans both in default and forborne. The loss attributed to the Illius business, a closed residential property portfolio, is £19.6 million (HY 2012: £0.8 million).

Interest margin for other non-core fell from a profit of £3.0 million for the six months ended 30 June 2012 to a loss of £10.6 million for the six months ended 30 June 2013. The main reasons for the fall are payment of 12.5 per cent. interest on cash received through the Calico synthetic securitisation, which payments started in January and totalled £6.3 million in the six months to 30 June 2013), and a provision of £3.6 million which has been raised for potential customer redress. Non-interest income fell from a profit of £8.1 million for the six months ended 30 June 2012 to a loss of £11.3 million for the six months ended 30 June 2013. The primary reason for this is the reduction in the fair value of the Illius portfolio of £18.9 million. The sale profile of these assets has been shortened, and therefore a higher discount factor of 11 per cent. applied to the book, reducing the carrying value.

LIQUIDITY AND FUNDING

Overview

Financial institutions such as the Bank are subject to liquidity risk as an inherent part of their business. Liquidity risk is the risk that an institution may not have sufficient funds at any time to make full payment in respect of liabilities falling due or can only do so at excessive cost.

The Bank raises the majority of its funding through accepting retail and corporate deposits. The Bank also maintains a range of funding programmes (including medium-term note, securitisation and covered bond programmes), targeting wholesale investors. In addition, the Bank maintains a high-quality portfolio of marketable asset pools that it uses for liquidity management within the Treasury operation.

The Bank actively monitors liquidity risk with liquidity risk management, which encompasses survival periods which measure the required liquidity levels of stress scenarios, adherence to regulatory liquidity risk limits and more strategic liquidity risk measures. The strategic measures include:

- Customer loan/deposit ratio, 94 per cent. as at 30 June 2013 (31 December 2012: 92 per cent.) – the ratio of customer loans to customer deposits;
- encumbrance ratio, 29 per cent. as at 30 June 2013 (31 December 2012: 27 per cent.) – the ratio of encumbered assets divided by total assets;
- regulatory limits – Internal Liquidity Guidance and Net Stable Funding Ratio; and
- internal liquidity stress tests – the survival period of the Bank under a range of stressed scenarios.

The Bank monitors its liquidity position on a daily basis and has committees which operate to oversee the operational liquidity management. A range of indicators, details of cash flows and media coverage are monitored to detect early signs of liquidity risk either in the market or specific to the Bank.

From 2009 (following the conclusion of Moody's systemic review of the UK banking sector) until recently the Bank had held a credit rating of A3 from Moody's. On 18 June 2013, Moody's downgraded the Bank's long-term credit rating by four notches to Caa1 from Ba3, reflecting concerns regarding the Bank's capital requirements following the announcement of the Recapitalisation Plan. This followed a six notch downgrade on 9 May 2013 from A3 to Ba3 and the placing of the Bank onto watch for a possible downgrade on 30 July 2012.

In addition, on 20 June 2013, Fitch downgraded the Bank's long-term credit rating by three notches to BB- from BBB-, reflecting concerns regarding the Bank's capital requirements following the announcement of the Recapitalisation Plan. This followed a two notch downgrade on 5 April 2013 from BBB+ to BBB- and a one notch downgrade on 19 July 2012 from A- (which was the long-term rating the Bank had held since 2009) to BBB+.

The following table sets out the Bank's short and long-term credit ratings from Moody's and Fitch.

	Long-Term	*Short-Term*	*Date of last action*
Moody's	Caa1	NP	18 June 2013
Fitch	BB-	B	20 June 2013

The credit rating downgrades have (i) 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, (ii) negatively impacted the Bank's ability to access short-term unsecured wholesale funding, and (iii) increased the Bank's collateral requirements within some clearing systems.

The credit rating downgrades and, to a lesser extent, the announcement of the Bank's regulatory capital shortfall, its results for the six months ended 30 June 2013, and the continued press attention and speculation to which the Bank is subject have all affected the Bank's funding profile and the cost to it of raising new funding.

Liquidity Portfolio

The Bank 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 the BIPRU regulations and industry guidelines. In the period to 30 June 2013, the Bank has continued to maintain a sufficiently strong liquidity position, with a liquid asset ratio (calculated as liquid asset buffer divided by total assets) of 13.2 per cent. at 30 June 2013 (31 December 2012: 14.6 per cent.). The Bank calculated its total liquidity resources as at 30 June 2013 as £8,971.9 million versus £8,657.7 million as at 31 December 2012. The table below analyses the Bank's liquidity portfolio by product and by liquidity value. Primary liquidity are liquid assets that are eligible under BIPRU 12.7 and secondary liquidity are all other liquid assets (excluding non-buffer assets described below), including self-issued retained securitisations.

	As at 30 June 2013	*As at 31 December 2012*	*Percentage change*
	(£ millions)		*(percentages)*
Operational balances with Central Banks	5,060.4	5,121.0	(1.2)
Gilts	272.5	664.8	(59.0)
Central government and multilateral development bank bonds	804.7	1,455.1	(44.7)
Total Primary Liquidity	6,137.6	7,240.9	(15.2)
Total Secondary Liquidity	2,834.3	1,416.8	100.0
Total Liquidity	8,971.9	8,657.7	3.6

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 liquidity has remained stable in the first part of 2013, supported by a large reduction in non-buffer assets over the period. 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 over the period. This reflects the change in the funding profile as a result of the Bank's rating downgrades. The sale of non-buffer assets has been used to maintain sufficient levels of primary liquidity.

	As at 30 June 2013	*As at 31 December 2012*	*Percentage change*
	(£ millions)		*(percentages)*
Short term deposits	37.3	38.4	(2.9)
Other public sector securities	3.0	117.5	(97.4)
Floating rate notes	12.2	703.0	(98.3)
Fixed rate bonds	95.7	999.5	(90.4)
Other securities and commodities	40.0	68.8	(41.9)
Total non-buffer assets	188.2	1,927.2	(90.2)

The Bank aims to have sufficient eligible and unencumbered assets available to meet the needs of its secured funding programmes. Details of the Bank's encumbered assets as at 30 June 2013 are shown in note 34d of its Interim Financial Information.

The Bank is also a participant in the Bank of England's sterling monetary framework and, as such and subject to certain eligibility criteria at the Bank of England's discretion (as detailed in Chapter VIII of the

Bank of England's Red Book), the Bank may be granted access to the DWF. The DWF offers liquidity insurance for idiosyncratic as well as system-wide shocks and is a bilateral facility designed to be able to address short-term liquidity shocks without disturbing the Bank of England's incentives for prudent liquidity management. At the Bank of England's discretion, eligible banks may therefore borrow gilts for 30 or 364 days, against a wide range of collateral in return for a fee, which will vary with the collateral used and the size and maturity of the borrowings. The Bank does not currently participate in the DWF scheme.

Retail and commercial funding

The majority of the Bank's funding comes from retail and commercial customer accounts. As at 30 June 2013, the Bank has total customer deposits of £34.9 billion, of which £28.8 billion were retail deposits and £6.1 billion were commercial deposits. The total amount of the Bank's corporate deposits fell by approximately by £1.4 billion in the first half of 2013, which the Bank believes was probably caused by the credit rating downgrade. The retail deposit base has, however, remained broadly stable.

£1.4 billion of outflow in relation to corporate deposits are mainly driven by the credit rating downgrade in the first half of 2013. The run-off of Non-core Assets may allow a reduction in expensive term funding.

The Bank's deposit funding is predominantly denominated in pounds sterling and comprises both fixed and variable rate deposits. As at 30 June 2013, approximately 49 per cent. by principal amount of the Bank's retail deposits were fixed rates of interest and 51 per cent. were variable rates of interest. As at the same date, approximately 37.6 per cent. by principal amount of the Bank's commercial deposits were fixed rates of interest and 62.4 per cent. were variable rates of interest.

The following table sets out the breakdown of the Bank's retail and commercial deposits as at 30 June 2013 and 31 December 2012.

	As at 30 June 2013	*As at 31 December 2012*	*Percentage change*
	(£ millions)		*(percentages)*
Current accounts:			
Retail	3,450.6	3,276.5	5.3
Corporate	2,410.8	3,066.7	(21.4)
Total current accounts	5,861.4	6,343.2	(7.6)
Instant access savings accounts:			
Retail	7,940.8	8,875.3	(10.5)
Corporate	748.2	877.0	(14.7)
Total instant access savings accounts	8,689.0	9,752.3	(10.9)
Term deposits and bonds:			
Retail	10,310.7	9,900.1	4.1
Corporate	2,959.8	3,615.5	(18.1)
Total term deposits and bonds	13,270.5	13,515.6	(1.8)
Individual savings accounts (ISA):			
Retail – ISA Fixed	3,609.0	3,415.3	5.7
Retail – ISA Demand	2,381.9	2,406.2	(1.0)
Total ISA accounts	5,990.9	5,821.5	2.9
Other deposits	1,110.5	1,339.9	(17.1)
Total customer deposits	34,922.3	36,772.5	(5.0)

The following table sets out the Bank's retail and commercial gross contractual cashflows by residual maturity as at 30 June 2013 and 31 December 2012.

	As at 30 June 2013	*As at 31 December 2012*	*Percentage change*
	(£ millions)		*(percentages)*
Repayable in less than 1 month	23,463.1	24,172.4	(2.9)
Repayable in less than 3 months	2,295.9	1,924.7	19.3
Repayable between 3 and 12 months	5,014.1	6,648.8	(24.6)
Repayable between 1 and 5 years	5,244.0	4,308.3	21.7
Repayable in more than 5 years	–	–	–
Total	36,017.1	37,054.2	(2.8)

Wholesale funding

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. The securitisation and covered bond transactions are in the process of being amended due to the downgrades received by the Bank from the rating agencies in the first half of 2013. These proposed amendments relate to the appointment of back up servicing and back up cash management and bank account triggers to accommodate, amongst other things, the latest structured rating agency methodology and changes to the rules relating to direct debits and payment schemes.

The Bank will consider further issuance from these programmes after these modifications are complete and if market conditions permit.

The following table sets out an analysis of the Bank's wholesale funding as at 30 June 2013 and 31 December 2012.

	As at 30 June 2013	*As at 31 December 2012*	*Percentage change*
	(£ millions)		*(percentages)*
Preference shares, PSBs and subordinated debt	1,248.1	1,258.6	(0.8)
Secured funding	3,592.3	3,611.0	(0.5)
Repos	3,188.2	2,727.6	16.9
Market borrowing	363.5	1,004.8	(63.8)
MTNs	983.8	982.3	0.2
Total wholesale funding	9,375.9	9,584.3	(2.2)

The credit rating downgrade by the rating agencies in the first half of 2013 has 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.

Carrying values of debt as at 31 December 2012 and 30 June 2013

The table below provides a breakdown (excluding issue costs, discounts and accrued interest) of the existing tier 1, upper and lower tier 2 securities that will be subject to the Liability Management Exercise, as at 31 December 2012 and 30 June 2013.

	Notional *£ thousands*	*Merger date fair value adjustment* *£ thousands*	*Fair value adjustment for hedged risk* *£ thousands*	*As at 31 December 2012* *£ thousands*	*Fair value adjustment* *£ thousands*	*Currency translation* *£ thousands*	*Swap value adjustment* *£ thousands*	*As at 30 June 2013* *£ thousands*
5.56% perpetual subordinated bonds	200,000.0	(64,724.2)	20,973.6	156,249.4	8,410.0	–	(3,785.3)	160,874.1
13% perpetual subordinated bonds	110,000.0	25,877.3	–	135,877.3	(292.0)	–	–	135,585.3
9.25% non-cumulative irredeemable preference shares	60,000.0	–	–	60,000.0	–	–	–	60,000.0
5.875% step up callable subordinated notes 2019	37,775.0	–	–	37,775.0	–	–	–	37,775.0
5.625% fixed rate subordinated notes 2021	8,747.0	–	–	8,747.0	–	–	–	8,747.0
9.25% fixed rate subordinated notes 2021	275,000.0	–	–	275,000.0	–	–	–	275,000.0
5.875% fixed rate subordinated notes 2033	150,000.0	(65,551.7)	40,999.4	125,447.7	862.7	–	(9,271.6)	117,038.8
5.75% fixed rate subordinated notes 2024	200,000.0	(75,089.2)	48,732.0	173,642.8	1,978.0	–	(10,671.4)	164,949.4
7.875% fixed rate subordinated notes 2022	235,402.0	–	–	235,402.0	–	–	–	235,402.0
Floating rate subordinated notes 2016	28,629.4	(6,955.7)	–	21,673.7	880.4	1,348.5	–	23,902.6
Total	**1,305,553.4**	**(186,443.5)**	**110,705.0**	**1,229,814.9**	**11,839.1**	**1,348.5**	**(23,728.3)**	**1,219,274.2**

Notes:

(1) Capitalised amounts of £1.76 million on the 5.875% step up callable subordinated notes 2019 will increase the carrying value of the liability for LME purposes.

(2) Fees paid of £2.4 million relating to the 5.625% fixed rate subordinated notes 2021 will reduce the carrying value of the liability for LME purposes.

(3) The Bank has naturally hedged a proportion of the 28 April 2021 9.25% fixed rate subordinated notes 2021 with liquid bonds which are accounted for as available for sale assets. It is the intention to sell these bonds in the same proportion as the percentage participation of the particular note class in the LME. Most recent market prices indicate a £11 million profit on based on a 100% participation rate in the LME.

(4) The floating rate subordinated notes 2016 issuance is a euro denominated note. The sterling statutory amount is calculated using the spot rate at the end of each presented period.

Notes issued by the Britannia Building Society prior to the 2009 merger were subject to a fair value adjustment at merger date in accordance with IFRS 3 (*Business Combinations*) which continues to unwind on an effective interest rate basis over the expected life of the note at the time of merger. The unamortised amount is shown separately in the table below for each of the notes impacted.

Some liabilities were accounted for as hedge items subject to fair value hedging in accordance with IAS 39 (*Financial instruments: Recognition and measurement*). A fair value adjustment for hedged risk has been added to the pre-hedging carrying value of these liabilities.

The following table sets out the Bank's wholesale funding by maturity as at 30 June 2013 and 31 December 2012.

	As at 30 June 2013	*As at 31 December 2012*	*Percentage change*
	(£ millions)		*(percentages)*
Repayable in less than 1 month	966.8	2,291.0	(57.8)
Repayable in less than 3 months	1,894.1	767.0	146.9
Repayable between 3 and 12 months	300.1	636.1	(52.8)
Repayable between 1 and 5 years	1,427.2	1,071.2	33.2
Repayable in more than 5 years	4,787.7	4,819.1	(0.7)
Total External Funding	9,375.9	9,584.3	(2.2)

Between 30 June 2013 and 30 September 2013, the Bank has raised £1.5 billion of private secured wholesale funding through repurchase transactions and a secured funding facility. As at 30 September 2013, the encumbrance ratio was 29.8 per cent.

See notes 24 and 34 to the Interim Statements for further details of the Bank's wholesale fundings, as at 30 June 2013.

Analysis of cash flow

The following table summarises the Bank's statements of cash flows for each of the six months ended 30 June 2013 and 2012.

	6 months to 30 June 2013	*6 months to 30 June 2012*
	(£ millions)	
Net cash flows from operating activities	(1,978.9)	(1654.5)
Net cash flows from investing activities	1,842.2	(194.2)
Net cash flows from financing activities	(47.2)	(51.2)
Net decrease in cash	(183.9)	(1,899.9)
Cash and cash equivalents at the start of the period	6,314.2	7,888.4
Cash and cash equivalents at the end of the period	6,130.3	5,988.5

Net cash outflows from operating activities for the six months ended 30 June 2013 were £1,978.9 million compared to a net cash outflow from operating activities for the six months ended 30 June 2012 of £1,654.5 million. The main reason for the net cash outflow is the decrease in customer accounts and capital bonds of £1,850.1 million together with a reduction in net derivative balances of £326.7 million.

Net cash flows from investing activities for the six months ended 30 June 2013 were an inflow of £1,842.2 million, compared to a net cash outflow from investing activities for the six months ended 30 June 2012 of £194.2 million. The net cash flow of £1,842.2 million in investing activities is as a result of the net movement in Treasury investment securities, being approximately £2 billion of new securities purchased and the proceeds of approximately £3.9 billion of securities sold during the period (see "*Liquidity and Funding*" in this Section 12 (*Operating and Financial Review*) for further explanation of underlying trends).

Net cash outflows from financing activities for the six months ended 30 June 2013 were £47.2 million compared to a net cash outflow from financing activities for the six months ended 30 June 2012 of £51.2 million. The main component of the financing net cash flows is the interest paid on other borrowed funds of £44.3 million.

CONTRACTUAL COMMITMENTS

For details of the amounts of certain of the Bank's financial and other contractual liabilities and when payments are due, without taking into account customer deposits and deposits by other financial institutions, see note 30 to the Interim Financial Information.

OFF-BALANCE SHEET ARRANGEMENTS

In the ordinary course of business, the Bank issues guarantees and letters of credit on behalf of customers. These include:

- Cheque guarantees – It is normal in the UK to issue cheque guarantee cards to current account customers holding chequebooks as historically retailers did not generally accept cheques without such form of guarantee. The issuing bank is liable to honour the cheque, if the cheque guarantee card is shown to the retailer, even when the customer does not have sufficient funds in deposit. The Bank's liability is, in theory, the total guarantee on each card multiplied by the number of cheques with retailers not yet presented to the Bank and as such is unquantifiable. Following a decline in the use of cheques– the UK Payments Council agreed to a UK-industry-wide withdrawal from the use of cheques from 30 June 2011, and therefore the Bank has been phasing out the cheque guarantee cards since that date; therefore the quantum of this guarantee has been reducing.

- The Bank issues letters of credit as part of its normal course of business. Letters of credit are common documents used in trade that are issued by the Bank and that guarantee payment to a third party provided certain documents have been presented to the Bank. The letter of credit serves as a guarantee to the seller that it will be paid by the Bank regardless of whether the Bank's customer ultimately fails to pay. The credit risk associated with these guarantees are considered within the Bank's usual credit monitoring and provisioning processes.

Other off-balance sheet exposures include: the undrawn portion of a loan commitment or credit cards; assets pledged as collateral under Treasury repurchase agreements with other banks; and commitments under operating leases. The details of these exposures are shown in note 30 to the Interim Financial Information.

In addition, the Bank has provided guarantees in respect of:

- The Britannia Scheme – Following the merger with Britannia, the Britannia Scheme transferred to CFSMS. Under the terms of this transfer, the Bank entered into a deed of guarantee to provide assurance to the trustees of the pension scheme to support CFSMS in meeting its funding obligations to the pension scheme should CFSMS be unable to meet its obligations as they fall due; and
- Intra-group guarantee – The Bank has an indemnification agreement, accounted for as a guarantee, with CFSMS in which the Bank has agreed to indemnify CFSMS against all and any liability, loss, damage, costs and expenses arising from the agreement.

Save as described above, the Bank did not have any material off-balance sheet transactions during the six months ended 30 June 2013.

RELATED PARTY TRANSACTIONS

For a description of the Bank's related party transactions, see paragraph 22 titled "*Related Party Transactions*" in Section 20 (*Additional Information*).

ACCOUNTING POLICIES, JUDGEMENTS AND CRITICAL ESTIMATES

For details of the accounting policies used by the Bank, see note 1 to the Interim Financial Information.

In preparing the Bank's financial statements, the Bank is required to make certain judgements and estimates. These affect the reported amounts of the Bank's assets and liabilities, including disclosure of contingent assets and liabilities, at the date of the financial statements as well as the reported amounts of its revenues and expenses during the periods presented. The Bank bases its estimates and assumptions on historical experience and other factors that it believes to be reasonable at the time the estimates and assumptions are made and evaluates the estimates and assumptions on an on-going basis. However, future events and their effects cannot be predicted with certainty and the determination of appropriate estimates and assumptions requires the use of judgement. Actual outcomes may differ from any estimates or assumptions made and such differences may be material to the financial statements.

Whilst there have been no changes in accounting policies in the six months to 30 June 2013, certain methods of computation and presentation have been adopted by the Bank in the preparation of its Interim Financial Information which the Bank currently expects to adopt in its 2013 financial statements. In particular IFRS 13, 'Fair value measurement', is effective from 1 January 2013 and additional fair value disclosures have been included but have not had a material impact on the financial statements. Significant additions and changes to underlying methodologies are discussed within the critical judgements and estimates section on pages 305 to 309 of the Interim Financial Information. In addition, the 2012 comparatives have been represented for the cash flow statement and the deferred tax asset/liability presentation. Further detail is provided on the cash flow statement and in note 28 respectively to the Interim Financial Information.

For a discussion of the most significant areas where judgements and estimates are made in the preparation of the Bank's financial statements, see pages 305 to 309 to the Interim Financial Information.

DISCLOSURES ABOUT RISK

For a discussion of the Bank's risk management activities, see Section 14 (*Risk Management*).

13

CAPITAL ADEQUACY

CAPITAL ADEQUACY

1. OVERVIEW OF BANK'S CAPITAL POLICY

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 (see the paragraph titled "*Recapitalisation Plan*" below).

The Bank is required to manage its capital in accordance with prudential rules issued by the PRA, and from 1 January 2008 the Bank has been subject to rules which implement the EU Capital Requirements Directive (which implements **Basel II**).

The FSA (as it was then known) granted approval to the Bank for the use of the IRB approach, effective from 1 January 2008, and as part of the merger with Britannia (see paragraph 4 titled "*History and Development of the Bank*" in Section 8 (*Description of the Bank*) approved the transfer of IRB permissions from Britannia to the Bank.

On 21 June 2013 the European Council approved new capital reforms (the PRR and PRD), which implemented Basel III in Europe. The PRR and the PRD entered into force on 17 July 2013. The objective of the reform package is to improve the banking sector's ability to absorb shocks arising from financial and/or economic stress, thus reducing the risk of spill-over from the financial sector into the real economy. The PRR and PRD will apply on a transitional basis from 1 January 2014 and will be phased in over a period of time, to be fully effective by 2019.

The actual impact of the PRR and PRD on capital ratios is also dependent on the related EBA technical standards and the PRA's approach to implementation in those areas for which it is responsible. The PRA published its consultation paper, "*Strengthening Capital Standards: Implementing CRD IV – CP5/13*", on the changes to the PRA's rules to implement the PRD and relevant discretions provided in the PRR, on 2 August 2013. The consultation period ended on 2 October 2013.

The Bank also monitors its capital position under the forthcoming Basel III requirements. Under the above-mentioned PRA consultation, the PRA proposes that the definition of Common Equity Tier 1 (**CET1**) capital will require capital deductions and amendments to prudential filters to apply fully from 1 January 2014, rather than on a transitional basis. However, the disclosures on the Bank's capital resources in this section are produced in line with PRA requirements issued before the consultation on CRD IV and do not include these proposed amendments to the transitional period (see "*The Bank's business, operating results, financial position and/or its ability to implement its strategy may be adversely impacted by it not maintaining adequate regulatory capital and by future changes to its regulatory capital requirements*" in Section 2 (*Risk Factors*) and Section 17 (*Supervision and Regulation*).

The Bank's Basel II regulatory capital is analysed in two tiers:

Tier 1 Capital:

Tier 1 Capital includes share capital, retained earnings and non-cumulative irredeemable preference shares. Retained earnings exclude gains or losses on cash flow hedges and available-for-sale assets.

Tier 2 capital:

Tier 2 Capital includes subordinated debt issues and perpetual subordinated bonds (**PSBs**). The rights of payment to the holders of this debt are subordinated to the claims of depositors and other creditors of the Bank. More information on these can be found in Note 24 to the Interim Financial Information (see "*Part A*" in Section 16 (*Financial Information*)).

Revaluation reserves relating to net gains on equity held in the available-for-sale financial assets category are included in Tier 2 Capital.

Regulatory adjustments

Intangible assets are deducted from Core Tier 1 Capital. Under the IRB approach presently provided for in Part 4 of the PRA's Prudential Sourcebook for Banks, Building Societies and Investment Firms (**BIPRU**), which forms part of the Financial Services Handbook, a deduction is made for expected losses in excess of impairment. Of this, 50 per cent. is deducted from Core Tier 1 Capital net of tax and 50 per cent. from tier 2 capital gross of tax. Other Core Tier 1 Capital is adjusted by the remaining 50 per cent. tax on the excess of expected losses over impairment. Further adjustments are explained within the appropriate footnote in "*Table 2: Basel II capital resources*" below.

2. RECAPITALISATION PLAN

On 17 June 2013, following the conclusion of the Bank's review of its capital position and discussions with the PRA, it was stated in the June Announcement that the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion, of which at least £1 billion is expected to be contributed pursuant to the Liability Management Exercise in 2013 and, conditional on completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is to be contributed by Banking Group in 2014 pursuant to the 2014 Commitment of which £170 million must be satisfied at the latest by 30 June 2014 (with £70 million of this contribution to be paid before 31 January 2014), and the remaining £163 million by 31 December 2014).

The Liability Management Exercise is intended to generate at least £1 billion of the £1.5 billion of Common Equity Tier 1 Capital required by the Bank. The Liability Management Exercise will generate Common Equity Tier 1 Capital in two ways:

- first, to the extent that the Bank exchanges Dated Notes for New Ordinary Shares and issues Additional New Ordinary Shares pursuant to the Scheme, the amount of such New Ordinary Shares and Additional New Ordinary Shares issued will constitute Common Equity Tier 1 Capital for the Bank; and

- second, to the extent that Existing Securities are exchanged or issued for New Securities at a discount to the Bank's book value of those Existing Securities (i.e. by imposing a discount on the Existing Securities through the Liability Management Exercise), the amount of that discount will also be recognisable as Common Equity Tier 1 Capital (on the basis that the Bank will reduce a liability for less than the book value of that liability in the Bank's accounts).

The offers in respect of the Preference Shares and Perpetual Subordinated Bonds are being conducted by way of exchange offers (the **Exchange Offers**) and certain proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds (the **Proposals**). The offer in respect of the Dated Notes is being conducted by way of the Scheme. The Liability Management Exercise will only be successfully completed if the entire principal amount of the Existing Securities are exchanged or sold pursuant to the Liability Management Exercise.

The Scheme will also provide 62,500,000 Additional New Ordinary Shares will be made available to Holders of the Dated Notes for subscription on the terms of the Scheme as described in the Explanatory Statement (the **Additional New Ordinary Shares Offer**).

The Exchange Offers, the Proposals and the Scheme are collectively referred to in this Prospectus as the Liability Management Exercise. In addition, as part of the Liability Management Exercise, a proportion of the New Ordinary Shares issued in exchange for Existing Securities will be delivered to Co-operative Group in exchange for the issue by Cooperative Group to the Holders of certain of the Existing Securities (being Preference Shares and 13% Bonds) of a Final Repayment Notes and/or Instalment Repayment Notes (the Group Notes). Each such Holder will have the opportunity to choose whether it would prefer to receive Final Repayment Notes and/or Instalment Repayment Notes (if the Liability Management Exercise is successfully completed) or a combination of the two, each to be issued by Co-operative Group pursuant to the Group Notes.

In addition, the Bank expects that capital created through interest savings on the Existing Securities surrendered in the Liability Management Exercise net of any coupon payments on the New Securities should contribute an additional amount of Common Equity Tier 1 Capital towards the Recapitalisation Plan, beyond that created as a result of the Liability Management Exercise. The Bank currently estimates that net interest savings should result in allowable Common Equity Tier 1 Capital in the region of £40 million during the course of 2014.

Under the Recapitalisation Plan, Banking Group has agreed to contribute £333 million of Common Equity Tier 1 Capital during 2014 (the **2014 Commitment**). On 4 November 2013 (being the date of the launch of the Recapitalisation Plan), Banking Group entered into a legally binding and irrevocable undertaking to pay (the **Undertaking to Pay**) in favour of the Bank in consideration for the issuance of 54,058,442 New Ordinary Shares immediately following the completion of the Liability Management Exercise (the **2014 Commitment Agreement**). Banking Group's obligations under the 2014 Commitment and the Undertaking to Pay are conditional only upon the successful completion of the Liability Management Exercise.

The Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Bank's Existing Securities are together referred to in this Prospectus as the **Recapitalisation Plan**.

For further details of the 2014 Commitment, see the paragraph titled "*The Recapitalisation Plan*" in Section 12 (*Operating and Financial Review*) above.

Assuming the Liability Management Exercise is completed and therefore at least £1 billion of Common Equity Tier 1 Capital is raised in respect of the Exchange Offers, Proposals and the Scheme, and £125 million is in 2013 raised pursuant to the Additional New Ordinary Shares Offer under the Scheme, the Bank expects to report, for the end of 2013, a Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9% but above the regulatory minimum requirement". Taking into account the benefit of the additional Common Equity Tier 1 Capital to be provided by Banking Group to satisfy the 2014 Commitment and a reduction in RWAs, partially offset by expected losses in the Bank in 2014, it is currently expected that the Bank's Common Equity Tier 1 Capital ratio will remain broadly stable, improving only modestly from this level in the coming years. The Bank expects to achieve a leverage ratio above the regulatory minimum by the end of 2014.

These components are expected to strengthen the capital position of the Bank, reduce the interest and dividend burden, and reduce costs through business simplification and improvements in operating efficiency, in particular to the Bank's existing IT platform.

On 29 August 2013 the Bank published its interim results for the six months ended 30 June 2013. The interim results showed a loss before taxation of £709.4 million, which was impacted by significant impairment charges of £496.0 million.

Significant credit impairments in 2013 were noted by the Bank in the announcement of the Recapitalisation Plan on 17 June 2013 and were factored into the Recapitalisation Plan. On 29 August 2013, the PRA reconfirmed its assessment of the Bank's capital shortfall of £1.5 billion.

3. OVERVIEW OF BANK'S CAPITAL RESOURCES UNDER BASEL II

Table 1 – Basel II capital ratios and risk weighted assets

	30 June 2013	*31 December 2012*
	(£millions, except for percentages)	
Capital ratios		
Core Tier 1 ratio	4.9%	8.8%
Tier 1 ratio	5.4%	9.4%
Total capital ratio	9.5%	14.4%
Risk-weighted assets		
Credit risk	14,758.0	15,974.8
Market and counterparty risk	2.1	492.6
Operational risk	1,255.2	1,441.3
Total risk-weighted assets	16,015.3	17,908.7
Segmental analysis of credit risk risk-weighted assets		
Core		
Retail	2,384.7	2,410.1
CABB core	5,396.0	6,081.9
Treasury/other	1,511.8	1,443.2
	9,292.5	9,935.2
Non-core		
Corporate	1,469.6	1,678.4
Other	3,995.9	4,361.2
	5,465.5	6,039.6
Total credit risk risk-weighted assets	14,758.0	15,974.8

Table 1 provides the risk-weighted assets of the Core Business, subdivided into its various businesses as at 30 June 2013. The measure of the Bank's total risk-weighted assets is used in determining the Bank's capital requirements.

The Bank's Core Tier 1 Capital ratio at 30 June 2013 was 4.9 per cent., a decrease of 3.9 percentage points from 8.8 per cent. as at 31 December 2012. This was due to a 50 per cent. (£779.5 million) decrease in Core Tier 1 Capital after regulatory adjustments offset by an 11 per cent. (£1,893.4 million) decrease in total risk weighted assets.

The reduction in Core Tier 1 Capital was primarily due to the statutory loss of £811.4 million before tax and £772.0 million after tax.

The reduction in risk-weighted assets for the six months ended 30 June 2013 was primarily due to a 12 per cent. (£894.7 million) reduction in total risk weighted assets for CABB core and non-core corporate. Slotting models are used by the Bank to analyse and monitor specialised lending exposures to property, which are assigned to PRA supervisory categories with predefined risk weights. A significant proportion of loans were downgraded with many moving into default. Loans in default have a zero risk weight (but a 50 per cent. expected loss). Movement to default was the primary reason for the reduction in corporate risk weighted assets.

In addition, other non-core risk-weighted assets have decreased by 8 per cent. (£365.3 million). 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, risk-weighted assets reduced by c£1.2 billion. An exercise to review the risk weightings of assets at 30 June 2013 increased risk-weighted assets by c£1.0 billion. In spite

of this, Optimum risk-weighted assets have decreased by 5 per cent. (c £200 million) due to on-going reduction in arrears and the continued run-off of the book.

For the six months ended 30 June 2013, market and counterparty risk-weighted assets have also decreased by £490.5 million due to the sale of the Bank's held-for-trading assets.

For the six months ended 30 June 2013, total excess of expected loss over impairment, a deduction from capital resources, decreased by £269.8 million. Credit impairments increased significantly, partially offset by a higher expected loss driven by corporate downgrades.

Table 2 – Basel II capital resources

	30 June 2013	*31 December 2012*
	(£millions, except for percentages)	
Core Tier 1 Capital before regulatory adjustments:		
Permanent share capital	410.0	410.0
Retained earnings	1,304.1	1,813.4
Minority interests[1]	32.8	32.0
Losses for the year/period	(772.0)	(508.1)
Share premium account	8.8	8.8
Total Core Tier 1 Capital before regulatory adjustments	983.7	1,756.1
Regulatory adjustments from Core Tier 1 Capital:		
Intangible assets[2]	(115.6)	(27.9)
50% of excess of expected losses over impairment (net of tax)[3]	(58.8)	(159.7)
50% of securitisation positions[3]	(21.0)	(0.7)
Total Core Tier 1 Capital after regulatory adjustments	788.3	1,567.8
Other Tier 1 Capital:		
Non-cumulative irredeemable preference shares	60.0	60.0
Regulatory adjustments from other Tier 1 Capital:		
50% of tax on excess of expected losses over impairment[3]	17.8	51.8
50% of material holdings	(2.2)	(2.0)
Total Tier 1 Capital after regulatory adjustments	863.9	1,677.6
Tier 2 Capital before regulatory adjustments:		
Revaluation reserves	2.0	2.0
Collective provisions	0.9	0.7
Subordinated notes and perpetual subordinated bonds[4]	1,116.8	1,112.1
Excess on limits for lower Tier 2 Capital[5]	(361.7)	–
Total Tier 2 Capital before regulatory adjustments	758.0	1,114.8
Regulatory adjustments from Tier 2 Capital:		
50% of excess of expected losses over impairment (gross of tax)[3]	(76.6)	(211.5)
50% of securitisation positions[3]	(21.0)	(0.7)
50% of material holdings	(2.2)	(2.0)
Total Tier 2 Capital after regulatory deductions	658.2	900.6
Total capital resources	1,522.1	2,578.2

Notes:

(1) Minority interests represent the interests of shareholders, other than the Bank, in the equity of Unity Trust Bank.

(2) Intangible assets are excluded from capital for regulatory purposes.

(3) Under IRB rules both the excess of expected losses over impairment and securitisation positions with an external credit rating below BB- are deducted 50 per cent. from Tier 1 and 50 per cent. from Tier 2 Capital.

(4) Subordinated notes and perpetual subordinated bonds include permanent interest-bearing shares of Britannia which converted to perpetual subordinated debt on merger. For regulatory purposes, these are included net of any unamortised issue costs and fair value adjustments arising from the merger with Britannia. Tier 2 instruments with less than five years to maturity are subject to amortisation per regulatory rules. More information regarding these instruments can be found in the Bank's 2012 financial statements.

(5) Under regulatory gearing rules, lower Tier 2 Capital cannot exceed 50 per cent. of Tier 1 Capital after deduction of intangible assets.

The Bank contracts with CFSMS to build certain assets, including IT developments. Whilst these intangible assets are on the balance sheet of CFSMS, at 30 June 2013 the share attributable to the Bank has been deducted from the Bank's capital resources. The £115.6 million includes £91.8 million of intangibles included on the CFSMS balance sheet. This is in line with the Bank's regulatory reporting to the PRA.

Approximately £361.7 million of lower Tier 2 Capital was ineligible at 30 June 2013 due to gearing rules, as lower Tier 2 Capital cannot exceed 50 per cent. of Tier 1 Capital after deductions.

Capital allocation

The allocation of capital among specific operations and activities is driven by optimisation of the return achieved on the capital allocated, and is based upon the regulatory capital. Capital allocation is undertaken independently of those responsible for capital management, and is reviewed by ALCO.

Table 3 – Basel II capital resources movement between 31 December 2012 and 30 June 2013

	(£millions)
Core Tier 1 Capital after regulatory adjustments as at 31 December 2012	1,567.8
Retained earnings	(1.2)
Minority interests	0.8
Losses for the period	(772.0)
Intangible assets	(87.7)
50% of excess of expected losses over impairment (net of tax)	100.9
50% of securitisation positions	(20.3)
Core Tier 1 Capital after regulatory adjustments as at 30 June 2013	788.3
Other Tier 1 Capital as at 31 December 2012	109.8
50% of tax on excess of expected losses over impairment	(34.0)
50% of material holdings	(0.2)
Other Tier 1 Capital after regulatory adjustments as at 30 June 2013	75.6
Total Tier 1 Capital after regulatory adjustments as at 30 June 2013	863.9
Tier 2 Capital after regulatory adjustments as at 31 December 2012	900.6
Collective provisions	0.2
Subordinated notes and perpetual subordinated bonds	4.7
Excess on limits for lower Tier 2 capital	(361.7)
50% of excess of expected losses over impairment (gross of tax)	134.9
50% of securitisation positions	(20.3)
50% of material holdings	(0.2)
Tier 2 Capital after regulatory adjustments as at 30 June 2013	658.2
Total capital resources as at 30 June 2013	1,522.1

Total capital resources decreased by £1,056.1 million over the period to £1,522.1 million as at 30 June 2013. Core Tier 1 Capital fell by £779.5 million partially due to the statutory loss of £811.4 million before tax and £772.0 million after tax.

Total excess expected loss over impairment provisions deduction (gross of tax) decreased by £269.8 million, primarily driven by an additional £279.2 million of provisions within the period.

The £40.6 million increase in the securitisation deduction (net of provisions) was primarily due to the completion of the Calico synthetic securitisation in January 2013.

Approximately £361.7 million of lower Tier 2 Capital was ineligible at 30 June 2013 due to gearing rules, as lower Tier 2 Capital cannot exceed 50 per cent. of Tier 1 Capital after deductions.

4. OVERVIEW OF BANK'S CAPITAL POSITION (CALCULATED IN ACCORDANCE WITH BASEL III)

The Bank also monitors its capital position under forthcoming Basel III requirements. These requirements (under the PRR and PRD) entered into force within the EU on 17 July 2013, but will apply to the Bank from 1 January 2014, with such application being on a transitional basis and in the case of the PRD subject to implementation by the PRA (see paragraph 2.3 titled "*Capital adequacy*" in Section 17 (*Supervision and Regulation*). During the transitional period to full implementation of Basel III, the Bank will have the opportunity to generate additional capital from earnings and to implement management actions in order to mitigate the impact of Basel III and meet target capital ratios.

Table 5 below shows the capital resources of the Bank as at 30 June 2013 and 31 December 2012 using transitional and final Basel III rules. For June 2013, year 1 transitional rules are based on 2014 percentages. For December 2012, year 1 transitional rules are based on 2013 percentages. As a result grandfathering percentages applied to Additional Tier 1 (**AT1**) and Tier 2 (**T2**) capital instruments are 80 per cent. in June 2013 and 90 per cent. in December 2012. In addition transitional percentages applied to regulatory adjustments are 20 per cent. in June 2013 and 0 per cent. in December 2012. Tier 2 capital as at 31 December has been restated such that those instruments which do not have an incentive to redeem remain eligible under Basel III.

Table 5 below is based on the reporting template in Annex VI of the "*EBA Consultation Paper on Draft Implementing Technical Standards on Disclosure for Own Funds by institutions*" (EBA/CP/2012/04), 7 June 2012. It has been completed according to the regulations as stated in the PRR along with the PRA's public statement CRD IV transitional provisions on capital resources. For clarity, only those parts of the table with relevance to the Bank are shown.

Note that the capital instruments included in Table 5 below are subject to the Liability Management Exercise. The Recapitalisation Plan will enable the Bank to improve its capital position and generate additional Common Equity Tier 1 Capital.

The leverage ratio as at 30 June 2013 and 31 December 2012, based on final Basel III rules, is 1.07 per cent. and 2.26 per cent. respectively. The leverage ratio is calculated as Basel III Tier 1 Capital after deductions divided by adjusted balance sheet exposure. Exposure is calculated using instructions for Basel III Quantitative Impact Studies (which are the results of the Basel Committee's Basel III monitory exercise published on 20 September 2012) and related frequently asked questions. Derivative balances are adjusted to reflect the exposure used for capital purposes, off-balance sheet commitments are added and some deductions from Tier 1 are also deducted from the exposure. The Bank expects to achieve a leverage ratio above the regulatory minimum by the end of 2014.

Table 4 – Basel III capital ratios and risk weighted assets

	30 June 2013	*31 December 2012*
	(£millions, except for percentages)	
Capital ratios		
Common Equity Tier 1 ratio	3.0%	6.3%
Tier 1 ratio	3.0%	6.3%
Total capital ratio	7.3%	10.3%
Basel II risk-weighted assets	16,015.3	17,908.7
Securitisations risk-weighted at 1250%	525.8	17.2
Credit valuation adjustment	431.0	397.5
Asset value correlation	379.1	431.5
Deferred tax assets	142.2	77.5
Other	10.7	9.9
Basel III risk-weighted assets	17,504.1	18,842.3

Table 5 – Capital resources of the Bank for the half year ended 30 June 2013 and the year ended 31 December 2012 on a Basel III basis

	Year 1 Basel III transitional rules (30 June 2013)	*Basel III final rules (30 June 2013)*	*Year 1 Basel III transitional rules (31 December 2012)*	*Basel III final rules (31 December 2012)*
		(£millions)		
Common Equity Tier 1 Capital: instruments and reserves				
Permanent share capital and the related share premium account	418.8	418.8	418.8	418.8
Retained earnings	1,304.1	1,304.1	1,813.4	1,813.4
Available for sale and cash flow hedge reserves	30.8	30.8	93.7	93.7
Minority Interests[1]	28.7	12.1	32.0	11.5
Common Equity Tier 1 (CET1) capital before regulatory adjustments	1,782.4	1,765.8	2,357.9	2,337.4

	Year 1 Basel III transitional rules (30 June 2013)	*Basel III final rules (30 June 2013)*	*Year 1 Basel III transitional rules (31 December 2012)*	*Basel III final rules (31 December 2012)*
		(£millions)		
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
Prudential valuation in trading book	(5.0)	(5.0)	(7.0)	(7.0)
Intangible assets (net of related tax liability)[2]	(23.1)	(115.6)	–	(27.9)
Deferred tax assets not arising from temporary differences[3]	–	–	(1.4)	(14.1)
Cash flow hedge reserves	(24.9)	(24.9)	(63.7)	(63.7)
Expected loss shortfall[4]	(55.9)	(279.5)	–	(537.4)
Securitisation positions treated as deduction[5]	–	–	–	–
Deferred tax assets arising from temporary difference (exceeding thresholds)	(29.5)	(46.6)	–	–
Losses for the period	(772.0)	(772.0)	(508.1)	(508.1)
Filter for unrealised gains on debt instruments held in the available for sale category[6]	(3.9)	–	(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]	(155.8)	–	(242.6)	–
Total regulatory adjustments to Common Equity Tier 1 (CET1)	(1,072.1)	(1,243.6)	(852.7)	(1,158.2)
Common Equity Tier 1 (CET1) capital	710.3	522.3	1,505.2	1,179.2
Additional Tier 1 (AT1) capital: instruments				
Perpetual non-cumulative preference shares[8]	48.0	–	54.0	–
Minority interest[1]	0.5	2.6	–	2.5
Additional Tier 1 (AT1) capital before regulatory adjustments	48.5	2.6	54.0	2.5
Additional Tier 1 (AT1) capital: regulatory adjustments				
Intangible assets[2]	(92.5)	–	(27.9)	–
Expected loss shortfall (half)[4]	(111.8)	–	(268.7)	–
Total regulatory adjustments to Additional Tier 1 (AT1) capital	(204.3)	–	(296.6)	–
AT1 adjustments in excess of AT1 capital[7]	155.8	–	242.6	–
Additional Tier 1 (AT1) capital	–	2.6	–	2.5
Tier 1 Capital (T1 = CET1 + AT1)	710.3	524.9	1,505.2	1,181.7

	Year 1 Basel III transitional rules (30 June 2013)	*Basel III final rules (30 June 2013)*	*Year 1 Basel III transitional rules (31 December 2012)*	*Basel III final rules (31 December 2012)*
		(£millions)		
Tier 2 (T2) capital: instruments and provisions				
Capital instruments[9]	1,120.4	747.2	1,119.8	747.3
Minority interests[1]	0.7	3.5	-	3.4
Collective provisions	0.9	0.9	0.7	0.7
Tier 2 (T2) capital before regulatory adjustments	1,122.0	751.6	1,120.5	751.4
Tier 2 (T2) capital: regulatory adjustments				
Expected loss shortfall[4]	(111.8)	-	(268.7)	-
Revaluation reserves[6]	2.0	-	2.0	-
Total regulatory adjustments to Tier 2 (T2) capital	(109.8)	-	(266.7)	-
Tier 2 (T2) capital	1,012.2	751.6	853.8	751.4
Total capital (TC = T1 + T2)	1,722.5	1,276.5	2,359.0	1,933.1

Notes:

(1) Under Basel III the amount of minority interest which can be recognised is reduced over the transitional period and allocated between the different tiers of capital.

(2) Intangible assets change from being a deduction from Tier 1 under Basel II to a deduction from CET1 under Basel III.

(3) Deferred tax assets not arising from temporary differences move from being risk-weighted to being a deduction from CET1.

(4) Expected loss shortfall change 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 Basel III they are gross with the full charge applying immediately. Under Basel III provisions for default accounts can only be recognised up to the value of the expected loss.

(5) Securitisation positions with an external credit rating below BB- are no longer shown as a deduction, and are risk-weighted instead.

(6) Some regulatory adjustments under Basel II do not apply under Basel III.

(7) The amount of qualifying deductions allowed against Additional Tier 1 exceeds the Bank's Additional Tier 1 resources and so is shown as a deduction against CET1. Under full implementation deductions are applied entirely from CET1.

(8) Perpetual non-cumulative preference shares have a cap of 80 per cent. of the nominal value applied (£48 million under year 1 transitional rules). The remaining £12 million is included in Tier 2 capital prior to the application of the Tier 2 cap.

(9) The year one transitional cap has a small impact on the recognised value of Tier 2 instruments. The cap is based on the nominal value of the underlying instruments at 31 December 2012. As a result of the merger with Britannia in 2009, some of the Bank's Tier 2 instruments are reported net of fair value adjustments and so the total value of the Tier 2 instruments only just exceeds the year one cap.

5. LEVERAGE RATIO

Under final Basel III rules, the leverage ratio as at 30 June 2013 is 1.07 per cent., based on an adjusted balance sheet exposure of £49,056.7 million and Tier 1 capital of £524.9 million.

14
RISK MANAGEMENT

RISK MANAGEMENT

1. OVERVIEW

The Bank acknowledges that, as a provider of banking and financial services, all of its business activities involve the management of risk. The Bank seeks to appropriately manage the risks that arise from those activities through the Bank's risk management framework (the **Risk Management Framework**). The Risk Management Framework is a hierarchy of strategies, policies and standards which are designed to support the Bank's risk-based decision-making and comprises six components:

- a risk strategy;
- a risk management framework policy (the **Risk Management Framework Policy**);
- a risk appetite statement;
- risk policies in respect of the Bank's Principal Risks, as defined below;
- control standards; and
- business unit operating procedures.

Listed below are the ten principal risks which are the key financial and non-financial risks to which the Bank is exposed and which it seeks to address through specific risk policies (the **Principal Risks**):

- Credit risk;
- People risk;
- Liquidity and funding risk;
- Market risk (including interest rate risk);
- Reputational risk;
- Pension risk;
- Strategic and business risk;
- Regulatory risk;
- Conduct risk; and
- Operational risk (including change risk).

2. THE RISK MANAGEMENT FRAMEWORK

2.1 The Risk Management Strategy

The Bank's overall risk strategy is described in its risk management strategy. The strategy is maintained by the CRO and approved by the Board. The risk strategy sets out the:

- way in which risk management supports the Bank through bringing transparency, clarity and insight;
- strategic goals for risk management (as summarised above); and
- risk management principles that must be followed across the Bank in order to achieve those strategic goals.

2.2 **Risk Management Principles**

To achieve the strategic goals, the following principles must be followed across the organisation:

- the Board requires the business to be managed in line with the risk strategy which sets out to realise the agreed vision within the agreed risk appetite. Risk, as well as reward, should be taken into account in a consistent way across the business when pursuing all strategic objectives to maintain the desired risk profile;
- the Board is ultimately responsible for all the Bank's risks and approves limits for the business so it may operate within the agreed risk appetite. The Board expects management to realise strategic objectives whilst operating within these limits and an effective risk culture must be in place so these limits are adhered to;
- an independent review and challenge is provided by the CRO who is supported by an appropriate governance structure to ensure effective implementation of the agreed risk management framework;
- The Bank operates a "three lines of defence" governance model to ensure appropriate responsibility and accountability are maintained 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 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**).
  - 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 Audit Committee and senior management on the adequacy of both the first and second lines.
- identified, emerging or current risks should be actively managed in line with the Bank's approach for identification, measurement, management, monitoring and reporting. Identification should be forward-looking to allow management to take a pro-active approach to risk management;
- the business is managed such that it is confident of weathering extreme but plausible stress scenarios and uses stress testing to demonstrate that it is able to withstand these shocks;
- management monitor the aggregated risk profile of the Bank and its regulated entities and review trends which are reported to the Board and externally to regulators to meet external obligations; and
- high quality risk management techniques are adopted across the business and the use of these should be evidenced through documentation and self-certification.

2.3 **The Development of the Bank's Risk Management Framework**

Until September 2013, Banking Group maintained a common governance, organisational and risk management structure, which had been developed and implemented across the subsidiaries of

Banking Group. As such, historically, the board of directors of Banking Group has been responsible for approving the corporate governance and risk strategy applicable to the Bank.

From September 2013, and as a result of the separation of the Bank from Co-operative Group, the Bank has put in place its own revised, updated and independent risk management framework. The revised and updated risk management framework and policies have been adopted by the Bank, however, these policies will take time to be embedded within individual business units, in particular in relation to awareness of responsibilities. 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. Whilst the revised overall risk management framework (and supporting documented risk policies) adheres to a clear three lines of defence model, there are still occasions where the first and second lines are blurred and improvements are still required to be made to the third line of defence, in particular improving the capability of the internal audit team.

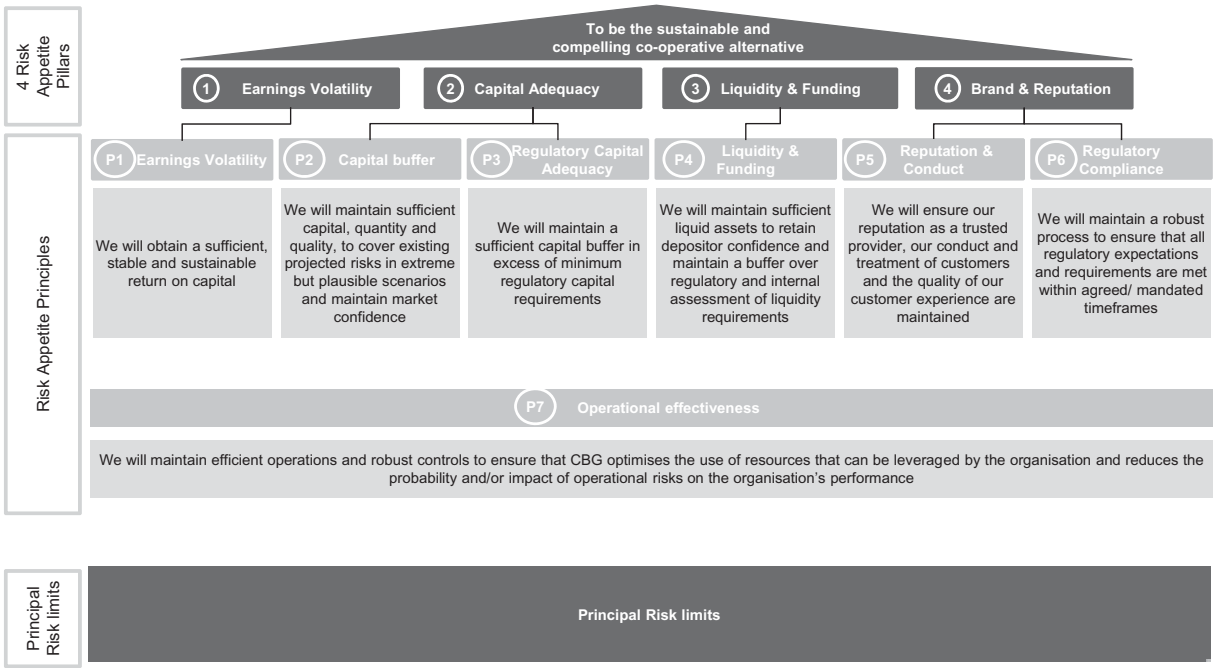
As a result of the new risk management framework, the Bank is now solely responsible for determining its principal risks and the level of acceptable risks as stipulated in the Bank's risk appetite statement, as well as for ensuring that there is an adequate system of risk management and that the levels of capital and liquidity held are consistent with the risk profile of the business.

The "three lines of defence" governance model previously adopted by the board of directors of Banking Group has also been replicated by the Bank to ensure appropriate responsibility and accountability is allocated to the management (see paragraph 2.2 titled "*Risk Management Principles*" above).

2.4 The Risk Appetite Framework

The Board has primary responsibility for identifying the key business risks facing the Bank, approving the Bank's risk strategy and the acceptable level of risk appetite and associated tolerances, and delegates the setting of the detailed risk limits and tolerances to the Chief Executive Officer (**CEO**). The CEO uses the Executive Committee (**ExCo**) governance structure to assist in consideration, review and setting of these more detailed risk appetite limits and tolerances.

The Bank's seven risk management principles are summarised in the following diagram:



The Bank's risk appetite framework encompasses seven key principles which are earnings volatility, capital buffer, regulatory capital adequacy, liquidity and funding, reputation and conduct, regulatory compliance and operational effectiveness.

Each of the seven risk appetite principles is supported by quantitative measures to ensure that the Bank operates within the expectations of key stakeholders, including its customers, rating agencies and regulators.

The risk appetite review process is aligned to the annual planning cycle and accordingly, the tolerances for each of the risk appetite measures have been recalibrated based on the plan for board approval, including a refresh of some measures. The framework is being developed to incorporate the plans for each of the Core and Non-core Businesses.

3. THE BANK'S PRINCIPAL RISKS

The Principal Risks are the key financial and non-financial risks to which the Bank is exposed and the Principal Risk policies provide the Bank with guidance on how to achieve strategic objectives whilst managing risk within defined risk appetite tolerances.

The ten Principal Risks cover the inherent risks faced by the Bank. Materialisation of any one of the Principal Risks can potentially impact the Bank's reputation, brand and ability to achieve its strategic objectives.

The risk categories outlined in the Risk Management Framework are described below. Each of these apply to the Bank, including its divisions and subsidiaries.

Risk category	*Definition*
Credit risk	The current or prospective risk to earnings and/or capital arising from a borrower's failure to meet the terms of any contract with the Bank or the various subsidiaries of the Bank or such borrowers failure to perform as agreed.
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 a stress. It arises from the mismatch of timings of cash flows generated from the Bank's assets and liabilities (including derivatives).
Market risk	The risk that the value 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.
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.
Reputation risk	The risk associated with an issue which could in some way be damaging to the brand of the Bank or to Co-operative Group, including issues arising as a result of the Bank's strategic decisions or business performance, operational failure, or external perception.
Strategic and business risk	The risk arising from changes to the Bank's businesses and the environment in which it operates, specifically the risk of not being able to carry out the Bank's business plan and desired strategy.
People risk	The risk characterised by individuals being engaged by other members of Co-operative Group, senior management being on

	contracts for services with other members of Co-operative Group, an inability to attract and retain sufficiently qualified employees, unduly high employee turnover, loss of key staff, lack of succession planning and staff development, and indicators of behaviours which are not compliant with the Bank's values.
Regulatory risk	The risk of fines, public censure, limitation on business, requirements for legal or operational restructuring, or restitution costs arising from the failure to understand, interpret, implement and comply with UK and EU regulatory requirements.
Conduct risk	The risk that the Bank's behaviour, offerings or interactions will result in unfair outcomes for customers.
Pension risk	The risk to the Bank's capital and company funds from the Bank's exposure to scheme liabilities (to the extent liabilities are not met by scheme assets) and risks inherent in the valuation of scheme liabilities and assets.

The policies in place to manage the Principal Risks (including any subcategories of risk and the associated risk appetite) are reviewed on an annual basis. They are subject to continuous monitoring by the relevant committees.

4. OVERSIGHT

4.1 The Chief Executive Officer (CEO)

In relation to the Risk Management Framework, the CEO is responsible for amongst other responsibilities:

- proposing risk appetite limits to the Board for approval and the implementation of detailed risk appetite limits in the business;
- approving detailed risk appetite, limits and tolerances to be implemented in the business and supported by the other members of the executive, insofar as is within the scope of the CEO's authority as delegated by the Board;
- reviewing and recommending to the BRC for approval, the risk strategy and Risk Management Framework Policy proposed by the CRO;
- leading and managing the business to achieve strategic objectives within the agreed risk appetite as delegated by the Board;
- delegation of responsibility for specific risk management tasks, including management of risk appetite, to appropriately skilled members of the executive team; and
- monitoring business operations within the risk appetite set out for each Principal Risk and reporting on this performance to the Board.

4.2 The Chief Risk Officer (CRO)

In relation to the Risk Management Framework the CRO is responsible for, amongst other responsibilities:

- leading the risk function in pursuit of the risk strategic objectives;
- maintaining the risk strategy, Risk Management Framework Policy and risk appetite statements on behalf of the CEO. The CRO will recommend and make material changes to the risk strategy and the Risk Management Framework Policy; such changes are to be agreed with the BRC and the CEO and approved by the Board;

- ensuring there is a robust operational risk framework and monitoring process in place;
- providing regular reporting to the Board, the BRC and executive management on risk exposures and the effectiveness of the control framework;
- ensuring adequate review and oversight of individual risks at first line committees;
- defining the requirements for the semi-annual risk certification process to confirm the Bank-wide operational implementation of the Risk Management Framework;
- undertaking periodic thematic/conformance reviews to ensure that the business is managing risk within the agreed appetite and in line with the requirements of the Risk Management Framework Policy; and
- agreeing waivers or dispensations to risk policies where applicable within delegated authorities.

4.3 **Risk Framework Owners**

Each of the ten Principal Risks are assigned to a Risk Framework Owner (**RFO**), each of whom is a senior member of management. In relation to the Risk Management Framework each RFO is responsible for, amongst other responsibilities:

- the writing and maintenance of the applicable risk policy and control standard(s);
- developing detailed risk appetite/tolerance thresholds for their risk, ensuring that these are communicated to each business area/function as applicable and recommended to the CEO for approval;
- recommending the risk policy and control standard(s) for approval to the relevant governance committee;
- establishing a semi-annual review cycle to evidence that the risk framework is appropriately established and maintained across the Bank and certify to the Board that it is fit for purpose and supports effective risk management;
- reporting on the overall risk profile for their risk (including but not limited to the key metrics) to the relevant oversight committee;
- ensuring that control failures and breaches of policies within their risk's framework are reviewed and reported by the business (including escalation to the CRO and to the ERC in line with the agreed event escalation process outlined in this document);
- overseeing remediation of control weaknesses, ensuring that these are set up and resourced appropriately by the business and tracked to conclusion.

RFO's responsibilities should be referenced in their role profile and incorporated in their annual performance objectives.

4.4 **Business management**

The Bank's business teams and first line management is responsible for:

- implementing and embedding the requirements of the Principal Risk policies and relevant control standards within their business area/function;
- ensuring that the requirements of the risk management framework are translated into effective operating processes and procedures and controls through an effective implementation plan;
- ensuring the requirements of the risk management framework are communicated to and understood by all staff as appropriate;

- identifying, assessing and understanding where the business area is exposed to risks, including those deriving from the development of new products, processes or other business change;
- managing the risks that reside within their business area/function on a day-to-day basis;
- implementing effective monitoring and control testing processes to ensure that the business' risk profile is understood and maintained within the appetite defined for each risk;
- timely escalation and reporting of control failures and breaches of policy or appetite, in accordance with the timescales/other escalation requirements set out in the control framework;
- establishing and managing remediation action plans to address control weaknesses or instances of risk exposures outside of appetite; and
- producing regular and *ad hoc* risk reports as required by the CRO, Risk Framework Owner, ExCo, Board or Risk Function.

4.5 **Risk Function**

Reporting to the CRO, the Bank's risk function's responsibilities include:

- challenging the Bank's risk appetite to support the setting of Bank operating limits that are appropriate and maintain the success and solvency of the Bank;
- monitoring and challenging risk management information (**MI**) submitted to second line committees and to consider current and emerging risks across the Bank and challenging MI submitted to first line committees;
- overseeing the Risk Management Framework and supporting consistent and effective implementation;
- providing review and challenge to the delegated authorities proposed by the first line;
- overseeing breaches of limits and ensuring appropriate escalation, mitigation actions and reporting to the ERC;
- reviewing the proposed control remediation programmes and action plans designed to bring risk exposure back within risk appetite where it has been exceeded;
- independently monitoring the semi-annual certification process and reporting on the control effectiveness to the ERC and the BRC; and
- the conducting of thematic reviews/conformance testing against areas of risk within the business that are deemed to require additional assurance due to market conditions or internal risk concentrations.

4.6 **Regulatory Risk**

The Regulatory Risk function is led by the regulatory risk director who reports to the CRO. The regulatory risk director's responsibilities include:

- monitoring and reporting on the Bank's compliance with key regulatory requirements, primarily driven by the FCA's and PRA's rules and guidance;
- monitoring regulatory and legislative change and identifying those changes to be escalated to the Bank's senior executive for action;
- monitoring key risk indicators;
- reporting to the Bank's executive on breaches of regulation and/or the approved risk appetite so that timely corrective actions can be taken;

- advising business lines on the regulator's expectations as applicable to the Bank's on-going conduct of business; and
- chairing the Regulatory Risk Committee and attending the Executive Risk Committee to report on regulatory and conduct risks and issues.

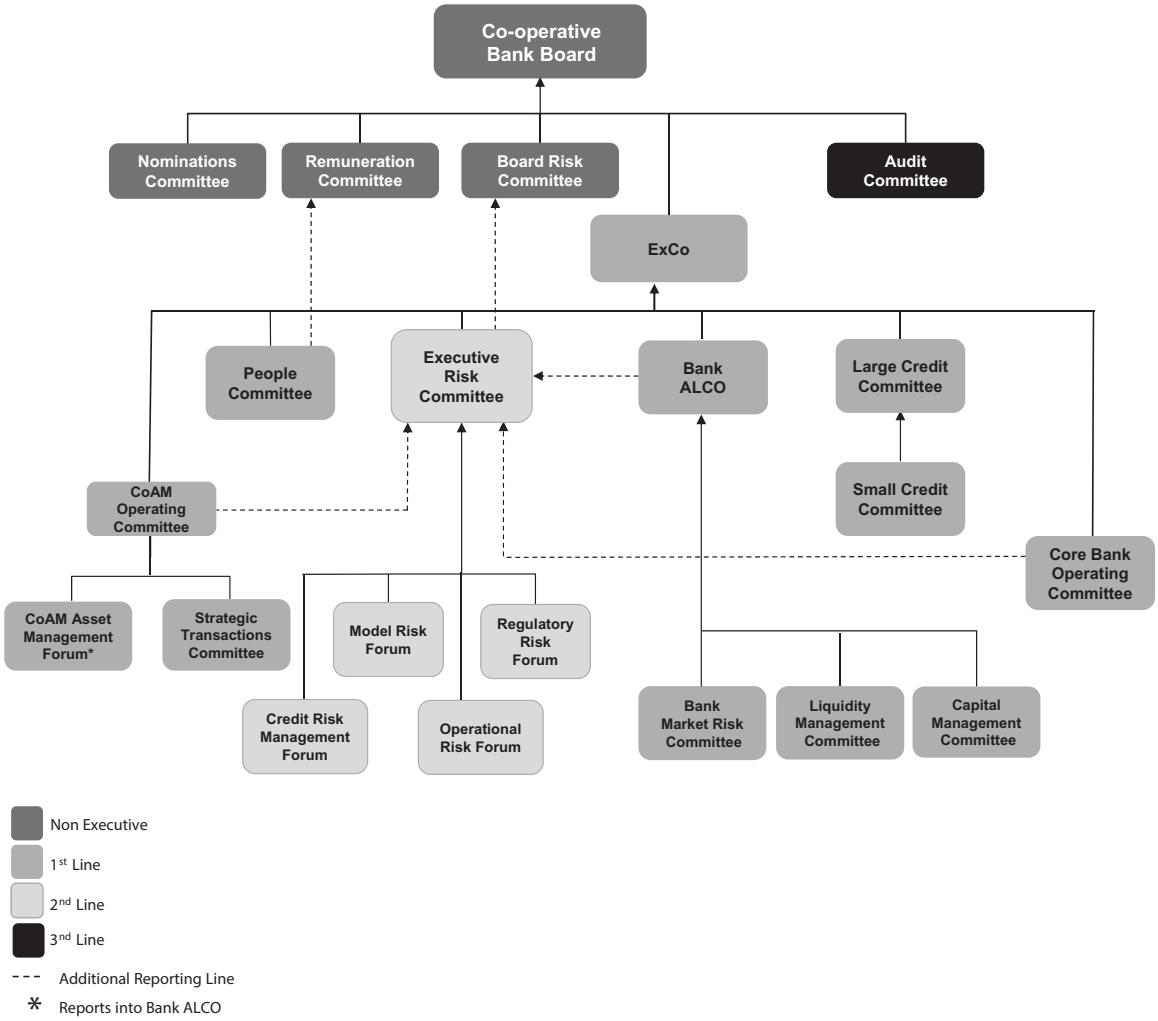
4.7 Internal Audit

The Bank's internal audit function (**Internal Audit**) acts as the third line of defence. They independently challenge the overall management of the framework and provide assurance to the Audit Committee and senior management on the adequacy of both the first and second lines.

Internal Audit is responsible for independently verifying that the Risk Management Framework has been implemented as intended across the business and is embedded and functioning effectively. In addition, the Board should receive reports on the design and operating effectiveness of the control requirements of each Principal Risk in line with the audit function's risk-based approach to audit planning.

5. COMMITTEE OVERSIGHT

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.

The key executive and non-executive risk management committees are as follows:

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 BRC;
- delegating authority for cascading the setting and approval of the more granular risk limits and tolerances to the 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.

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. It also determines and ensures policy on main terms and conditions of employment having regard to applicable good practice on remuneration and corporate governance.

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 Audit Committee, 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.

Audit Committee

Audit Committee responsibilities include:

- assisting the Board in carrying out its responsibilities relating to internal control, including control breaches and remediation; and
- exercising oversight of identified Risk Management Framework failings and weaknesses as well as management actions taken to resolve them.

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 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.

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. The STC ensures that liquidity and funding risk are managed in line with risk appetite, initiating remedial action where necessary.

Any deal sanctioned by the STC must be approved by the CEO and Chief Financial Officer of the Bank or the Treasurer of the Bank 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)

ALCO is chaired by the Chief Financial Officer. 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 solvency position of the Bank is managed in line with policy and that adequate capital is maintained at all times;
- overseeing and monitoring relevant risk control frameworks; and
- recommending relevant principal risk policies and detailed risk appetite limits to the CEO and the ERC for approval.

To assist in carrying out these responsibilities, ALCO is supported by a Treasury Market Risk Committee, Liquidity Management Committee and Capital Management Committee.

People Committee

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

- review all people data within 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.

Core Business Operating Committee

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

CoAM Operating Committee

Chaired by the Executive Director 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, ensuring that the correct governance processes are followed and that a robust and effective control environment exists.

CoAM Asset Management Forum

This is a forum for discussing progress on deleveraging, value-decision making including workout, credit and market opportunities, management of market interface, and oversight of project management of structured and enterprise solutions. It is also where portfolio performance is monitored and strategic changes to plans are proposed.

Operational Risk Forum (ORF)

The purpose of the ORF is to support the Operational Risk Director in the execution of his 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, including the provision of oversight for:

- maintenance of the appropriate authorisations for the regulated entities within the Bank, including oversight of any variation to permissions;
- review and recommend to the ERC for approval of the regulatory risk policy (the **Regulatory Risk Policy**) and conduct risk policy (the **Conduct Risk Policy**);
- review and approval of the Bank's regulatory risk control standard (**Regulatory Risk Control Standard**);
- review and approval of the conduct risk control standard (**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.

Credit Risk Management Forum

The Credit Risk Management Forum 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.

Bank Market Risk Committee (BMRC)

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

Liquidity Management Committee (LMC)

The role of the LMC is to enable more 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 Committee (CMC)

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

Model Risk Forum

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.

6. CREDIT RISK

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

All authority to take credit risk derives from the Board. This authority is delegated to the CEO who then sub-delegates to appropriate 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 principal risk policy for credit risk is 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 fully embedded in the Bank's operations and the business is managed in line with the risk strategy and risk appetite set by the Board. Identified, emerging or current risks are actively managed in line with the Bank's risk management approach of identification, measurement, management, monitoring and reporting. Risk measurement is based on a set of metrics/ratios which are aligned with the risk appetite and support the limits framework.

Timely processes for assessing and reviewing credit risks throughout the credit life cycle are established and documented including completion of risk reports, and credit risk decisions are supported by fully evidenced rationale.

The credit risk control standard has been embedded in each of the business divisions. The Credit Risk Management Forum includes key management information to support the oversight and challenge of the credit risk embedded in each division and across the credit risk life cycle. This includes appropriate benchmarking information from similar portfolios in the market and is key to calibrating risk appetite. The Credit Risk Management Forum is supported by three forums that exist to support the Credit Risk Director in discharging the second line mandate. These include a Reserve Adequacy Forum that was implemented in June 2013 for the first time and 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 including, where necessary, support by an appropriate sampling regime. In addition, a Credit Risk Executive Committee Forum will be implemented in the second half of 2013 as a mechanism for approving and reviewing programmes that may impact on the credit risk appetite or profile of the business, including potential departures from the business plan. 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 uses both application and behavioural scoring techniques to rank a customer's risk of default and this is embedded into the front end of the business, in common with other retail banks. In addition, the corporate division includes a number of specialist models to reflect the embedded credit risk of sectors such as PFI and commercial property. The performance of all rating systems is governed by the Credit Risk Model Review Forum with oversight from a new Model Risk Policy Committee that will meet for the first time during the third quarter of 2013.

7. LIQUIDITY RISK

Liquidity risk arising from the structure of the balance sheet (structural liquidity) and stresses occurring from cash withdrawals from customers are managed in line with policies developed by the Liquidity Management Committee (**LMC**), ALCO and the Board. The Bank's liquidity risk management framework is reviewed and approved annually by the BRC and compliance is reviewed by ALCO and the ERC. The Bank's policy is to ensure that sufficient funds are 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 risk appetite is met.

A summary of the Bank's liquidity risk management framework is noted below:

- risk appetite, controls and governance approach are defined in the Bank's Liquidity and Funding Risk Policy and Control Standard;
- articulation of how liquidity risk is identified, measured, monitored and managed in the individual liquidity adequacy assessment and procedures and governance in place to mitigate the risk;
- liquidity risk quantification and mitigation techniques and processes in place;
- 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;
- on-going development and enhancement of the Bank's liquidity risk appetite framework; and
- a process to attribute the cost, benefit and risks of liquidity to specific business lines via the Bank's funds transfer pricing mechanism.

The Bank monitors its liquidity position on a daily basis via liquidity risk metrics and the LMC meets weekly to oversee the operational liquidity management. A range of early warning indicators are monitored which are used to identify the emergence of increased risk or vulnerabilities in the Bank's liquidity position or potential funding needs. Such indicators are used to identify any negative trend. In the event that a negative trend is identified, an assessment and potential response by management would follow in order to mitigate the Bank's exposure to the emerging risk. The LMC, ALCO and the Board discuss the Board's current and projected liquidity position incorporating business plans. More frequent meetings are held if necessary, for instance when the markets have a heightened period of stress or liquidity shortage. The meetings ensure that the business plans are accurate and can be flexed as required. The liquidity position is reported at least monthly to ALCO and the Bank Board. The LMC 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 in line with the requirements of the FCA's BIPRU regulations and industry guidelines.

The Bank uses a liquidity cash flow model in order to perform various stress tests which 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.

8. MARKET RISK

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. The Treasury department also creates market risk through its investments within its liquid asset portfolios.

The main market risk faced by the Bank is 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 BMRC and the 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 Business and CoAM divisions and consolidated at the centre of the Bank where it is managed from the core balance sheet within agreed limits.

The Treasury department 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 BMRC and ALCO review the balance sheet risk positions and the utilisation of wholesale market risk limits.

Core Business interest rate risk

The Bank uses a gap report and earnings approach for managing interest rate risk, focusing in detail on the sensitivity of assumed changes in interest rates on net interest income for one year.

The BMRC 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's non-trading portfolios (excluding wholesale portfolios), managed by the Treasury department.

All interest rate risk is centralised into the Treasury department, using appropriate transfer pricing rates. Gap reports are based on defined time periods. ALCO set guidance limits around the gap, principally that the sum of positions maturing in more than 12 months and non-sensitive balances (includes non-maturity deposits) is 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 a residual balance, which can fluctuate. In the gap report, the residual balance (along with interest bearing non-maturity deposits) is deemed to re-price 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.

Pipeline risk, in particular for fixed rate mortgages, is the risk that the sales profile does not match the associated hedging assumption resulting in a mismatch between asset and liability and the associated hedge. This is managed through weekly balance sheet meetings. The asset and liability management team undertake hedges for interest rate risk using (i) derivative instruments and investment securities (executed via the Treasury markets team to external wholesale markets, and (ii) loans and deposits) which are executed internally with the Treasury markets team. The Bank is also subject to prepayment risk such that the asset or liability (eg a fixed rate mortgage) repays more quickly or slowly, thereby resulting in a mismatch between the asset or liability and the associated hedge position.

Basis risk is the risk that different assets and liabilities reprice with reference to different indices and at different times, and is principally applicable to the Core Business. This exposes the Bank to income volatility if indices do not move at a ratio of one-to-one. Basis risk is monitored by BMRC and ALCO monthly and action is taken as required, which includes pricing, new products or external hedging. The Bank is also exposed to asset swap spread risk, which is another form of basis risk.

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 per cent. 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 £20 million intraday or £10 million at the close of each day.

9. 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 to reputation;
- *Ineffective organisation design* – the risk that the organisational design does not support 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 and 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.

10. 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. A key component of the Bank's vision to deliver sustainable financial services for members and society is that its customers can trust the Bank to treat them fairly. Demonstrating compliance with all applicable regulatory requirements helps the Bank to maintain this trust and ensures fair treatment of customers.

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. The Bank's Regulatory Risk Policy and Regulatory Risk Control Standard aim to ensure that that regulatory risk is managed in a way that is effective, robust and consistent with the Bank's overall risk appetite and aligned to its vision, purpose and values, by clearly defining the requirements of the regulatory risk management process.

The Bank's inherent regulatory risk exposure is determined by the scope of its permitted activities. The Bank continues to experience, along with the rest of the banking industry, increased levels of government and regulatory intervention in the banking sector through changes to laws and regulations from national and supranational regulators in relation to both conduct and prudential regulation. A strong regulatory risk framework is fundamental to the Bank's business objectives and to maintaining stakeholder confidence.

Regulatory risks are reported to, and overseen by, the RRF which is chaired by the Bank's Regulatory Risk Director. Any regulatory risks outside the Bank's appetite are escalated to the ERC and BRC.

11. OPERATIONAL RISK

The Bank adopts the Basel-standardised approach to the management of operational risk. This 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. The framework continues to be reviewed and enhanced in line with best 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, monitoring of key risk metrics, and scenario analysis. Operational risks and key controls are formally reviewed on a regular basis. Significant operational risks and the associated capital requirements are reported to the ERC and the BRC. These meet regularly to monitor the suitability of the risk management framework and the management of significant risks within the Bank.

The Bank defines operational risk in line with the Basel Accord as "the risk of loss resulting from inadequate or failed internal processes, people and systems or external events." The Bank further categorises operational risk into a number of distinct themes for internal management, monitoring and reporting. These are as follows:

Operational risk theme	**Description**
Financial crime risk	The risk of losses resulting from criminal activity relating to fraud or dishonesty; misconduct in, or misuse of information relating to, a financial market.
Anti-money laundering risk	The risk that the Bank may be used to facilitate the laundering of the proceeds of crime or the financing of terrorist activity.
Legal risk	The risk of a failure to comply with the laws and regulations, including primary and secondary legislation, of the jurisdictions in which the Bank operates.
People risk	The risk characterised by individuals being engaged by other members of Co-operative Group, senior management being on contracts for services with other members of Co-operative Group, an inability to attract and retain sufficiently qualified employees, unduly high employee turnover, loss of key staff, lack of succession planning and staff development, and indicators of behaviours which are not compliant with the Bank's values.
Physical assets and security risk	The risk associated with internal and external threats, either deliberate or accidental, against physical assets, employees and customers that could cause financial and/or non-financial losses and/or damage to or non-availability of Bank assets.
Business continuity planning risk	The risk that the Bank is unable to continue to deliver products or services at acceptable pre-defined levels following a disruptive incident.
Third party suppliers risk	The risk of financial and non-financial loss associated with all third parties relied upon to provide services to functions that support the performance of the Bank.
New product approval risk	The risk in launching new products or modifying existing ones.
Technology risk	The risk of financial and non-financial consequences resulting from the lack of effective IT systems.
Information risk	The risk associated with the theft, loss, corruption, misuse and inadequate quality of business, customer and employee data across the Bank.
Financial reporting risk	The risk of reputational damage, loss of investor confidence and/or financial loss caused by incorrect financial reporting.
Change risk	The risk of change not being implemented successfully and/or that the change adversely impacts the Bank's risk profile.

The Bank also has a corporate insurance programme to transfer specific risks to insurers as part of its risk management approach that is held by Banking Group.

12. REPUTATIONAL RISK

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 member, customer and market confidence.

13. STRATEGIC AND BUSINESS RISK

Strategic and business risk arises from changes to the Bank's business and the environment in which it operates, specifically the risk of not being able to carry out the Bank's business plan and desired strategy.

The Bank's strategy is to grow the business in order to achieve the Bank's vision of becoming the compelling, co-operative alternative in the markets in which we compete.

The Bank Board and senior executive management team set and monitor the strategic plan in the light of this strategy having considered the stresses that extreme, but plausible, scenarios could have upon it.

14. CONDUCT RISK

Conduct risk is a category of risk that relates to regulatory risk and is specifically focused on the risks to which the Bank's customers are exposed. 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 FCA's 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 and, importantly, the primary focus in managing conduct risk within the Bank will be ensuring fair outcomes for all its customers.

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 crystallises.

15. PENSION RISK

Risks are identified at Co-operative Group level, with the impact of any potential changes to contribution assessed under the Bank's risk management framework.

The Bank is exposed to pension risk through two schemes, namely, Pace and the Britannia pension scheme, as further detailed in Section 20 (*Additional Information*) and the paragraph titled "*The contributions that the Bank is required to make to its pension schemes may change over time. The Bank may be obliged to make large one-off payments to the pension schemes if certain events occur*" in Section 2 (*Risk Factors*).

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

Co-operative Group and the Bank have agreed to limit certain risks to the Bank relating to Pace and the Britannia Scheme as further detailed in paragraph 20.10 "*Pensions Undertaking*" in Section 20 (*Additional Information*).

16. RECOVERY AND RESOLUTION PLANNING (RRP)

RRP is a Bank of England/PRA requirement, which has two distinct elements:

- the recovery plan details the Bank's options for addressing a range of financial stresses caused by idiosyncratic problems, market-wide stresses, or both; and
- resolution planning is the provision of information and analysis to the authorities, in order to help them prepare a resolution plan for the Bank.

There are six separate modules for RRP, all of which have gone through formal governance approval.

Since June 2012 when the recovery plan (module two) was put into place, a series of management information triggers and early warning signals are reported each month to the ERC, so that the ERC can determine whether to recommend the invocation of the recovery plan.

15
SEGMENTAL FINANCIAL AND OTHER INFORMATION

SEGMENTAL FINANCIAL AND OTHER INFORMATION

This segmental and other information represents the current division between the Bank's core and non-core businesses. It is consistent with the approach used in Section 8 (*Description of the Bank*), but distinct from the pre-existing division deployed in Section 12 (*Operating and Financial Review*). Prior to the 2012 financial year, the Bank reported its operating segments as 'Retail', 'Corporate and Business Banking' and 'Treasury/Unity Trust Bank', based on differences in products and services. In 2012, the Bank redefined these operating segments into core and non-core business segments. In 2013, the two distinct business areas were further redefined into new core and non-core businesses as: (i) the Retail, BACB and Treasury/other divisions (the **Core Business**); and (ii) the non-core division (the **Non-core Business**), which comprises the Co-operative Asset Management business (**CoAM**). For further information, refer to paragraph 5A titled "*The Core Business and the Non-core Business*" in Section 8 (*Description of the Bank*).

The table below sets out the segmental information reconciliation to the statutory income statement for the six months ended 30 June 2013.

	For the six months ended 30 June 2013 (unaudited)					
	Core Business			*Total*		
	Retail Banking	*BACB*	*Treasury/ other*	*Core Business*	*Non-core Business*	*Total for the Bank*
	(£millions)					
Net interest income	203.5	34.4	6.6	244.5	4.5	249.0
Non-interest income	65.0	7.7	28.3	101.0	5.8	106.8
Operating income	268.5	42.1	34.9	345.5	10.3	355.8
Operating expenses	(242.8)	(27.8)	(16.3)	(286.9)	(30.5)	(317.4)
Impairment losses on loans and advances	(24.8)	(1.4)	–	(26.2)	(469.1)	(495.3)
Impairment losses on investments	–	–	(0.7)	(0.7)	–	(0.7)
Operating result	0.9	12.9	17.9	31.7	(489.3)	(457.6)
Significant items						(346.0)
Share of post-tax profits from joint ventures						0.3
Financial Services Compensation Scheme levies						0.1
Fair value amortisation						(8.2)
Loss before taxation						(811.4)
Income tax						39.4
Loss after taxation						(772.0)

The table below sets out the segmental information reconciliation to the statutory balance sheet statement as at 30 June 2013:

	As at 30 June 2013 (unaudited)					
	Core Business					
	Retail Banking	*BACB*	*Treasury/ other*	*Total Core Business*	*Non-core Business*	*Total*
Segment assets	17,797.1	979.5	11,245.2	30,021.8	14,164.4	44,186.2
Unallocated assets						1,633.9
Total assets for reportable segments						45,820.1
Statutory reclassifications						812.2
Consolidated total assets						46,632.3
Segment liabilities	27,969.4	4,655.3	9,791.5	42,416.2	1,485.6	43,901.8
Unallocated liabilities						724.6
Total liabilities for reportable segments						44,626.4
Statutory reclassifications						991.2
Consolidated total liabilities						45,617.6

The table below sets out a breakdown of the operating costs of the Bank by directorate for the six months ended 30 June 2013:

	For the six months ended 30 June 2013 (unaudited)		
	Core Business	*Non-core Business*	*Total*
Branch Network	46.2	0.2	46.4
Retail	74.1	3.2	77.3
Customer Operations	39.9	4.0	43.9
BACB	8.6	–	8.6
Treasury	4.6	0.2	4.8
Non-core Business	–	10.4	10.4
Head office/support	97.1	9.6	106.7
Other	1.1	0.4	1.5
	271.6	28.0	299.6
Strategic initiatives	11.8	2.5	14.3
Unity Trust Bank	3.5	–	3.5
	286.9	30.5	317.4

A. Core Business

1. PROFIT AND LOSS ACCOUNTS & BALANCE SHEETS

The following table illustrates the financial performance of the Core Business by setting out the operating results for the Core Business and subdividing the results between the Retail Banking Business, the BACB and the Treasury/other, for the six months ended 30 June 2013.

	For the six months ended 30 June 2013 (unaudited)			
	Retail Banking	*BACB*	*Treasury/ other*	*Total Core Business*
	(£millions)			
Net interest income	203.5	34.4	6.6	244.5
Non-interest income	65.0	7.7	28.3	101.0
Total income	268.5	42.1	34.9	345.5
Operating costs				
Steady state	(235.0)	(25.3)	(14.8)	(275.1)
Strategic initiatives	(7.8)	(2.5)	(1.5)	(11.8)
	25.7	14.3	18.6	58.6
Impairment losses	(24.8)	(1.4)	(0.7)	(26.9)
Operating result	0.9	12.9	17.9	31.7

The following table sets out the assets, liabilities and risk-weighted assets of the Core Business and its three business areas as at 30 June 2013.

	As at 30 June 2013 (unaudited)			
	Retail Banking	*BACB*	*Treasury/ other*	*Total Core Business*
	(£millions)			
Gross loans and advances to customers	17,760.5	1,093.7	–	18,854.2
Net loans and advances to customers	17,583.9	1,083.2	–	18,667.1
Segment assets	17,797.1	979.5	11,245.2	30,021.8
Customer deposits	28,132.8	4,655.3	–	32,788.1
Segment liabilities	27,969.4	4,655.3	9,791.5	42,416.2
Risk-weighted assets (B2.5)	2,384.7	1,192.4	1,398.9	4,976.0
Risk-weighted assets (B3 final rules)	2,384.7	1,192.4	2,636.8	6,213.9

The following table sets out a breakdown between the business of the Core Business:

Average net interest margin and spread for the Core Business	*For the six months ended 30 June 2013 (unaudited)*
Net average interest-earning assets	£18,616.1 million
Net average interest-bearing liabilities	£32,835.9 million
Net interest income	£237.9 million
Average yield on average interest-earning assets	2.77%
Average rate on average interest-bearing liabilities	0.91%
Net interest spread	1.86%
Net interest margin	2.56%

2. KEY PERFORMANCE INDICATORS

The following table provides the key performance indicators in relation to the Core Business, and its three business areas as at and for the six months to 30 June 2013.

	As at the six months to 30 June 2013 (unaudited)			
	Retail Banking	*BACB*	*Treasury/ other*	*Total Core Business*
Net interest margin bps[1]	230	685	11	158
Non-interest income/Total income	24.2%	18.3%	81.1%	29.2%
Cost-to-income ratio[2]	87.5%	60.1%	42.4%	79.6%
Non-performing loans ratio[3]	2.2%	2.3%	0.0%	2.2%
Non-performing loans coverage[4]	54.7%	38.2%	0.0%	53.9%
Loan to deposit ratio	63.1%	23.5%	0.0%	57.5%
Cost of risk[5] bps	28	24	–	29

Notes:

(1) The net interest margin is calculated by dividing annualised net interest income by average segment assets.

(2) The cost-to-income ratio is calculated by dividing the steady state costs by total income.

(3) The non-performing loans ratio is calculated by dividing impaired customer balances by gross customer balances.

(4) The non-performing loans coverage ratio is calculated by dividing total credit protection by impaired customer balances.

(5) The cost of risk is calculated by dividing the annualised impairment charge by average assets.

3. LOAN PORTFOLIOS AND DEPOSITS

As at 30 June 2013, the total gross loans and advances of the Core Business to customers were £18.9 billion.

Approximately 42 per cent. of curent lending is made up of customers who have no broader relations with the Bank.

(a) ***Loan Portfolio of the Core Business***

The table below sets out the outstanding loan portfolio (on a gross basis) of the Core Business by business segment as at 30 June 2013.

	As at 30 June 2013 (unaudited)	
	(£millions)	*(percentages)*
BACB balances:		
Business Banking	28.5	0.2
Relationship-managed Banking	804.1	4.3
Larger charities	61.3	0.3
Larger co-operatives	195.1	1.0
Total BACB balances	1,089.0	5.8

	As at 30 June 2013 (unaudited)	
	(£millions)	*(percentages)*
Retail Banking unsecured balances:		
Credit cards	584.5	3.1
Other unsecured	795.1	4.2
Total Retail Banking unsecured balances	1,379.6	7.3
Total Retail Banking secured balances	16,305.2	86.9
Total Core Business gross customer balances	18,773.8	100.0

The following table illustrates the breakdown of impaired loans in the Core Business by setting out the non-performing loans ratio as at 30 June 2013.

	As at 30 June 2013 (unaudited)	
Core Business	*Non-performing loans (percentages)*	*Non-performing loans coverage ratio*
Retail unsecured	16.7	87.1
Retail secured	0.9	5.9
BACB	2.3	38.2
Total Core Business	2.0	53.9

(b) ***Deposits of the Core Business***

The table below sets out the customer deposits of the Core Business, broken down by the Retail Banking and BACB business areas.

	As at 30 June 2013 (unaudited)	
Core Business	*(£millions)*	*(percentages)*
Retail Banking	28,132.8	85.8
BACB	4,655.3	14.2
Total Core Business	32,788.1	100.0

(c) ***Retail Banking unsecured lending***

The following table provides a breakdown of the Retail Banking unsecured lending portfolio, by impairment charge, the net charge rate and the level of credit protection as a percentage of the impaired balances as at 30 June 2013.

		As at 30 June 2013 (unaudited)	
Product type	*Impairment charge[1] (£millions)*	*Net charge rate[2] (percentages)*	*Credit protection as a percentage of impaired balances[3] (percentages)*
Credit cards	1.8	0.7	81.1
Overdrafts	3.6	12.0	101.0
Personal loans	15.0	4.4	103.1
Total	20.4	3.3	90.6

Notes:

(1) The impairment charge is the cost to the profit and loss account of the period-to-period movement in total impairment provision stock, plus write-offs less recoveries. Total impairment provision stock includes impairment raised against up-to-date, delinquent, forborne and charged-off balances.

(2) The net charge rate is the annualised impairment charge divided by gross customer balances.

(3) Credit protection is the total impairment provisions divided by impaired customer balances, which is commonly referred to as the non-performing loans coverage ratio.

(d) ***BACB loan portfolio***

The table below sets out a breakdown of the BACB loan portfolio by industry sector (on a gross basis, including credit commitments) by industry sector as at 30 June 2013.

	As at 30 June 2013 (unaudited)	
Industry	*(£millions)*	*(percentages)*
Accommodation, food and licensed services	87.3	5.9
Business banking	55.0	3.7
Care	71.0	4.8
Education	50.1	3.4
Financial services	64.2	4.3
Football clubs	0.8	0.1
Housing associations	53.4	3.6
Manufacturing	39.9	2.7
Motor trade and garages	33.3	2.2
PFI	–	–
Professional services	62.1	4.2
Property and construction	461.0	30.9
Public sector entities	–	–
Renewable energy	8.1	0.5
Retail and wholesale trade	323.5	21.7
Services	154.0	10.3
Transport, storage and communication	14.9	1.0
Utilities	4.9	0.3
Other	6.2	0.4
Total	1,489.7	100.0

4. LOAN RISK ANALYSIS

The following table shows the distribution of the BACB gross customer balances (including commitments, but excluding Unity Trust Bank) by sector and risk grade as at 30 June 2013.

				As at 30 June 2013 (unaudited) Standard is:			
	Standardised	*Strong*	*Good*	*Satisfactory*	*Weak*	*Default*	*Total*
BACB				*(£millions)*			
Accommodation, food and licensed services	44.6	13.3	29.4	–	–	–	87.3
Business banking	1.1	42.0	7.9	3.0	0.5	0.5	55.0
Care	39.6	17.0	14.4	–	–	–	71.0
Education	38.7	8.4	2.9	0.1	–	–	50.1
Financial services	15.6	25.5	23.1	–	–	–	64.2
Football clubs	–	–	–-	–	–	0.8	0.8
Housing associations	2.2	50.3	0.9	–	–	–	53.4
Manufacturing	9.8	13.5	16.2	0.3	–	0.1	39.9
Motor trade and garages	1.6	12.4	19.3	–	–	–	33.3
PFI	–	–	–	–	–	–	–
Professional services	35.6	14.7	9.5	2.3	–	–	62.1
Property and construction:							
Commercial investment	6.8	16.5	277.1	–	–	–	300.4
Residential investment	4.1	0.6	77.1	–	–	–	81.8
Commercial development	1.2	2.3	44.6	–	–	–	48.1
Residential development	4.9	1.9	20.8	3.1	–	–	30.7
Total property and construction	17.0	21.3	419.6	3.1	–	–	461.0
Public sector entities	–	–	–	–	–	–	–
Renewable energy	8.1	–	–	–	–	–	8.1
Retail and wholesale trade	3.5	308.6	11.4	–	–	–	323.5
Services	116.5	20.2	16.7	0.6	–	–	154.0
Transport, storage and communication	4.0	6.8	3.4	0.3	0.4	–	14.9
Utilities	3.1	1.2	0.6	–	–	–	4.9
Other	3.6	1.7	0.9	–	–	–	6.2
	344.6	556.9	576.2	9.7	0.9	1.4	1,489.7

The following table analyses the exposures of the Core Business subject to forbearance, as at 30 June 2013. Impairment provisions are made for accounts subject to forbearance that are in default or on the watchlist. In cases where the customer benefits from a concession to repayment, the Bank retains the forbearance status until the concession lapses. Where the concession is a one-off, the Bank removes the forbearance status a year after the occurrence of the concession.

		As at 30 June 2013 (unaudited)	
	Forbearance	*Non-forbearance*	*Total*
Core Business		*(£millions)*	
Default	113.8	113.4	227.2
Watchlist	18.8	126.7	145.5
Neither default nor watchlist	525.9	17,875.2	18,401.1

The following table breaks down the gross balances by impairment classification for the BACB and Retail Banking (secured and unsecured) by setting out the credit commitments, impairment provisions, fair value adjustments and a reconciliation to gross customer balances as at 30 June 2013.

	As at 30 June 2013 (unaudited)		
	Retail Banking		
	Secured	*Unsecured*	*BACB*
	(£millions)		
Gross balance	16,358.4	1,402.1	1,093.7
Less: allowance for losses	(4.6)	(172.0)	(10.5)
	16,353.8	1,230.1	1,083.2
Analysis of credit risk exposure:			
Not impaired	16,209.7	1,204.4	1,068.3
Impaired	153.2	197.7	25.4
Credit commitments	486.5	2,303.5	620.6
Gross credit exposure	16,849.4	3,705.6	1,714.3
Fair value adjustments	(4.5)	–	–
Allowances for losses	(4.6)	(172.0)	(10.5)
Net credit risk exposure	16,840.3	3,533.6	1,703.8
Reconciliation of accounting to customer balances:			
Gross balance	16,358.4	1,402.1	1,093.7
Fair value adjustments	4.5	–	–
Other accounting adjustments	(57.7)	(22.5)	(4.7)
Gross customer balances	16,305.2	1,379.6	1,089.0

Details on the impaired loans of the Bank's Core Business, BACB segment as at 30 June 2013

	As at 30 June 2013 (unaudited)			
BACB	*Impaired loan ratio*	*Expected performance*	*Loans with collateral*	*Provision*
		(percentages)		
Business Banking	1.6	52.3	0.0	47.7
Commercial Banking	0.1	0.0	0.9	99.1
Total	0.1	19.6	0.6	79.8

B. Non-core Business

1. LENDING AND LOAN PORTFOLIOS

As at 30 June 2013, the CoAM business total gross loans and advances to customers were £14.9 billion.

2. IMPAIRMENT AND NON-PERFORMING LOANS

The following table sets out the loans within the CoAM portfolio which are on the Bank's watchlist or in default, and the percentage of those which are expected to perform and which have been impaired, covered by collateral or fair value provisions, as at 30 June 2013.

CoAM	*As at 30 June 2013 (unaudited) (millions)*
Loans on the watchlist	1,084.7
Loans in default	2,714.0
Total watchlist/default loans	3,798.7
Loans that are expected to perform	–
Impaired loans, loans with collateral or FV loans	3,798.7

The following table provides a breakdown of the non-performing loans ratio in the CoAM portfolio by asset class. The table also illustrates the percentage of impaired loans that are expected to perform, the percentage against which the Bank holds collateral, and the percentage which the Bank has made a provision for, as at 30 June 2013.

		As at 30 June 2013 (unaudited)		
	Non-performing loans ratio[1]	*Expected performance*[2]	*Loans with collateral*[3]	*Provision*[4]
CoAM		*(percentages)*		
Optimum	16.5	–	100.0	–
Corporates	32.9	23.2	35.2	41.6
CRE	57.1	3.1	63.6	33.3
PFI	2.3	80.2	0.0	19.8
Housing/Associations	0.0	0.0	0.0	0.0
Local authorities	0.0	0.0	0.0	0.0
REAF	1.8	12.6	0.0	87.4
Total Non-core Business	25.1			

Notes

(1) Non-performing loans ratio is calculated by dividing the impaired loan balances by the gross customer balances.

(2) Expected performance is the amount expected to be received as against loans.

(3) Loans with collateral is the percentage of loans covered by collateral.

(4) Provision is the percentage of loans covered by provisions.

The following table provides the gross and net impairment charges for the CoAM portfolio as at 30 June 2013.

CoAM	*As at 30 June 2013 (unaudited) (£millions)*
Net impairment charge	838.6
Fair value unwind	198.6
Gross impairment charge	1,037.2

3. LOAN RISK ANALYSIS

The following table sets out the distribution of the CoAM gross customer balances (including commitments) by sector and risk grade as at 30 June 2013.

	As at 30 June 2013 (unaudited) Standard is:						
CoAM	*Standardised*	*Strong*	*Good*	*Satisfactory*	*Weak*	*Default*	*Total*
				(£millions)			
Accommodation, food and licensed services	169.9	122.8	134.0	20.2	21.7	300.1	768.7
Business banking	–	–	–-	–	–	–	–
Care	142.5	1.6	58.6	23.2	3.7	16.8	246.4
Education	48.6	26.1	–	0.9	–	–	75.6
Financial services	50.3	52.1	5.3	4.4	–	4.5	116.6
Football clubs	–	33.1	–	0.4	0.1	15.1	48.7
Housing associations	5.6	1,032.5	45.9	–	–	–	1,084.0
Manufacturing	35.6	11.7	8.0	16.3	12.2	8.6	92.4
Motor trade and garages	22.5	43.0	5.1	3.5	0.7	1.7	76.5
PFI	–	32.0	1,179.0	13.3	20.9	4.8	1,250.0
Professional services	37.4	0.7	12.1	11.9	0.7	3.7	66.5
Property and construction:							
Commercial investment	33.8	87.5	977.1	241.2	54.9	1,502.6	2,897.1
Residential investment	4.1	–	111.4	44.9	63.7	139.3	363.4
Commercial development	0.5	0.2	132.4	72.8	2.4	60.4	268.7
Residential development	1.0	–	41.5	11.7	2.9	11.1	68.2
Total property and construction	39.4	87.7	1,262.4	370.6	123.9	1,713.4	3,597.4
Public sector entities	172.9	0.3	–	–	–	–	173.2
Renewable energy	631.0	–	–	–	–	9.3	640.3
Retail and wholesale trade	66.2	93.8	16.4	11.9	1.1	19.3	208.7
Services	282.0	107.5	19.4	29.7	0.6	33.8	473.0
Transport, storage and communication	20.8	8.8	0.5	6.3	0.9	28.7	66.0
Utilities	39.8	-	0.8	0.9	–	0.6	42.1
Other	3.2	0.6	0.5	2.2	–	2.1	8.6
	1,767.7	1,654.3	2,748.0	515.7	186.5	2,162.5	9,034.7

The following table sets out the fair value of the property collateral held against assets in the CoAM CRE portfolio (on a gross basis) as at 30 June 2013.

CoAM CRE portfolio	*Exposure*	*As at 30 June 2013 (unaudited) Impairment Collateral (£millions)*	*Provision*
Non-defaulting loans with <= 1 year & all defaulted exposures regardless of term			
Less than 50 per cent.	36.5	34.8	1.7
50 per cent. to 60 per cent.	69.6	68.2	1.4
60 per cent. to 70 per cent.	159.8	153.6	6.1
70 per cent. to 80 per cent.	124.3	119.2	5.1
80 per cent. to 90 per cent.	102.7	95.1	7.6
90 per cent. to 100 per cent.	81.2	70.7	10.5
Greater than 100 per cent.	1,378.1	877.4	462.2
Unsecured	245.8	–	161.2
Total non-defaulting loans with <= 1 year & all defaulted exposures regardless of term	2,198.0	1,419.0	655.8
Non-defaulting loans with > 1 year			–
Less than 50 per cent.	106.8	106.8	–
50 per cent. to 60 per cent.	237.4	237.4	–
60 per cent. to 70 per cent.	445.4	445.4	–
70 per cent. to 80 per cent.	320.4	320.4	–
80 per cent. to 90 per cent.	74.0	74.0	–
90 per cent. to 100 per cent.	63.3	63.3	–
Greater than 100 per cent.	67.9	42.4	–
Unsecured	84.2	–	–
Total non-defaulting loans with > 1 year	1,399.4	1,289.7	–

The following table sets out the CoAM portfolio exposures subject to forbearance, as at 30 June 2013. Impairment provisions are made for accounts subject to forbearance (on a gross basis) which are in default or on the watchlist. In cases where the customer benefits from a concession to repayment, the Bank retains the forbearance status until the concession lapses. Where the concession is a one-off, the Bank removes the forbearance status a year after the occurrence of the concession.

CoAM (excluding Optimum)	*Forbearance*	*As at 30 June 2013 (unaudited) Non-forbearance (£millions)*	*Total*
Default	1,390.4	772.1	2,162.5
Watchlist	246.0	192.4	438.4
Neither default nor watchlist	88.7	6,345.1	6,433.8

The following table breaks down the gross balances by impairment classification for CoAM, by setting out the credit commitments, impairment provisions, fair value adjustments and reconciliation to gross customer balances, as at 30 June 2013.

CoAM (excluding Optimum)	*As at 30 June 2013 (unaudited) (£millions)*
Gross balance	7,772.1
Less: allowance for losses	(838.6)
	6,933.5
Analysis of credit risk exposure:	
Not impaired	5,361.0
Impaired	2,609.7
Credit commitments	1,113.4
Gross credit exposure	9,084.1
Fair value adjustments	(198.6)
Allowances for losses	(838.6)
Net credit risk exposure	8,046.9
Reconciliation of accounting to customer balances:	
Gross balance	7,772.1
Fair value adjustments	198.6
Other accounting adjustments	(49.7)
Gross customer balances	7,921.0

16
FINANCIAL INFORMATION

PART A: AUDITED FINANCIAL INFORMATION FOR THE SIX MONTHS ENDED 30 JUNE 2013

The Co-operative Bank plc

Financial information for six months ended 30 June 2013

Part of The **co-operative** banking group

Contents

Consolidated financial information
- Consolidated income statement 281
- Consolidated statement of comprehensive income 282
- Consolidated balance sheet 283
- Consolidated statement of cash flows 284
- Consolidated statement of changes in equity 286

Basis of preparation and accounting policies 287
Critical judgments and estimates 305
Risk management 310
Capital management 339
Notes to the financial information 342

Reference is made to the Bank, the consolidated Co-operative Banking Group and the wider Co-operative Group throughout this financial information. Information in relation to the Bank and its subsidiary undertakings is referred to as 'the Bank', information relating to the consolidated Co-operative Banking Group is referred to as 'the Banking Group' and information relating to the wider Co-operative Group is referred to as 'the Group'.

In setting out the Bank's main risks and uncertainties, and likely future developments, this document contains statements which, by their nature, cannot be considered indications of likelihood or certainty. The statements are based on the knowledge and information available at the date of preparation of the report and accounts and are believed to be reasonable judgments. These statements should not be construed as a profit forecast.

Consolidated income statement

For the period ended 30 June 2013

All amounts are stated in £m unless otherwise indicated

		Period to 30 June 2013			*Period to 30 June 2012*		
	Notes	*Before significant items*	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
Interest receivable and similar income	2	715.6	(39.0)	676.6	744.7	–	744.7
Interest expense and similar charges	2	(470.8)	–	(470.8)	(473.5)	–	(473.5)
Net interest income		244.8	(39.0)	205.8	271.2	–	271.2
Fee and commission income	3	116.2	(94.0)	22.2	128.0	(40.0)	88.0
Fee and commission expense	3	(36.2)	–	(36.2)	(41.2)	–	(41.2)
Net fee and commission income		80.0	(94.0)	(14.0)	86.8	(40.0)	46.8
Net trading income	4	1.1	–	1.1	9.3	–	9.3
Other operating income	5	26.0	–	26.0	39.8	–	39.8
Operating income		351.9	(133.0)	218.9	407.1	(40.0)	367.1
Operating expenses	6	(321.7)	(213.0)	(534.7)	(294.3)	(39.3)	(333.6)
Financial Services Compensation Scheme levies	27	0.1	–	0.1	(0.8)	–	(0.8)
Impairment losses on loans and advances	11	(496.0)	–	(496.0)	(94.6)	–	(94.6)
Impairment gains on investments	12	–	–	–	2.7	–	2.7
Operating (loss)/profit		(465.7)	(346.0)	(811.7)	20.1	(79.3)	(59.2)
Share of post tax profits from joint ventures	31	0.3	–	0.3	0.6	–	0.6
(Loss)/profit before taxation		(465.4)	(346.0)	(811.4)	20.7	(79.3)	(58.6)
Income tax	7	(41.0)	80.4	39.4	(6.1)	19.4	13.3
(Loss)/profit for the period		(506.4)	(265.6)	(772.0)	14.6	(59.9)	(45.3)
Attributable to:							
Equity shareholders	8	(506.7)	(265.6)	(772.3)	13.8	(59.9)	(46.1)
Minority interests		0.3	–	0.3	0.8	–	0.8
		(506.4)	(265.6)	(772.0)	14.6	(59.9)	(45.3)
(Losses)/earnings per share	8	(6.18)p	(3.24)p	(9.42)p	0.17p	(0.73)p	(0.56)p

The significant items in 2013 relate to:

- £10.0m (2012: £nil) of provisions made for potential customer redress relating to past sales of interest rate swaps (notes 2 and 27);
- £53.0m (2012: £40.0m) of provisions made for potential customer redress relating to past sales of payment protection insurance (notes 3 and 27);
- £30.0m (2012: £nil) of provisions made for potential customer redress relating to the processing of first payments on certain mortgages (notes 6 and 27). A further £3.7 million of redress costs relating to interest payments are included in the results before significant items;
- £26.0m (2012: £nil) of provisions made for potential customer redress relating to alleged failings in the introduction of third party sales of card and identity protection products (notes 3 and 27);
- £15.0m (2012: £nil) of provisions made for potential customer redress relating to arrears charges (notes 3 and 27);
- £29.0m (2012: £nil) of provisions made for potential customer redress following identification of a technical breach of the Consumer Credit Act (notes 2 and 27);
- £10.0m (2012: £20.0m) of costs incurred as a result of the bid for the Lloyds Bank branches (note 6);
- £14.7m (2012: £19.3m) of costs incurred on a programme of investment and integration (note 6);
- £9.9m (2012: £nil) of impairment of property, plant and equipment (note 6); and
- £148.4m (2012: £nil) of recharged costs relating to intangible asset impairment regarding the development of new banking systems (note 6).

The accounting policies and notes on pages 287 to 389 form part of this financial information.

Consolidated statement of comprehensive income

For the period ended 30 June 2013

All amounts are stated in £m unless otherwise indicated

	Period to 30 June 2013			*Period to 30 June 2012*		
	Equity shareholders	*Minority interests*	*Total*	*Equity shareholders*	*Minority interests*	*Total*
(Loss)/profit for the period	(772.3)	0.3	(772.0)	(46.1)	0.8	(45.3)
Other comprehensive (expense)/ income that may be recycled to profit or loss:						
Changes in cashflow hedges						
Net changes in fair value recognised directly in equity	(39.9)	(0.5)	(40.4)	32.4	(0.3)	32.1
Income tax	9.2	0.1	9.3	(3.9)	0.1	(3.8)
Transfers from equity to income or expense	(10.6)	–	(10.6)	(23.1)	(0.1)	(23.2)
Income tax	2.4	–	2.4	2.5	–	2.5
Changes in available for sale assets						
Net changes in fair value recognised directly in equity	(44.4)	–	(44.4)	159.3	–	159.3
Income tax	10.0	–	10.0	(40.7)	–	(40.7)
Transfers from equity to income or expense	13.4	–	13.4	(89.3)	–	(89.3)
Income tax	(3.1)	–	(3.1)	23.7	–	23.7
Other comprehensive (expense)/ income for the period, net of income tax	(63.0)	(0.4)	(63.4)	60.9	(0.3)	60.6
Total comprehensive (expense)/ income for the period	(835.3)	(0.1)	(835.4)	14.8	0.5	15.3

The accounting policies and notes on pages 287 to 389 form part of this financial information.

Consolidated balance sheet
At 30 June 2013
All amounts are stated in £m unless otherwise indicated

	Notes	*30 June 2013*	*30 June 2012*
Assets			
Cash and balances at central banks	9	5,402.1	4,316.6
Loans and advances to banks	10	1,737.5	2,359.7
Loans and advances to customers	11	32,715.9	34,008.4
Fair value adjustments for hedged risk	11	217.0	368.2
Investment securities – loans and receivables	12	30.6	483.0
Investment securities – available for sale	12	3,429.7	3,217.6
Investment securities – fair value through income or expense	12	1,622.3	817.4
Investment securities – held for trading	12	–	439.0
Derivative financial instruments	13	804.3	910.8
Equity shares	14	5.7	5.7
Investments in joint ventures	31	4.3	3.4
Goodwill	15	–	0.6
Intangible fixed assets	16	29.9	37.9
Investment properties	17	153.0	172.2
Property, plant and equipment	18	48.4	72.2
Amounts owed by other Co-operative Group undertakings	32	0.5	288.9
Other assets	19	44.4	51.7
Prepayments and accrued income	20	16.9	17.6
Current tax assets		266.3	37.3
Deferred tax assets	28	103.5	109.9(1)
Total assets		46,632.3	47,718.1
Liabilities			
Deposits by banks	21	3,517.8	4,416.0
Customer accounts		34,166.3	33,054.7
Customer accounts – capital bonds	22	756.0	1,141.7
Debt securities in issue	23	4,610.0	4,146.8
Derivative financial instruments	13	662.7	983.1
Other borrowed funds	24	1,248.1	1,257.1
Amounts owed to other Co-operative Group undertakings	32	123.9	97.7
Other liabilities	25	88.5	90.6
Accruals and deferred income	26	33.9	26.4
Provisions for liabilities and charges	27	293.0	104.4
Deferred tax liabilities	28	117.4	111.5(1)
Total liabilities		45,617.6	45,430.0
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	33	410.0	410.0
Share premium account	33	8.8	8.8
Retained earnings		532.0	1,687.7
Available for sale reserve		5.9	72.5
Cashflow hedging reserve		24.8	75.5
		981.5	2,254.5
Minority interests		33.2	33.6
Total equity		1,014.7	2,288.1
Total liabilities and equity		46,632.3	47,718.1

(1) The 2012 balance sheet comparatives have been re-presented to reflect that certain deferred tax liabilities cannot be offset against the deferred tax assets.

The accounting policies and notes on pages 287 to 389 form part of this financial information.

Consolidated statement of cash flows
For the period ended 30 June 2013
All amounts are stated in £m unless otherwise indicated

	Period to 30 June 2013	*Period to 30 June 2012*
Cash flows from operating activities		
Loss before taxation	(811.4)	(58.6)
Adjustments for:		
Increase in prepayments and accrued income	(7.7)	(0.2)
Increase/(decrease) in accruals and deferred income	23.9	(18.9)
Interest payable in respect of other borrowed funds	45.3	36.3
Effect of exchange rate movements	(12.8)	8.6
Fair value movement on investment properties	18.9	(0.1)
Impairment losses on loans and advances	495.8	95.8
Movements on investment impairments	(19.0)	(2.7)
Depreciation and amortisation	4.8	8.4
Impairment of intangible fixed assets	2.0	–
Interest amortisation	(0.2)	(4.7)
Fair value movements and amortisation of investment securities	44.0	(55.6)
Impairment of property, plant and equipment	9.9	–
Profit on disposal of property, plant and equipment	–	(0.4)
Unwind of fair value adjustments arising on transfer of engagements	8.2	(19.7)
Preference dividend	2.8	2.8
	(195.5)	(9.0)
(Decrease)/increase in deposits by banks	(94.2)	1,113.3
Decrease in customer accounts and capital bonds	(1,850.1)	(2,223.7)
Decrease in debt securities in issue	(148.4)	(59.7)
(Increase)/decrease in loans and advances to banks	(41.4)	76.9
Decrease/(increase) in loans and advances to customers	291.2	(278.5)
Decrease/(increase) in amounts owed by other Co-operative Group undertakings	255.9	(109.7)
Increase/(decrease) in amounts owed to other Co-operative Group undertakings	11.9	(34.6)
Net movement of other assets and other liabilities	(224.7)	(128.8)
Income tax received/(paid)	16.4	(0.7)
Net cash flows from operating activities	(1,978.9)	(1,654.5)
Cash flows from investing activities		
Purchase of tangible and intangible fixed assets	(0.5)	(0.5)
Proceeds from sale of fixed assets	–	0.8
Proceeds from sale of investment property	1.3	0.7
Purchase of investment securities	(2,033.8)	(2,176.7)
Proceeds from sale and maturity of investment securities	3,875.2	1,981.5
Net cash flows from investing activities	1,842.2	(194.2)

	Period to 30 June 2013	*Period to 30 June 2012*
Cash flows from financing activities		
Interest paid on other borrowed funds	(44.3)	(48.1)
Dividends paid to minority interests	(0.1)	(0.3)
Preference share dividends paid	(2.8)	(2.8)
Net cash flows from financing activities	(47.2)	(51.2)
Decrease in cash and cash equivalents	(183.9)	(1,899.9)
Cash and cash equivalents at the beginning of the period	6,314.2	7,888.4
Cash and cash equivalents at the end of the period	6,130.3	5,988.5
Cash and balances with central banks (note 9)	5,331.7	4,278.3
Loans and advances to banks (note 10)	673.6	1,450.2
Short term investments (note 12)	125.0	260.0
	6,130.3	5,988.5

The cash flows cannot be directly reconciled to the balance sheet movements as these movements include the non-cash unwinds of the fair value adjustments arising on the transfer of engagements of Britannia Building Society.

The 2012 comparatives have been re-presented to reflect a correction of the analysis of loans and advances to banks between the cash and cash equivalent analysis and the increase/decrease in loans and advances to banks line.

The accounting policies and notes on pages 287 to 389 form part of this financial information.

Consolidated statement of changes in equity

For the period ended 30 June 2013

All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Bank							
	Share capital	*Share premium*	*Available for sale reserve*	*Cashflow hedging reserve*	*Retained earnings*	*Total*	*Minority interest*	*Total equity*
Period from 1 January 2013 to 30 June 2013								
At the beginning of the period	410.0	8.8	30.0	63.7	1,304.3	1,816.8	33.4	1,850.2
Total comprehensive income for the period	–	–	(24.1)	(38.9)	(772.3)	(835.3)	(0.1)	(835.4)
Transactions with owners recorded directly in equity:								
Dividend	–	–	–	–	–	–	(0.1)	(0.1)
At the end of the period	410.0	8.8	5.9	24.8	532.0	981.5	33.2	1,014.7
Period from 1 January 2012 to 30 June 2012								
At the beginning of the period	410.0	8.8	19.5	67.6	1,733.8	2,239.7	33.4	2,273.1
Total comprehensive income for the period	–	–	53.0	7.9	(46.1)	14.8	0.5	15.3
Transactions with owners recorded directly in equity:								
Dividend	–	–	–	–	–	–	(0.3)	(0.3)
At the end of the period	410.0	8.8	72.5	75.5	1,687.7	2,254.5	33.6	2,288.1

The accounting policies and notes on pages 287 to 389 form part of this financial information.

Basis of preparation and significant accounting policies
For the period ended 30 June 2013

1. Basis of preparation

The Bank's financial information has been prepared and approved by the directors in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and IFRS Interpretations Committee (IFRIC) guidance as adopted by the European Union (EU).

Standards and interpretations issued and effective

In preparing this consolidated financial information, the Bank has adopted the following pronouncements during the year that are new or revised:

- *IFRS 13 (Fair Value Measurement (2011))*

  This new standard defines fair value and also acts as its single authority, dealing primarily with both its measurement and disclosure. It does not require fair value measurements in addition to those already required, or permitted by other IFRSs, and is not intended to establish valuation standards or affect valuation practices outside of financial reporting. The adoption of this new standard resulted in additional disclosures set out in note 34.

- *Amended IAS 1 (Presentation of Items of Other Comprehensive Income)*

  This amendment's objective is to split the presentation of other comprehensive income into two sections. The different sections will distinguish between items which may or may not be recycled into any future income or expense. The amendment to IAS 1 has no material impact on the financial information of the Bank.

- *Revised IAS 19 (Employee Benefits (2011))*

  This revision covers the standard's recognition, measurement and presentation criteria with regard to a pension scheme's expense contained within IAS 19's 'defined benefit' scope. Actuarial gains or losses will now be fully recognised within income or expense, thus removing the previous partial recognition of 'corridor and spreading'.

  Furthermore, the revision eliminates the 'expected return on assets' from the measurement of a pension's expense and directs entities to instead charge a cost of finance against its net unfunded liability position.

  When determining a discount rate, that calculates a pension obligation's present value, reference should be made to market yields. These yields should be matched to high quality corporate bonds, in terms of both the obligation's currency and maturity, ahead of any previously assumed government bond yield reference point.

  The adoption of this revised standard resulted in additional disclosure (see note 29). The impact to income statement was immaterial to 30 June 2013 as the rate of future contributions remains unchanged. Contributions are reviewed triennially as part of the Pace scheme's valuation.

- *Amendments to IFRS 7 (Disclosures Offsetting Financial Assets and Liabilities)*

  This amendment requires disclosures to include information that will enable users of an entity's financial information to evaluate the effect of netting arrangements, on the entity's financial position. The amendment to IFRS 7 has no material impact on the financial information of the Bank.

Standards and interpretations issued but not yet effective

- *IFRS 9 (Financial Instruments: Classification and Measurement (2010))*

  This new standard replaces IAS 39 (Financial Instruments: Recognition and Measurement (2009)). Phase one requires financial assets to be classified as at amortised cost or at fair value. Further phases of IFRS 9 are scheduled to cover impairment and hedge accounting.

  It becomes effective for accounting periods beginning on or after 1 January 2015. Early adoption is permitted, once endorsed by the EU. The impact of IFRS 9 is likely to be material to the Bank, due to the value of financial instruments held on the Bank's balance sheet. The standard is currently being drafted and so a detailed assessment of its impact is not currently possible.

- *IFRS 10 (Consolidated Financial Statements (2011))*

  This new standard establishes principles for the presentation and preparation of consolidated financial information when an entity controls one or more other entities. It supersedes both IAS 27 (Consolidated and Separate Financial Statements (2008)) except where IAS 27 still applies as noted below, and Amended SIC 12 (Consolidation: Special Purpose Entities (2004)). It aims to provide transparency in identifying off balance sheet, parent subsidiary relationships, using a consistent basis for determining the existence and thus consolidation of those underlying entities being controlled by the reporting entity.

  It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact to the Bank of IFRS 10 is likely to be immaterial.

- *IFRS 11 (Joint Arrangements (2011))*

  This new standard establishes principles for financial reporting by parties to a joint arrangement. It supersedes both IAS 31 (Interests in Joint Ventures (2010)) and Amended SIC 13 (Jointly Controlled Entities: Non-Monetary Contributions by Venturers (2007)). Recognition criteria now distinguish between joint operations and joint ventures on their relative 'rights and obligations' scope. A joint operation interest is accounted for between assets, liabilities, revenue and expense, whilst a joint venture is restricted to equity accounting.

  It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact to the Bank of IFRS 11 is likely to be immaterial.

- *IFRS 12 (Disclosure of Interests in Other Entities (2011))*

  This new standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It aims to provide disclosure transparency on the reporting entity's risks associated with its interests in other entities, in conjunction with IFRS 10's application which determines the existence of such entities.

  It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact to the Bank of the additional disclosure requirements is likely to be immaterial.

- *Amended IAS 27 (Consolidated and Separate Financial Statements (2011))*

  This amendment occurs as a direct consequence of IFRS 10's issuance, which now acts as the new single authority on consolidation requirements. IAS 27's scope has therefore reduced and focuses more specifically on separate financial information accounting bases. An entity shall therefore prepare its separate financial information using one of two bases; either at cost or in accordance with IFRS 9.

  It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact of the amendment to IAS 27 is likely to be immaterial to the Bank.

- *Amended IAS 28 (Investments in Associates and Joint Ventures (2011))*

  This amendment occurs as a direct consequence of IFRS 11's issuance, which now acts as the new single authority on joint arrangements. IAS 28 changes in order to consistently apply equity accounting methods for both joint ventures and associates. An entity shall therefore use IAS 28's equity accounting method, when accounting for any of IFRS 11's joint arrangements.

  It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact of the amendment to IAS 28 is likely to be immaterial to the Bank.

- *Amendments to IAS 32 (Offsetting Financial Assets and Financial Liabilities)*

  The current offsetting model in IAS 32 requires an entity to offset a financial asset and financial liability only when the entity currently has a legally enforceable right of set-off and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. This amendment clarifies the position when offsetting financial assets and financial liabilities. The legal right of set-off must be available today and legally enforceable for all counterparties in the normal course of business, as well as in the event of default, insolvency or bankruptcy. The amended disclosures will require more extensive disclosures than are currently required. The disclosures focus on quantitative information about recognised financial instruments that are offset in the statement of financial position, as well as those recognised financial instruments that are subject to master netting or similar arrangements irrespective of whether they are offset.

  It becomes effective for accounting periods beginning on or after 1 January 2014. It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact of the amendment to IAS 32 is likely to be immaterial to the Bank.

  Other standards and interpretations have been issued but these are not considered to be relevant to the Bank's operations.

2. Going concern

a. **Introduction**

This financial information is prepared on a going concern basis. The directors have a reasonable expectation that the Bank will have the resources to continue in business for the foreseeable future, subject to the comments below.

The assessment of the going concern basis of preparation has been subject to a thorough process involving analysis and discussion by management, Executive and Board committees and the Board, in line with our governance processes and discussion with the PRA. This analysis covered forecast information for the Bank's planning period, 2013-2018, with a particular focus on the period up to and including 2015, as well as the management actions agreed as part of the Recapitalisation Plan (as defined and detailed below). The forecasts covering the planning period included stressed scenarios, which the Board considered to be reasonable and appropriate.

Since the publication of its unaudited interim financial report for the six month period ended 30 June 2013, on 29 August 2013, the Bank has continued to work on its plan and has continued its engagement with the PRA in relation to this plan. The successful execution of the Recapitalisation Plan, is intended to significantly strengthen the Bank's capital base through the generation of an additional £1.5bn of common equity tier 1("CET1") capital, and to reshape the business as a core relationship bank. This is intended to enable the Bank to meet the requirement to hold CET1 resources of at least 7% of risk weighted assets. Despite this, the Bank is currently below the Individual Capital Guidance for total capital set by the PRA, and is forecast to remain so for most of the duration of the planning period. The PRA has reviewed and accepted this plan.

Nevertheless, at present, there is material uncertainty around the implementation of the Recapitalisation Plan, a cornerstone of which is the Exchange Offer, as outlined below.

b. **Recapitalisation Plan**

Continuing losses in the first half of 2013 have reduced capital to a point where if the Exchange Offer, discussed below, does not take place, the Bank would not remain a going concern. Successful execution of the Recapitalisation Plan is necessary in order for the Bank to remain a going concern. Total Basel II capital resources as at 30 June 2013 are £1.5bn (30 June 2012: £3.1bn) with core tier 1 capital after regulatory deductions of £0.8bn (30 June 2012: £2.0bn). As at 30 June 2013, the Bank's CET1 ratio stands at 3.0% on a Basel III end point basis, representing a shortfall to the PRA's direction that, based on Basel III end point rules, major UK banks should hold CET1 capital resources of at least 7% of their risk weighted assets by December 2013.

In the Bank's 17 June 2013 announcement, updated on 4 November, the directors acknowledged a £1.5bn CET1 capital shortfall. To address this, the current plan (the Recapitalisation Plan) announced on 4 November comprises the following:

i. **Exchange Offer**

The Exchange Offer, is forecast to generate approximately £1.14bn of CET1 capital towards the end of 2013 and comprises the following components:

a) £1.019bn to be generated, net of £43m of expenses, via an Exchange Offer to holders of the Bank's subordinated capital securities including the issue of £129m Co-operative Group bonds and £206m of new Bank Tier 2 bonds; and

b) Lower Tier 2 investors injecting £125m of new equity capital, fully underwritten by a group of Lower Tier 2 bondholders.

ii. **Further contribution in 2014**

A further cash contribution to the Bank in 2014 of £333m, committed by The Co-operative Banking Group, is expected to be sourced primarily from the sale proceeds of the Insurance businesses. This contribution is contingent on a successful Exchange Offer. The Co-operative Banking Group has informed the Bank that it has appropriate arrangements in place to satisfy the discharge of this further contribution in the event that the proceeds for the sale of Insurance businesses are not sufficient to satisfy The Co-operative Banking Group's contribution of £333m or otherwise not received in time to satisfy the PRA's required timing for the satisfaction of this commitment. Based on the information provided by The Co-operative Banking Group and on investigations made by and on behalf of the Bank, the Bank believes that the incorporation of this contribution into its plans is appropriate. In addition, retiring the subordinated capital securities is expected to generate interest savings of approximately £40m in 2014.

iii. **Refocus on core relationship banking proposition**

The Co-operative Bank remains a strong brand and continues to maintain a loyal customer base. Moving forward, the strategy is to reshape the business as a core relationship bank providing business banking and standard retail banking services including but not limited to current accounts, loans, credit cards, residential mortgages and savings products to individuals and small businesses and restructuring the business, including head office costs, to drive a significant reduction of the cost base.

A key underpin of the reshaping of the business is the reduction in the non-core banking business and assets, which carry the majority of the impairment risk for the Bank currently. This will reduce the risk weighted assets of the Bank, thereby improving its Basel III CET1 and leverage ratios.

Risks and uncertainties

Risks associated with successful execution of the Recapitalisation Plan include:

i. Successful execution and completion of the Exchange Offer within the required timeframe;

ii. Continued ability of The Co-operative Banking Group to enhance the capital of the Bank through the 2014 contribution;

iii. The ability of the Bank to implement the plan and to achieve the results set out in the plan. In this respect particular challenges include (but are not limited to): ability to achieve the targeted cost savings; ability to retain customers and deposits; the timing and quantum of impacts to capital from the asset reduction exercise; meeting its planned improvements in net interest margin; a possible further deterioration in the quality of the Bank's asset portfolio; unplanned costs from (for example) conduct risk matters and ability to maintain the Bank's access at an appropriate cost to liquidity and funding;

iv. The ability of the Bank to raise further tier 2 capital which is assumed in its forecasts covering the planning period; and

v. The Bank needs the continuing support of the PRA in accepting and moving forward with its plan and to the extent this is not forthcoming or to the extent that the Bank doesn't perform in line with its plan, additional capital over and above that included in the plan may be required. This could also be the case if there are increases in regulatory capital requirements as a result of changes to international regulations (e.g. Basel III) or other changes to legislation or other market wide regulatory requirements.

The Recapitalisation Plan is forecast to increase CET1 capital by approximately £1.14bn in 2013 and an additional £333m generated in 2014 from The Co-operative Banking Group's contribution and £40m of interest savings on retired bonds. The Bank's Basel III end point CET1 ratio is forecast to move above 7% following the successful completion of the Exchange Offer. These strengthened capital ratios will put the Bank in a better position to withstand future market wide or idiosyncratic stresses.

c. **Liquidity**

The Bank has continued to maintain an acceptable liquidity position through the period to 30 June 2013, with a liquid asset ratio of 13.2% (30 June 2012: 12.4%). In addition, during the first half of 2013, the Bank proactively managed its liquidity position, maintaining a regulatory liquidity buffer, and has continued to restructure existing exposures to improve the funding profile.

Retail deposits have remained broadly stable in the period to 30 June 2013, however the Bank recognises that liquidity risk is particularly elevated until the short term objectives under the Recapitalisation Plan have been achieved.

d. **Conclusion**

The directors have concluded that risks set out above in connection with the Recapitalisation Plan, a cornerstone of which is the Exchange Offer, and their potential consequential effects, represent a material uncertainty which may cast significant doubt upon the Bank's ability to continue as a going concern. The Bank may, therefore, be unable to continue realising its assets and discharging its liabilities in the normal course of business. Nevertheless, after making enquiries and considering the current forecasts, in particular those for the period up to and including 2015, and taking into account the material uncertainty described above, the directors have a reasonable expectation that the Bank will have adequate resources to continue in business over this period. For these reasons, they continue to adopt the going concern basis in preparing this financial information. This set of financial information does not include the adjustments that would result if the Bank was unable to continue as a going concern.

Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in this financial information.

1. Business combinations

On 1 August 2009, The Co-operative Bank p.l.c merged with Britannia Building Society, with Britannia transferring their engagements to the Bank.

This business combination has been accounted for applying the requirements of IFRS 3 (Business Combinations (2004)).

The consideration transferred was valued by reference to the members' interests acquired. Financial assets and liabilities which, following the Bank's accounting policies, would be carried at amortised cost, were brought onto the balance sheet at their fair value at acquisition and were subsequently carried at amortised cost using the effective interest rate method. The income statement includes the results of the engagements transferred from Britannia since the date of acquisition.

2. Basis of consolidation

a. **Subsidiaries**

Subsidiaries are entities controlled by the Bank. Control exists whenever the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial information of subsidiaries is included in the consolidated financial information from the date that control commences until the date that control ceases. The financial information has been prepared using uniform accounting policies and is based on the same accounting period as the Bank.

Intra-group balances and transactions, and any unrealised gains and losses arising from intra-group transactions, are eliminated in preparing the consolidated financial information.

b. **Special purpose entities**

Special purpose entities (SPEs) are 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; and
- Covered Bond Limited Liability Partnerships created in order to act as a guarantor for the issue of covered bonds (refer to note 34d for further information).

An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Bank and the SPE's risks and rewards, the Bank concludes that it controls the SPE.

The following circumstances may indicate a relationship in which, in substance, the Bank controls and consequently consolidates an SPE:

- the activities of the SPE are being conducted on behalf of the Bank according to its specific business needs so that the Bank obtains benefits from the SPE's operation;
- the Bank has the decision making powers to obtain the majority of the benefits of the activities of the SPE;
- the Bank has the rights to obtain the majority of the benefits of the SPE and therefore may be exposed to the risks incidental to the activities of the SPE; or
- the Bank retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The above circumstances apply to all of the SPEs. Consequently the Bank consolidates each SPE.

The assessment of whether the Bank has control over an SPE is carried out at inception. No further assessment of control is carried out unless changes in the structure or terms of the SPE or additional transactions between the Bank and the SPE occur.

c. **Interests in joint ventures**

The Bank's interests in joint ventures are accounted for using the equity method. The consolidated financial information includes the Bank's share of the income and expenses and equity movements of equity accounted investees, after adjustments to align the accounting policies with those of the Bank.

3. Revenue recognition

a. **Interest income and expense**

Interest income and expense is recognised on an effective interest rate (EIR) basis, inclusive of directly attributable incremental transaction costs and fees including arrangement and broker fees, valuation and solicitor costs, discounts and premiums where appropriate and early redemption fees.

The EIR basis spreads the interest income and expense over the expected life of each instrument. The EIR is the rate that, at the inception of the instrument, exactly discounts expected future cash payments and receipts through the expected life of the instrument back to the initial carrying amount. When calculating the EIR, the Bank estimates cash flows considering all contractual terms of the instrument (for example, prepayment options) but does not consider assets' future credit losses except for assets acquired at a deep discount.

For assets acquired at a value significantly below the carrying value in the acquiree's financial information because they have incurred loss, expectations of future loss are higher than at origination, and interest spreads have widened because of deteriorating market conditions, the calculation of EIR is the same as shown above with the exception that the estimates of future cash flows include credit losses.

b. **Fees and commissions**

Fee and commission income is predominantly made up of arrangement and other fees relating to loans and advances to customers that are included in the effective interest calculation. Commitment fees received are deferred and included in the EIR calculation upon completion or taken in full at the date the commitment period expires and completion does not occur.

Fees and commissions payable to introducers in respect of obtaining lending business, where these are direct and incremental costs related to the issue of a financial instrument, are included in interest income as part of the effective interest rate.

All other fee and commission income, such as loan closure fees or arrears fees, not included in the effective interest calculation, is recognised on an accruals basis as the service is provided.

4. Significant items

Items which are material by both size and nature (ie outside of the normal operating activities of the Bank) are treated as significant items and disclosed separately on the face of the income statement.

The separate reporting of significant items helps to provide an indication of the Bank's underlying business performance. Events which may give rise to the classification of items as significant include individually significant programmes of restructuring, investment, integration and provisions for material non-recurring items.

5. Financial instruments (excluding derivatives)

a. **Recognition**

The Bank initially recognises loans and advances, deposits, debt securities issued and other borrowed funds on the date at which they are originated.

Regular way purchases and sales of financial assets are recognised on the trade date at which the Bank commits to purchase or sell the asset. All other financial assets and liabilities are initially recognised on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

b. **Derecognition**

Financial assets are derecognised when all the rights to receive contractual cash flows have ceased, or they are qualifying transfers where:

- the rights to receive contractual cash flows from the assets have ceased; and
- the Bank has transferred substantially all the risks and rewards of ownership of the assets.

When a financial asset is derecognised in its entirety, the difference between the carrying amount and the sum of the consideration received (including any new asset obtained less any new liability assumed), and any cumulative gain or loss that had been recognised in other comprehensive income, is recognised in the income statement.

When available for sale financial assets are derecognised, the cumulative gain or loss, including that previously recognised in reserves, is recognised in the income statement.

A financial liability is derecognised when the obligation is discharged, cancelled or expires. Any difference between the carrying amount of a financial liability derecognised and the consideration paid is recognised through the income statement.

c. **Financial assets**

i. **Overview**

The Bank classifies its financial assets (excluding derivatives) as either:

- loans and receivables;
- available for sale; or
- financial assets at fair value through income or expense.

ii. **Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and the Bank does not intend to sell immediately or in the near term. These are initially measured at fair value plus transaction costs that are directly attributable to the financial asset. Subsequently, these are measured at amortised cost using the effective interest method. The amortised cost is the amount advanced less principal repayments, plus or minus the cumulative amortisation using the EIR method of any difference between the amount advanced and the maturity amount less impairment provisions for incurred losses.

Loans and receivables mainly comprise loans and advances to banks and customers (except where the Bank has elected to carry the loans and advances to customers at fair value through income or expense as described in accounting policy (5c. iv. below) and assets reclassified from available for sale (see below)).

iii. **Available for sale**

Available for sale financial assets are debt securities and equity shares that are not held for trading and are intended to be held for an indefinite period of time. These are measured at fair value based on current bid prices where quoted in an active market. Where the debt securities and equity shares are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Movements in fair value are recorded in equity as they occur. On disposal, gains and losses recognised previously in equity are transferred to the income statement. In exceptional circumstances, for instance where the market in the securities has become inactive, the Bank has reclassified such assets as loans and receivables.

Any transfer back from loans and receivables, upon reclassification, would be measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the debt securities or equity shares are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques.

iv. **Financial assets at fair value through income or expense**

These are:

- financial assets designated at fair value through income or expense

  Financial assets designated at fair value are assets which have been designated to eliminate or significantly reduce a measurement and recognition inconsistency or where management specifically manages an asset or liability on that basis eg capital bonds.

  These assets are measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the securities are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Gains and losses arising from changes in the fair value are brought into the income statement within trading income as they arise.

- financial assets held for trading

  Financial assets held for trading are assets which have been principally acquired for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together for which there is evidence of a recent pattern of short term profit taking. These financial assets are recognised on the date of trade, when the Bank enters into contractual arrangements with counterparties to purchase or sell financial instruments, and are normally derecognised when sold. Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequently their fair values are remeasured, and gains and losses from changes therein are recognised in the income statement within trading income.

d. **Financial liabilities**

i. **Overview**

Financial liabilities are contractual obligations to deliver cash or another financial asset. Financial liabilities are recognised initially at fair value, net of directly attributable transaction costs.

Financial liabilities, other than derivatives and capital bonds, are subsequently measured at amortised cost.

Capital bonds within customer accounts have been designated at fair value through income or expense upon initial recognition in the balance sheet. Changes in fair value are recognised through the income statement.

The capital bonds are economically matched using equity linked derivatives, which do not meet the requirements for hedge accounting. Recording changes in fair value of both the derivatives and the related liabilities through the income statement most closely reflects the economic reality of the transactions. In doing so this accounting treatment eliminates a measurement inconsistency that would otherwise arise from valuing the capital bonds at amortised cost and the derivatives at fair value.

ii. **Borrowed funds**

Borrowings are recognised initially at fair value, which equates to issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. The Bank's preference shares are classified as financial liabilities as they carry the right to a fixed non-cumulative preferential dividend (further information is provided in note 24) and are subsequently presented in other borrowed funds. The dividends on these preference shares are recognised in the income statement as interest expense on an amortised cost basis using the EIR method.

iii. **Perpetual subordinated bonds**

Perpetual subordinated bonds are carried at their nominal value plus any premium and a fair value adjustment for hedged risk where items are designated as part of a fair value hedge relationship.

Interest payable on perpetual subordinated bonds is recognised in the income statement using the EIR method.

6. Impairment provisions

a. Assessment

i. **Objective evidence**

At the balance sheet date, the Bank assesses its financial assets, not at fair value through income or expense, for objective evidence that an impairment loss has been incurred.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower, a breach of contract, such as default or delinquency in interest or principal payments, the granting by the Bank to the borrower, for economic and legal reasons relating to the borrower's financial difficulty, a concession that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy or other financial reorganisation, or the disappearance of an active market for a security.

The Bank considers evidence for impairment for loans and advances at both a specific asset and collective level.

ii. **Forbearance**

The Bank operates a policy of forbearance which mitigates against borrower default. All such cases are included within its provisioning methodology.

- Residential secured mortgages

  If a loan is identified as being subject to forbearance, it is assessed for impairment. Once classified as impaired, mortgages subject to forbearance are treated in the same way as all other impaired mortgages in the impairment provisions calculations.

- Unsecured retail business

  Loans are treated as impaired where the Bank has granted forbearance concessions. The amount of the impairment provision will vary with the type of concession granted.

- Corporate business

  Impairment provisions are made for accounts subject to forbearance which are in default or on a watchlist.

  Corporate customers are placed on a watchlist when they show signs of unsatisfactory performance and require close control, but are currently expected to continue trading and where no provision for bad debt is required. Forbearance is a strong indicator that a customer should be placed on the watchlist.

For further information on the Bank's approach to forbearance, its management and execution, see the risk management section on pages 310 to 338.

b. **Scope**

i. **Individual accounts**

All secured loans and advances are assessed for impairment using a range of criteria graded for levels of risk. Accounts at risk of impairment are monitored and impaired where they display clear indicators of underperformance.

Loans and advances that do not meet the criteria for individual impairment are collectively assessed for impairment by grouping together loans and advances of similar risk characteristics.

ii. **Collective accounts**

a. **Retail**

When assessing collective impairment for secured retail loans, the Bank estimates incurred losses on mortgages based on the borrower's external credit score or where the loan is identified as being subject to forbearance.

When assessing collective impairment for unsecured retail loans, the Bank estimates losses on loans with delinquency greater than a pre-determined trigger point. In addition the Bank makes provision on all loans arising from fraud and loans transferred to debt collection agencies. In respect of unsecured loans, the Bank uses statistical modelling of historical trends of probability of default, timing of recoveries and the amount of loss incurred.

The model's results are adjusted for management's judgment as to whether current economic and credit conditions are such that actual losses are likely to differ from those suggested by historical modelling. Once impaired, accounts are subjected to higher levels of impairment according to both their relevant stage of delinquency, ie the number of days in arrears, and their consequent likelihood of ultimately being charged off. Default rates, loss rates and future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

b. **Corporate**

Collective risk cover provides further balance sheet protection for impairment losses. The amount of collective risk cover is reviewed regularly by the Bank. The Bank reviews all loans and considers the potential loss which might arise were the borrowers to fail (notwithstanding that continued trading remains the expectation). Trigger events may include a deteriorating balance sheet, material losses, trading difficulties (eg loss of material contracts or suppliers), breach of financial covenants, poor account conduct, arrears and material reduction in value of security. A collective impairment provision is raised against these loans based on the total estimated loss that may arise and the propensity for the borrower to fail.

c. **Measurement**

The amount of the loss is the difference between:

- the asset's carrying amount; and
- the present value of estimated future cash flows (discounted at the asset's original or variable EIR for amortised cost assets and at the current market rate for available for sale assets).

Where the debt is secured, the assessment reflects the expected cash flows from the realisation of the security, net of cost to realise, whether or not foreclosure or realisation of the collateral is probable.

d. **Impairment of financial assets carried at amortised cost**

The amount of the impairment loss on assets carried at amortised cost is recognised immediately through the income statement and a corresponding reduction in the value of the financial asset is recognised through the use of an allowance account.

A write off is made when all or part of a claim is deemed uncollectable or forgiven after all the possible collection procedures have been completed and the amount of loss has been determined. Write offs are charged against previously established provisions for impairment or directly to the income statement.

Any additional recoveries from borrowers, counterparties or other third parties made in future periods are offset against the write off charge in the income statement once they are received.

Provisions are released at the point when it is deemed that following a subsequent event the risk of loss has reduced to the extent that a provision is no longer required.

e. **Impairment of financial assets classified as available for sale**

Available for sale assets are assessed at each balance sheet date to see whether there is objective evidence of impairment. In such cases, any impairment losses are recognised by transferring the cumulative loss that has been recognised directly in equity to income or expense.

When a subsequent event causes the amount of impaired loss on available for sale investment securities to decrease, and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income statement.

However any further recovery in fair value of an impaired available for sale equity security is recognised directly in equity.

7. Offsetting

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to do so and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

8. Sale and repurchase agreements

Securities sold subject to repurchase agreements (repos) are reclassified on the balance sheet as pledged assets when the transferee has the right by contract or custom to sell or repledge the assets. The liability to the transferee is also included on the balance sheet, in deposits by banks. The difference between sale and repurchase price is accrued over the life of the agreements using the EIR method.

Securities purchased under agreements to re-sell (reverse repos) are classified as loans and advances to banks on the balance sheet, as appropriate.

9. Derivative financial instruments and hedge accounting

a. **Derivatives used for asset and liability management purposes**

Derivatives are used to hedge interest and exchange rate exposures related to non-trading positions. Instruments used for hedging purposes include swaps, forward rate agreements, futures, options and combinations of these instruments. The Bank also uses equity derivatives to hedge the equity risks within its capital bonds.

Derivative financial instruments are stated at fair value based on quoted market prices in active markets and, where these are not available, using valuation techniques such as discounted cashflow models. Further information is provided on note 34. All derivatives are carried as assets when the fair

value is positive and liabilities when the fair value is negative. The gain or loss on re-measurement to fair value is recognised immediately in the income statement except where derivatives qualify for cashflow hedge accounting.

On initial designation of derivatives and qualifying hedged items as a hedge, the Bank formally documents the relationship between the hedging instrument(s) and hedged item(s) including the risk management objective and strategy in undertaking the hedge transaction together with the method used to assess effectiveness of the hedging relationship.

The Bank makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, as to whether the hedging instruments are expected to be 'highly effective' on offsetting the changes in fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80% to 125%.

i. **Cash flow hedges**

Where derivatives are designated as hedges of the exposure to variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the portion of the fair value gain or loss on the derivative that is determined to be an effective hedge is recognised directly in equity. The ineffective part of any gain or loss is recognised in the income statement immediately.

The accumulated gains and losses recognised in equity are reclassified to the income statement in the periods in which the hedged item will affect income or expense. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss recognised at that time remains in equity until the forecast transaction is eventually recognised in the income statement.

When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in equity is immediately reclassified to the income statement.

ii. **Fair value hedges**

Where a derivative is designated as the hedging instrument to hedge the change in fair value of a recognised asset or liability or a firm commitment that could affect income or expense, changes in the value of the derivative are recognised immediately in the income statement together with changes in the fair value of the hedged item that are attributable to the hedged risk.

Fair values are based on quoted market prices in active markets or, where these are not available, using valuation techniques such as discounted cashflow models.

If the derivative expires or is sold, terminated, or exercised, or no longer meets the criteria for fair value hedge accounting, or the designation is revoked, then hedge accounting is prospectively discontinued. Any adjustment up to that point, to a hedged item for which the EIR method is used, is amortised to income or expense as part of the recalculated EIR of the item over its remaining life.

iii. **Fair value hedge accounting for a portfolio hedge of interest rate risk**

As part of its risk management process the Bank identifies portfolios whose interest rate risk it wishes to hedge. The portfolios may comprise only assets, only liabilities or both assets and liabilities. The Bank analyses each portfolio into repricing time periods based on expected repricing dates, by scheduling cash flows into the periods in which they are expected to occur. Using this analysis, the Bank decides the amount it wishes to hedge and designates as the hedged item an amount of assets or liabilities from each portfolio equal to this.

The Bank measures monthly the change in fair value of the portfolio relating to the risk that is being hedged. Provided that the hedge has been highly effective, the Bank recognises the

change in fair value of each hedged item in the income statement with the cumulative movement in its value being shown on the balance sheet as a separate item, fair value adjustment for hedged risk, either within assets or liabilities as appropriate. If the hedge no longer meets the criteria for hedge accounting, this amount is amortised to the income statement over the remaining average useful life of the hedge relationship.

The Bank measures the fair value of each hedging instrument monthly. The value is included in derivative financial instruments in either assets or liabilities as appropriate, with the change in value recorded in the income statement.

Any hedge ineffectiveness is recognised in the income statement as the difference between the change in fair value of the hedged item and the change in fair value of the hedging instrument.

b. **Embedded derivatives**

A derivative may be embedded in another instrument, known as the host contract. Where the economic characteristics and risks of an embedded derivative are not closely related to those of the host contract (and the host contract is not carried at fair value through income or expense), the embedded derivative is separated from the host and held on balance sheet at fair value.

Movements in fair value are posted to the income statement, whilst the host contract is accounted for according to the relevant accounting policy for that particular asset or liability.

c. **Derivatives used for trading purposes**

Derivatives entered into for trading purposes include swaps, forward rate agreements, futures, options and combinations of these instruments. Derivatives used for trading purposes are measured at fair value and any gains or losses are included in the income statement. The use of derivatives and their sale to customers as risk management products is an integral part of the Bank's trading activities.

10. Financial guarantee contracts

Other financial guarantees, in respect of intra-group funding and the pension deficit in respect of the Britannia Pension Scheme, between the Bank and its subsidiaries are treated as insurance contracts in accordance with IFRS 4 (Insurance Contracts (2004)). In accordance with the standard, the recognised insurance liability is assessed based on the current estimate of forecast future cash flows. If this highlights that the liability is inadequate, the liability is increased and the corresponding charge taken through the income statement.

11. Property, plant and equipment

Items of property, plant and equipment are stated at cost less any accumulated depreciation and impairment losses. Depreciation is provided on a straight line basis at the following rates, which are estimated to write down the assets to realisable values at the end of their useful lives.

Freehold and long leasehold land and buildings	40–50 years
Freehold and leasehold improvements	10–40 years
Short leasehold buildings	life of lease
Equipment:	
Computer	3–7 years
Furniture and equipment	3–10 years

All items of property, plant and equipment are reviewed for indications of impairment on a regular basis and at each balance sheet date. If impairment is indicated, the asset's recoverable amount (being the greater of fair value less cost to sell and value in use) is estimated. Value in use is calculated by discounting the future cash flows generated from the continuing use of the asset.

If the carrying value of the asset is less than the recoverable amount, an impairment charge is recognised in the income statement.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment, and are recognised net within operating expenses in the income statement.

12. Intangible assets

a. Computer software

Computer software is stated at cost less cumulative amortisation and impairment and comprises computer software together with the costs of development of the software.

Acquired computer software licences are capitalised on the basis of cost incurred to acquire and bring the software to use.

Costs that are directly associated with the internal production of software products that will generate future economic benefit are capitalised. Only costs which meet the definition of development costs under IAS 38 (Intangible Assets) are capitalised, with costs being capitalised only if the asset can be reliably measured, will generate future economic benefits and there is an ability to use the asset. Expenditure that is not directly attributable to the development of such assets is recognised in the income statement in the period to which it relates.

The expenditure capitalised includes direct employee costs and an appropriate portion of relevant direct overheads. Amortisation is charged to the income statement on a straight line basis to allocate the cost over the estimated useful life up to a maximum of seven years.

b. Other intangible assets

Other intangible assets are stated at cost less cumulative amortisation and impairment. Amortisation is charged over the useful life of the asset. For core systems, a review of the asset's useful life is carried out and a maximum useful life of up to ten years is applied.

c. Impairment

Intangible assets are assessed for indications of impairment at least annually. If impairment is indicated, the asset's recoverable amount (being the greater of fair value less cost to sell and value in use) is estimated. Value in use is calculated by discounting the future cash flows generated from the continuing use of the asset. If the carrying value of the asset is less than the greater of the value in use and the fair value less costs to sell, an impairment charge is recognised to this value in the income statement. Irrespective of whether there is any indication of impairment, intangible assets in the course of construction are tested for impairment at least annually.

13. Goodwill

All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries, associates and joint ventures and represents the difference between the cost of the acquisition and the fair value of the identifiable assets, liabilities and contingent liabilities acquired.

If a business combination is achieved without transfer of consideration, the amount of goodwill is calculated by reference to the fair value of the Bank's interest in the acquiree using a valuation technique. The technique involves assessing the future net profit of the acquiree and then discounting using a rate that reflects current market assessment of the time value of money and risks specific to the acquiree.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is not amortised but is tested for impairment on an annual basis. Where impairment is required, the amount is recognised in the income statement and cannot be subsequently reversed.

14. Leases

a. Overview

The Bank enters into leases for land and buildings and operating leases for vehicles and equipment.

Leases for land and buildings are split between leases for the land and leases for the buildings for accounting purposes only. The leases are separately assessed as to whether they are finance or operating leases.

The Bank policy is to provide for the minimum future lease payments on buildings that it does not currently use, net of expected rental income from sub-leases.

b. Assets leased to customers

All leases of assets to customers are finance leases. Income from assets leased to customers is credited to the income statement based on a pattern reflecting a constant periodic rate of return on the net investment in the lease.

c. Assets leased from third parties

i. Finance leases

Finance lease assets are initially recorded at the lower of fair value and the present value of the minimum lease payments, and subsequently in accordance with the relevant policy for the underlying asset. An equal liability is recorded in other liabilities. Interest is allocated to the lease payments so as to record a constant periodic rate of charge on the outstanding liability.

ii. Operating leases

Operating lease payments are charged to the income statement on a straight line basis over the term of the lease and the asset is not recognised on the balance sheet.

15. Investment property

Property held for long term rental yields that is not occupied by the Bank, or property held for capital appreciation, is classified as investment property.

Investment property comprises freehold land and buildings. It is carried at fair value. Fair value is based on discounted expected future cashflows, subject to periodic review via external third parties, reflecting market conditions. No depreciation is provided on these properties. Any gain or loss arising from a change in fair value is recognised in the income statement.

If the Bank takes occupancy of an investment property, it is reclassified as property, plant and equipment and its fair value at the date of reclassification becomes its cost for subsequent accounting purposes. Similarly, transfers to the investment property portfolio are made when occupancy by the Bank ceases and the property meets the criteria of an investment property under IAS 40. Prior to such a transfer the property is measured at fair value with any gain or loss recognised in the income statement.

16. Cash and cash equivalents

Cash and cash equivalents comprises cash balances and balances with a maturity of three months or less from the acquisition date, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Overdrafts that are repayable on demand and form an integral part of the Bank's cash management are included as a component of cash and cash equivalents for the purpose of the cashflow statement.

17. Income tax

a. Overview

Tax on the income statement for the year comprises current and deferred tax, which is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in the statement of comprehensive income.

b. **Current tax**

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

c. **Deferred tax**

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided for is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

18. Pension costs

a. **Defined contribution basis**

The Bank, along with other businesses within the Co-operative Group, participates in the Co-operative Pension Scheme (Pace), the assets of which are held in a separate fund administered by trustees. Pace is a non-segregated hybrid scheme, consisting of a defined benefit and a defined contribution section.

As a Co-operative Group wide pension scheme, the Pace defined benefit section exposes the participating businesses to actuarial risks associated with the current and former employees of other Co-operative Group companies, with the result that there is no consistent and reliable basis for allocating Pace's liabilities, assets and costs to individual companies participating in the scheme.

Therefore pension costs in respect of the scheme are accounted for on a defined contribution basis and recognised as an expense in the income statement as incurred.

b. **Britannia Pension Scheme**

The Britannia Pension Scheme is a hybrid scheme, consisting of a defined benefit and a defined contribution section. Following the transfer of engagements of Britannia Building Society, ownership of the Britannia Pension Scheme transferred to CFSMS, a fellow subsidiary undertaking of The Co-operative Banking Group. The pension costs in respect of this scheme are accounted for, by the Bank, on a defined contribution basis and recognised as an expense in the income statement as incurred.

19. Foreign currency

The functional and presentational currency for the Bank is sterling. Transactions in foreign currencies are translated at the foreign exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to sterling at the foreign exchange rate ruling at that date. Foreign currency differences arising on translation are recognised in the income statement, except for foreign currency differences arising on translation of available for sale equity instruments or a qualifying cashflow hedge, which are recognised directly in the statement of comprehensive income. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair values are translated to sterling at the exchange rates prevailing at the dates the values were determined.

20. Provisions for liabilities and charges

A provision is recognised in the balance sheet if the Bank has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax

rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

21. Profit based payments to members of The Co-operative Group

Members of The Co-operative Group receive a dividend based on their transactions with The Co-operative Group and its subsidiaries including the Bank. Once these profit based payments are approved by The Co-operative Group Limited, the Bank is recharged an amount which reflects its eligible products' contribution to the overall Co-operative Group member dividend.

Critical judgments and estimates

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

Estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

The judgments and assumptions that are considered to be the most important to the portrayal of the Bank's financial condition are those relating to loan impairment provisions, conduct risk issues, intangible and tangible asset impairment and deferred tax.

a. **Loan impairment provisions**

i. **Overview**

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

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

The changes in impairment provisions for Corporate, Optimum and Retail result from a management review of assumptions, with respect to the determination and operational alignment of the; probability of possession given default (PPD), treatment of forbearance, length of loss emergence periods, timing of impairment recognition and the formalising of charge off policy. Where required, management also periodically overlays collective provisions for additional risk parameters upon existing individual and collective impairment models.

Further explanation of the treatment of forborne balances is included in the Bank's risk management disclosures in sections 1.4.1.3, 1.4.1.4 and 1.4.1.5 on pages 314 to 327.

ii. **Collective provisions**

a. **Unsecured and secured residential**

The Bank's collective provision for retail personal advances has increased to £217.0m (30 June 2012: £167.3m). Loans are identified as impaired by taking account of the age of the debt's delinquency, the product type and the regularity of payments made whilst in arrears. The provision is calculated by applying a percentage rate to different categories and ages of impairment debt. The provision rates reflect the likelihood that the debt in that category/age will be written off or charged off at some point in the future. The rates are based on historical experience and current trends, which incorporate the effects of discounting at the customer interest rate and are subject to regular review. The provision is the product of the rate and the balance for the relevant arrears segment.

During 2013 the Bank has amended its unsecured provisioning methodology to treat accounts that are in arrears for over 180 days as charge off. These accounts will be operationally charged off during the second half of 2013. The Bank has also used improved management information which has resulted in a better understanding of the probability of possession given default on its exposure to residential mortgage assets. The status level for PPD has changed to 180 days past due for non-forborne customers and all customers that are on a forbearance plan from the previous state of possession. The material impact of this change was a PPD charge of £53.5m for Optimum. Consequently, the prevailing collective Optimum management overlay covering additional risks now stands at £25.7m (30 June 2012: £48.6m). Loss emergence periods have been extended to 12 months.

Further explanation of collective residential loan impairment method is included in the Bank's risk management disclosures in sections 1.4.1.3, 1.4.1.4 and 1.4.1.5 on pages 314 to 327.

The majority of provisions are made against unsecured loans. A key estimate within this provisioning model is the percentage provision rate applied to regular visa payers. A 5% change would change the collective provision by £2.5m.

b. **Corporate**

The Bank's corporate collective provision has increased to £100.1m (30 June 2012: £17.7m).

The methodology's key components comprise risk parameters defined by the Bank. The collective provision is calculated using factors such as observed default rates and loss given default. An assessment is made of the likelihood of the assets becoming recognised as impaired in the loss emergence period. It is a broad based approach, covering all live accounts not individually reviewed and where a trigger event could have occurred but has not yet been observed.

During 2013, the Bank has amended its methodology by reclassifying out of collective, into individual, those accounts which are being observed on a watchlist. These accounts may not carry any actual impairment, but display performance characteristics which indicate the emergence of such cases. No management overlay has been applied. Loss emergence period has changed from six to nine months. The definition of exposure within the calculation of impairment has been changed to exposure at default in order to exclude an element of balances which have not yet been drawn.

The formula underpinning this methodology applied to the unimpaired portfolio is:

Exposure at Default x Probability of Default x Loss Given Default x Loss emergence period of nine months. Both the Probability of Default and Loss Given Default are based on observed default rates in this portfolio.

A key estimate within the corporate collective model is the loss emergence period. A movement of one month in this estimate would change the provision by £14m.

iii. **Individual provisions**

a. **Secured residential**

The Bank's provision for credit protection on secured residential has increased. It is split between Retail £9.1m (30 June 2012: £9.4m) and Optimum £148.1m (30 June 2012: £129.6m) mortgages. Mortgage accounts are identified as impaired and provided for on an individual basis by taking account of the age of the debt's delinquency on a case by case basis.

Due to continuing difficulties and uncertainties currently being experienced in this sector, the Bank classifies all accounts with arrears outstanding for one monthly instalment or more as individually impaired.

The Bank has also used improved management information which has resulted in a better understanding of the probability of possession given default on its exposure to residential mortgage assets. The status level for PPD has changed to 180 days past due for non-forborne customers and all customers that are on a forbearance plan from the previous state of possession. The key management overlay for individual provisions covering such additional risks crystallising currently stands within Optimum at £25.7m (30 June 2012: £48.6m) and is being made on a collective basis. Loss emergence periods have been extended from three months to 12 months.

A key assumption in the judgment of estimated future credit losses is our estimate of future HPI movements, the material element of which sits in Optimum. If Optimum's future HPI movements were to differ from expectations by 5%, the impact on the estimate would be £22.1m.

b. **Corporate**

The Bank's corporate individual provision has increased to £749.1m (30 June 2012: £147.1m). It reflects the change in Bank strategy which is now focused on accelerating the reduction of its non-core assets. Impairments are further exacerbated because the Bank has exhausted its associated fair value adjustment for credit risk in 2012, alongside a deterioration of expected future recoveries against impaired loans which are now being managed for exit.

The methodology's key components comprise risk parameters defined by the Bank. It incorporates normal course of business default cases, improving management information to support decisions, improved credit processes where there have been changes to accounting estimates and progression of the Bank's stated intent to reduce the assets held.

Given the persistent weakness in economic recovery and the increasing levels of risk associated with refinancing and interest payment cover currently being experienced in this sector, a significantly higher number of cases meet the definition of corporate loans identified as being individually impaired.

The increase in cases arises from a change in methodology which allocates any account previously held on a watchlist to one which is individually assessed for impairment, irrespective of whether any actual impairment has been made.

Each corporate account is assessed and allocated a 'risk grade' to enable the Bank to monitor the overall quality of its lending assets. Those of lesser quality, where the lending is potentially at risk and loss provisions may be required, are centrally monitored with specific management actions taken at each stage within laid down procedures and specific provisioning criteria. Provisions represent the likely net loss after realisation of any security.

A key estimate within the corporate individual impairment model is collateral valuation. A 10% movement in this estimate would change the provision by £140.8m.

For further information on credit risk and impairment, see section 1 of the risk management disclosures.

b. **Conduct risk and legal provisions**

The Bank has identified a number of conduct risk and legal issues against which it has raised provisions, based on management's best estimate of the potential costs to the Bank. The calculation of these provisions requires significant judgment by management in determining appropriate assumptions, which include basis of redress, operating costs of resolving redress, the level of complaints, uphold rates, proactive contact and response rates and Financial Ombudsman Service referral and uphold rates.

In respect of potential customer compensation claims relating to past sales of payment protection insurance (PPI) the Bank has recognised an additional provision of £53.0m (30 June 2012: £40.0m) in the period, in respect of the total expected cost to the Bank of carrying out this work and paying compensation, making total provisions raised of £297.0m (30 June 2012: £134.3m). The two key sensitivities are complaint uphold rate and response rate. A 5% change in these assumptions would lead to a £4.3m and £4.2m additional liability respectively.

Other provisions in the period include £33.7m (2012: £nil) for potential customer redress relating to processing of certain mortgage 'first payments' in a manner other than that shown in the customers' illustrations, £26.0m (2012: £nil) for alleged failings in the introduction of third party sales of card and identity protection products, £15.0m (2012: £nil) for potential customer redress in relation to arrears charges and £10.0m (2012: £nil) for potential interest rate swap mis-selling. The main area of judgment on the first payments issue regarded the presumed response rate of 40% for customers post 2002 and 15% pre 2002. Both judgments are based upon response rates from PPI and also the published experience of other financial institutions. An increase in post 2002 response rates by 10% would lead to an additional liability of £2.1m. A 5% increase in pre 2002 response rates would lead to an additional liability of £0.5m. Operating costs provided to facilitate the redress are based upon our experience providing redress on PPI.

In addition, provisions of £29.0m (2012: £nil) for potential customer redress following identification of a technical breach of the Consumer Credit Act have been recognised. Legal advice has been sought to identify the customer accounts which are affected by this issue. Once the population was confirmed, the provision has been calculated using assumptions of terms of loan. The assumptions were based on average terms over the last seven years. An increase in the average term by 10% would lead to an increased liability of £2.6m.

Also, given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies, the media and politicians, there is a risk that certain other aspects of the Bank's current or historic business, including, inter alia, mortgages and relationship banking, may be determined by the Financial Conduct Authority (FCA) and other regulatory bodies or the courts as not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment in their opinion.

c. **Intangible and tangible asset impairment**

The Bank had a strategic programme of investment around the replacement of the core banking system. This intangible asset, along with other assets bought or developed for the Bank and other Banking Group entities, is held on the balance sheet of CFSMS, a sister company of the Bank. These assets undergo a regular impairment review, where the present values of projected future benefits are assessed against the carrying value of the asset plus estimated costs to complete.

The Banking Group has reviewed its IT strategy and has decided not to complete or implement the majority of the replacement of the core banking platform. £136.4m has therefore been written off and recharged to the Bank.

£36.4m of the total balance remains in use and this has been assessed for impairment in light of the current strategic direction and business plans of the Bank. Following that review, the asset has been impaired by £12.0m making the total write down £148.4m.

The carrying value of the asset at 30 June 2013 is £24.4m and is no longer subject to any specific key sensitivity.

The Bank was also recharged £4.0m for the impairment of other intangible assets.

d. **Deferred tax**

The Bank has reconsidered the deferred tax position in light of the Bank's five year plans approved by the Board as part of the Exchange Offer and the preparation of a debt prospectus.

Recognition of deferred tax assets is only possible to the extent it is probable that future taxable profits will be available against which the unused tax losses and other deductible temporary differences can be utilised. Any deferred tax asset representing tax losses carried forward can only be offset against future taxable profits in the Bank. After approving the plans, the directors are satisfied that there will be sufficient profits in the foreseeable future to absorb a proportion of the Bank's deductible

temporary differences, and deferred tax has been recognised on a proportion of the tax losses carried forward.

The Bank has recognised a deferred tax asset of £103.5m (30 June 2012: £109.9m) and a deferred tax liability of £117.4m (30 June 2012: £111.5m), making a net deferred tax liability of £13.9m (30 June 2012: £1.6m). These balances represent the net of reversing taxable temporary differences and recognised deductible temporary differences.

Risk management

For the period ended 30 June 2013
All amounts are stated in £m unless otherwise indicated

Risk management structure

The governance and organisation structure for the period to 30 June 2013 is consistent with that described in the Bank's risk management section of the 2012 financial statements on pages 54 to 79.

Significant risks

The following are considered to be significant risks facing the Bank:

	Risk type	*Definition*	*Page*
1.	**Credit risk**	Credit risk is 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.	310
2.	**Liquidity and funding risk**	Liquidity and funding risk is 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 a stress. It arises from the mismatch of timings of cash flows generated from the Bank's assets and liabilities (including derivatives).	331
3.	**Market risk**	Market risk is the risk that the value 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.	335

1. Credit risk

1.1 Overview

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

All authority to take credit risk derives from the Bank's Board. This authority is delegated to the CEO and then on to other 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.

1.2 Credit risk policy

The principal risk policy for credit risk is approved annually by the Executive Risk Committee (ERC) and defines appropriate standards and principles for the effective management of credit risk throughout the Bank.

The key principles of the policy are:

- credit risk management is fully embedded in Bank operations and the business is managed in line with the risk strategy and risk appetite set by the Board;
- identified, emerging or current risks are actively managed in line with the Bank's overall risk management approach of identification, measurement, management, monitoring and reporting;
- risk measurement is based on a set of metrics/ratios which are aligned with the risk appetite and support the limits framework;

- timely processes for assessing and reviewing credit risks throughout the credit life cycle are established and documented including completion of risk reports; and
- credit risk decisions are supported by fully evidenced rationale.

1.3 Credit exposure

1.3.1 *Definitions*

Impaired and not impaired in the tables below are defined in the following sections on retail and corporate credit risk and investment securities.

During the period to 30 June 2013, the only amendment to impairment definitions is to corporate loans. Watchlist cases are now included within impaired.

Fair value adjustments represent credit losses on assets acquired on the merger of the Bank with Britannia Building Society on 1 August 2009 and are reviewed on a regular basis to ensure appropriate allocation and utilisation.

1.3.2 *Analyses of credit exposure*

The following analysis of credit exposure shows:

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

Cash and balances at central banks are credit exposures with the Bank of England and have been excluded from the analysis.

	Loans and advances to banks	*Loans and advances to customers*	*Investment securities*	*Derivative financial instruments*	*Total*
30 June 2013					
Analysis of balance in note	10	11	12	13	
Gross balance	1,737.5	33,785.5	5,102.6	804.3	41,429.9
Less: allowance for losses	–	(1,069.6)	(20.0)	–	(1,089.6)
	1,737.5	32,715.9	5,082.6	804.3	40,340.3
Analysis of credit risk exposure					
Not impaired	1,737.5	29,954.0	5,082.6	797.4	37,571.5
Impaired	–	4,138.8	20.0	6.9	4,165.7
	1,737.5	34,092.8	5,102.6	804.3	41,737.2
Credit commitments	48.0	4,524.0	–	–	4,572.0
Gross credit risk exposure	1,785.5	38,616.8	5,102.6	804.3	46,309.2
Less:					
Fair value adjustments	–	(307.3)	–	–	(307.3)
Allowance for losses	–	(1,069.6)	(20.0)	–	(1,089.6)
Net credit risk exposure	1,785.5	37,239.9	5,082.6	804.3	44,912.3

	Loans and advances to banks	*Loans and advances to customers*	*Investment securities*	*Derivative financial instruments*	*Total*
30 June 2012					
Analysis of balance in note	10	11	12	13	
Gross balance	2,359.7	34,349.5	4,999.3	910.8	42,619.3
Less: allowance for losses	–	(341.1)	(42.3)	–	(383.4)
	2,359.7	34,008.4	4,957.0	910.8	42,235.9
Analysis of credit risk exposure					
Not impaired	2,359.7	31,761.6	4,957.0	910.8	39,989.1
Impaired	–	2,965.7	42.3	–	3,008.0
	2,359.7	34,727.3	4,999.3	910.8	42,997.1
Credit commitments	93.0	5,345.1	–	–	5,438.1
Gross credit risk exposure	2,452.7	40,072.4	4,999.3	910.8	48,435.2
Less:					
Fair value adjustments	–	(377.8)	–	–	(377.8)
Allowance for losses	–	(341.1)	(42.3)	–	(383.4)
Net credit risk exposure	2,452.7	39,353.5	4,957.0	910.8	47,674.0

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

1.4 Analysis of impaired assets and associated collateral

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

- loans and advances to customers;
- investment securities; and
- loans and advances to banks.

1.4.1 *Loans and advances to customers*

1.4.1.1 *How we oversee and control credit risk*

The credit risk team is part of the Risk Directorate, with an independent reporting line from business management, and provides second line risk oversight. Accountability for the origination of credit risk sits with business management subject to compliance with key credit criteria, policy and risk appetite. Where business management recommend the sanction of a facility that is outside of their discretion then the recommendation is made to the Credit Approvals Committee.

On pages 314 to 327 the management of credit risk by portfolio is described covering:

- acquisition and account management;
- collateral;
- impairment assessment; and
- forbearance.

1.4.1.2 *Assessment for impairment*

The loan portfolios are periodically reviewed to assess impairment. A loan is deemed to be impaired when there is objective evidence that a loss event has occurred at 30 June 2013.

Once a loan is defined as impaired, the impairment provision is calculated as the difference between the current carrying value of the asset (including fair value adjustments) and the expected future recovery, discounted at the loan's effective interest rate, taking into account the expected charge off rate and any supporting collateral.

Full details are contained in the significant accounting policies on page 296 and in the following credit risk sections.

The tables below analyse the gross balance by impairment classification for the Retail and Corporate and Business Banking (CABB) business segments. They include credit commitments, impairment provisions, fair value adjustments and a reconciliation to gross customer balances as this is the basis on which the business manages risk.

There has been an increase in impairment provisions in the period to 30 June 2013 driven primarily by the decision to reduce non-core assets, revised collateral values for the corporate business and updated experience in support of our credit risk impairment policy.

	Retail		*CABB*			
	Secured	*Unsecured*	*Corporate*		*Optimum*	
			Core	*Non-core*		*Total*
30 June 2013						
Analysis of balance in note 11						
Gross balance	16,358.4	1,402.1	5,870.9	2,994.9	7,159.2	33,785.5
Less: allowance for losses	(4.6)	(172.0)	(272.7)	(576.4)	(43.9)	(1,069.6)
	16,353.8	1,230.1	5,598.2	2,418.5	7,115.3	32,715.9
Analysis of credit risk exposure						
Not impaired	16,209.7	1,204.4	5,134.3	1,337.0	6,068.6	29,954.0
Impaired	153.2	197.7	736.6	1,856.5	1,194.8	4,138.8
	16,362.9	1,402.1	5,870.9	3,193.5	7,263.4	34,092.8
Credit commitments	486.5	2,303.5	1,694.3	39.7	–	4,524.0
Gross credit risk exposure	16,849.4	3,705.6	7,565.2	3,233.2	7,263.4	38,616.8
Less:						
Fair value adjustments	(4.5)	–	–	(198.6)	(104.2)	(307.3)
Allowance for losses	(4.6)	(172.0)	(272.7)	(576.4)	(43.9)	(1,069.6)
Net credit risk exposure	16,840.3	3,533.6	7,292.5	2,458.2	7,115.3	37,239.9
Reconciliation of accounting to customer balances						
Gross balance	16,358.4	1,402.1	5,870.9	2,994.9	7,159.2	33,785.5
Fair value adjustments	4.5	–	–	198.6	104.2	307.3
Other accounting adjustments	(57.7)	(22.5)	(58.3)	3.9	18.0	(116.6)
Gross customer balances	16,305.2	1,379.6	5,812.6	3,197.4	7,281.4	33,976.2

	Retail		*CABB*			
	Secured	*Unsecured*	*Corporate*		*Optimum*	
			Core	*Non-core*		*Total*
30 June 2012						
Analysis of balance in note 11						
Gross balance	16,226.8	1,531.8	5,639.7	3,375.3	7,575.9	34,349.5
Less: allowance for losses	(3.4)	(164.9)	(83.4)	(81.4)	(8.0)	(341.1)
	16,223.4	1,366.9	5,556.3	3,293.9	7,567.9	34,008.4
Analysis of credit risk exposure						
Not impaired	16,080.9	1,309.6	5,412.3	2,697.8	6,261.0	31,761.6
Impaired	151.9	222.2	227.4	927.7	1,436.5	2,965.7
	16,232.8	1,531.8	5,639.7	3,625.5	7,697.5	34,727.3
Credit commitments	556.5	2,340.1	2,328.7	119.7	0.1	5,345.1
Gross credit risk exposure	16,789.3	3,871.9	7,968.4	3,745.2	7,697.6	40,072.4
Less:						
Fair value adjustments	(6.0)	–	–	(250.2)	(121.6)	(377.8)
Allowance for losses	(3.4)	(164.9)	(83.4)	(81.4)	(8.0)	(341.1)
Net credit risk exposure	16,779.9	3,707.0	7,885.0	3,413.6	7,568.0	39,353.5
Reconciliation of accounting to customer balances						
Gross balance	16,226.8	1,531.8	5,639.7	3,375.3	7,575.9	34,349.5
Fair value adjustments	6.0	–	–	250.2	121.6	377.8
Other accounting adjustments	(10.3)	(24.9)	209.8	(142.1)	25.5	58.0
Gross customer balances	16,222.5	1,506.9	5,849.5	3,483.4	7,723.0	34,785.3

Corporate impaired balances have been restated to show all watchlist cases as impaired, in line with revised 2013 treatment. The comparative table has also been updated to include the changes made to impairment criteria in the December 2012 financial statements.

Other accounting adjustments include accrued interest, interest fair value adjustments and effective interest rate adjustments.

The disclosures in sections 1.4.1.3 Secured residential credit risk, 1.4.1.4 Unsecured retail credit risk and 1.4.1.5 Corporate credit risk are all based on the gross customer balances in the above tables.

1.4.1.3 *Secured residential credit risk*

Acquisition and account management

Mortgages are loans to customers secured by a first charge over a residential property. Mortgages are originated directly to customers via branches, telephone and the internet under the Britannia and Co-operative Bank brands, and via intermediaries under the Platform brand. In the period to 30 June 2013, 70% (30 June 2012: 66%) of mortgages were originated directly and 30% (30 June 2012: 34%) through intermediaries.

The Britannia and Co-operative Bank brands only originate prime residential mortgages, while Platform primarily originates a combination of prime residential and buy-to-let loans.

Historically, loans may have been advanced on a capital and interest payment basis, where the loan is repaid over the term of the loan, or interest only, where the capital element of the loan is repayable at the end of the term. All new advances are on a capital repayment basis, with the exception of buy-to-let lending and existing interest only customers moving home.

The table below shows residential mortgage completions in the period, analysed by loan-to-value (LTV) and repayment method:

	Period to 30 June 2013			*Period to 30 June 2012*		
	Amount advanced	*Average LTV %*	*Interest only %*	*Amount advanced*	*Average LTV %*	*Interest only %*
Retail prime	1,076.9	63.5	1.3	972.9	57.8	10.6
Platform prime	404.2	68.5	–	180.3	58.6	25.0
Total prime	1,481.1	65.0	0.9	1,153.2	57.9	12.2
Buy-to-let	57.0	65.8	84.9	306.6	62.8	84.5
Almost prime	1.6	54.8	–	3.4	56.1	2.8
Total completions	1,539.7	65.0	4.2	1,463.2	59.0	25.6

The risk in the portfolio is recalculated monthly, using internally developed behavioural models, to assess the likelihood of default. A regional house price index is used to reflect any changes in the value of collateral (see below). This process is also used to determine the amount of capital required to be held for individual loans.

Mortgages originated prior to 2009 by Platform or acquired by Britannia, are managed as part of a closed portfolio, Optimum. These loans include a range of asset types, including prime residential (both income verified and self-certified), buy-to-let, and non-conforming mortgages.

The table below shows gross customer balances for residential mortgages analysed by current LTV banding:

	30 June 2013			*30 June 2012*		
	Retail secured	*Optimum*	*Total*	*Retail secured*	*Optimum*	*Total*
Less than 50%	5,613.4	471.5	6,084.9	5,654.8	459.4	6,114.2
50% to 60%	2,389.1	380.3	2,769.4	2,217.0	355.5	2,572.5
60% to 70%	2,802.5	708.5	3,511.0	2,613.6	641.9	3,255.5
70% to 80%	2,704.4	1,122.8	3,827.2	2,792.7	1,010.5	3,803.2
80% to 90%	2,021.9	1,407.9	3,429.8	1,876.5	1,523.7	3,400.2
90% to 100%	475.0	1,450.5	1,925.5	630.5	1,600.3	2,230.8
Greater than 100%	298.9	1,739.9	2,038.8	437.4	2,131.7	2,569.1
	16,305.2	7,281.4	23,586.6	16,222.5	7,723.0	23,945.5

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

	30 June 2013			*30 June 2012*		
	Gross customer balance	*Average LTV %*	*Interest only %*	*Gross customer balance*	*Average LTV %*	*Interest only %*
Prime residential	15,743.5	44.5	20.2	15,875.7	44.3	24.1
Buy-to-let	3,194.2	73.5	90.6	3,119.1	75.8	90.5
Self-certified	2,031.1	75.8	78.1	2,164.0	77.3	77.5
Almost prime	912.7	88.7	68.0	969.0	91.2	67.4
Non-conforming	1,705.1	76.3	67.2	1,817.7	78.2	66.2
	23,586.6	53.1	40.0	23,945.5	53.5	42.6

Collateral

Mortgages are secured by a first charge over the property being purchased or remortgaged. Valuation of the property is normally assessed by a RICS certified surveyor from the Bank's approved panel. For low LTV remortgages, valuation may be assessed through the use of an automated valuation model (AVM).

It is not normal practice to reassess the valuation of collateral unless further lending is being considered, or the property has been repossessed, but on a quarterly basis the valuation is restated using a regional property price index.

The table below analyses the indexed value of property collateral held against mortgage portfolios:

	30 June 2013			*30 June 2012*		
	Gross customer balance	*Collateral*	*Cover %*	*Gross customer balance*	*Collateral*	*Cover %*
Impaired	1,350.9	1,297.0	96.0	1,594.1	1,523.8	95.6
Not impaired	22,235.7	22,111.9	99.4	22,351.4	22,202.0	99.3
	23,586.6	23,408.9	99.2	23,945.5	23,725.8	99.1

The comparative figures have been updated to include the changes made to impairment criteria in both the December 2012 financial statements and the current period.

In the table, collateral is constrained to a maximum of 100% of the exposure to each customer to correctly reflect the maximum protection available to the Bank.

Impairment

A loan is identified as impaired when:

- arrears outstanding are equivalent to one monthly instalment or more; or
- the loan is more than 90 days past its term but has not been repaid; or
- the account is in litigation or the property is in possession; or
- the estimated forced sale value of the collateral on a roll up mortgage has reduced below the loan balance outstanding.

Loans meeting any of these criteria are considered impaired even if a loss is not expected in the event of repossession.

Loans that are not identified as impaired are collectively assessed for unidentified impairment (where a loss event has occurred, but objective evidence of impairment has not manifested).

Certain segments are separated into discrete pools for assessment where there are potential indicators of impairment that are not, by themselves, sufficient to identify a loan as impaired. These are:

- the loan is in arrears by less than one monthly instalment; and
- there has been a material deterioration in the borrower's external credit score in the last 12 months.

For each loan assessed for impairment, whether identified or unidentified, a shortfall is calculated based on the difference between the current loan balance and the expected 'forced sale' price of the collateral, discounted at the current interest rate to reflect the anticipated time to sale, and taking into account anticipated fees and costs prior to sale. This shortfall is then reduced on a collective basis to reflect the probability of the loan being taken into possession.

The table below shows:

- impaired customer balances as a percentage of gross customer balances; and

- impairment coverage, ie impairment provisions and fair value adjustments as a percentage of impaired customer balances.

	30 June 2013			*30 June 2012*		
	Retail secured	*Optimum*	*Total*	*Retail secured*	*Optimum*	*Total*
Gross customer balances	16,305.2	7,281.4	23,586.6	16,222.5	7,723.0	23,945.5
Impaired customer balances	153.1	1,197.8	1,350.9	152.9	1,441.2	1,594.1
Impaired as a % of gross customer balances	0.9%	16.5%	5.7%	0.9%	18.7%	6.7%
Credit protection						
Impairment provisions	4.6	43.9	48.5	3.4	8.0	11.4
Fair value adjustments	4.5	104.2	108.7	6.0	121.6	127.6
	9.1	148.1	157.2	9.4	129.6	139.0
Credit protection as a % of impaired customer balances	5.9%	12.4%	11.6%	6.1%	9.0%	8.7%

The comparative figures for impaired customer balances have been re-presented to reflect the changes made to impairment criteria in the December 2012 financial statements.

The table below shows the credit quality of loans and advances that are not impaired:

	30 June 2013			*30 June 2012*		
	Retail secured	*Optimum*	*Total*	*Retail secured*	*Optimum*	*Total*
Low to medium risk	15,826.0	4,522.0	20,348.0	15,674.4	4,477.0	20,151.4
Medium to high risk	326.1	1,561.6	1,887.7	395.3	1,804.7	2,200.0
	16,152.1	6,083.6	22,235.7	16,069.7	6,281.7	22,351.4

Low to medium risk is defined as exposures with a probability of default (PD) in the next year of 1% or below using the internal ratings based (IRB) approach under Basel II. Medium to high risk is defined as exposures with a PD in the next year of greater than 1%. 2012 balances have been restated based on the same risk classification used at 30 June 2013.

Forbearance

A number of options are available to borrowers in financial difficulty. Repossession of the property will only be considered when all other avenues have been explored. The precise treatment selected depends on the borrower's individual circumstances, but may include:

- arrangements to repay outstanding arrears over a period of time, by making payments above the contractual amount. The loan is deemed to be impaired, until the arrears have been cleared in full;
- short term concessions, where the borrower is allowed to make reduced repayments (or, in exceptional circumstances, no repayments) on a temporary basis to assist with a short term financial hardship. In these cases the shortfall on the repayments will accrue as arrears and the loan is deemed to be impaired;
- payment holidays are allowed as part of a customer's flexible mortgage contract. Payment holidays are not knowingly allowed for customers experiencing financial hardship. However, in the absence of evidence to the contrary, loans

that have had a payment holiday in the last two years are treated as being subject to forbearance;

- temporary conversion of a mortgage to interest only repayments. The capital repayments due in this period are spread over the remaining term on conversion back to capital repayment as part of an instalment recalculation exercise;
- permanent conversion to interest only repayments, is no longer allowed, however where this has been agreed in the past two years, a loan is considered to be subject to forbearance;
- an extension to the mortgage term to reduce the borrower's repayments. All loans that have had a term extension in the last two years are considered to be subject to forbearance, even where these were not agreed as a forbearance treatment;
- capitalisation, where outstanding arrears are added to the capital value of the loan to be repaid over the remaining term. This is only considered by exception with eight cases capitalised during the period to 30 June 2013 (30 June 2012: eight); and
- where applicable we will work with the customer as part of a government support scheme. Unmet loan payments will continue to accrue as arrears until such time as the loan is cleared, or the outstanding payments are brought up to date.

Loans subject to forbearance are only classed as impaired if they meet the impairment definition in this section on page 316.

The underlying basis for the calculation of residential mortgage impairment provisions remains unchanged. Mortgages subject to forbearance, once classified as impaired, are assessed for the appropriate impairment rate to apply.

The table below analyses secured residential mortgage balances by type of forbearance and the associated gross impairment coverage, including credit fair value adjustments:

	Neither past due nor impaired	*Impaired*	*Loans subject to forbearance*	*Impairment coverage*
30 June 2013				
Arrangements	54.5	436.4	490.9	(51.8)
Concessions	1.0	3.4	4.4	(0.1)
Payment holidays	166.4	0.5	166.9	–
Interest only switches	276.1	46.8	322.9	(2.6)
Term extensions	334.8	5.3	340.1	(0.2)
Capitalisations	0.4	–	0.4	–
	833.2	492.4	1,325.6	(54.7)

	Neither past due nor impaired	*Impaired*	*Loans subject to forbearance*	*Impairment coverage*
30 June 2012				
Arrangements	57.6	493.8	551.4	(25.6)
Concessions	1.2	4.0	5.2	(0.1)
Payment holidays	175.8	–	175.8	–
Interest only switches	616.6	–	616.6	(1.4)
Term extensions	240.2	–	240.2	(0.1)
Capitalisations	3.6	–	3.6	–
	1,095.0	497.8	1,592.8	(27.2)

1.4.1.4 *Unsecured retail credit risk*

Acquisition and account management

The Bank offers unsecured lending through fixed repayment loans, credit cards and overdrafts. Customers are assessed using a combination of credit scoring and policy rules. Credit cards and overdrafts are subject to ongoing account management to increase or decrease credit limits and manage over limit authorisations.

The risk in the portfolio is reassessed monthly using internally developed behavioural scorecards to determine the amount of capital required to be held for individual loans.

The following table shows unsecured lending gross customer balances (including undrawn commitments) by product type:

	30 June 2013	*30 June 2012*
Loans	723.2	750.6
Credit cards	2,597.2	2,724.6
Overdrafts	362.7	371.8
	3,683.1	3,847.0

Impairment

Impairment provision is raised for:

- identified impairment – at one penny, one day past due or in excess, based on the probability of default and the discounted cash flow of recoveries from default;
- unidentified impairment – on the performing book, based on the probability of emerging as delinquent, the probability of default and the discounted cash flow of recoveries from default; and
- fraud upon identification.

The table below shows:

- gross customer balances (excluding undrawn commitments);
- impaired customer balances as a percentage of gross customer balances; and
- impairment coverage, ie impairment provisions including those charged off in relation to Debt Collection Agencies (DCA) as a percentage of impaired customer balances.

	30 June 2013	*30 June 2012*
Gross customer balances	1,379.6	1,506.9
Impaired customer balances	230.8	305.6
Impaired as a % of gross customer balances	16.7%	20.3%
Credit protection		
Impairment provisions	172.0	164.9
DCA balances charged off	29.0	83.4
	201.0	248.3
Credit protection as a % of impaired customer balances	87.1%	81.3%

The comparative figure for impaired customer balances in the table above has been re-presented to reflect the changes made to impairment criteria in the December 2012 financial statements.

The reduction observed in impaired customer balances between June 2012 and June 2013 is reflective of debt sale, made in the period between 1 January 2013 and 30 June 2013.

Forbearance

A number of forbearance options are available to borrowers in financial difficulty. Accounts classified as impaired remain so until the arrears are cleared in full. This will be achieved through making arrangement either with customers directly or through a third party whom they have chosen to represent them.

1.4.1.5 *Corporate credit risk*

Acquisition and account management

The Bank is managed through two distinct classifications. Currently the Core business represents activity consistent with the strategy and risk appetite for the Bank and within corporate comprises corporate banking, business banking and business services. Non-core business lines predominantly include corporate banking business (Optimum and Illius (the residential property company) business which originated from the non-member Britannia prior to merger are reported elsewhere in this report). The non-core business is managed for value and targeted for run down or exit.

The Bank operates to a new lending policy which is subject to meeting criteria as laid down in the corresponding sector strategy guidelines and strict policy with regards single name and sector concentrations. New lending is approved within the centrally based credit underwriting team, independent from income generation. Lending discretions are based on the risk profile of the customer and the amount of exposure. The lending discretions of the Credit Risk Sanctions Committee, Chief Risk Officer, Credit Risk Director, the Chief Executive and the Credit Approvals Committee are operated to sanction the largest credit applications. In the context of the non-core strategy this is limited to annual reviews and renewals and in certain circumstances where additional lending may protect value in the work out of a customer asset. Following the Bank's decision to change business focus a challenge process has been applied by senior management to the pipeline business.

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.

Monitoring of portfolios and impairment provisioning governance is in place across the portfolios. 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 Credit Risk Management Committee (CRMC) and Executive Risk Committee (ERC) (and by exception Board Risk Committee BRC) receive regular reports on the performance of the portfolio.

The tables below show the distribution of the Corporate and Business Banking gross customer balances (including commitments, but excluding Unity Trust Bank) by sector and risk grade, where PD grades have been mapped to regulatory slotting categories for ease of interpretation in this report.

	Stand-ardised	*Strong*	*Good*	*Satis-factory*	*Weak*	*Default*	*Total*
30 June 2013							
Core							
Accomodation, food and licensed services	214.5	136.2	125.1	20.2	21.7	40.7	558.4
Care	182.0	18.6	73.0	23.3	3.7	16.8	317.4
Education	87.3	34.5	2.9	1.0	–	–	125.7
Financial services	65.9	77.6	28.4	4.4	–	4.5	180.8
Football clubs	–	33.1	–	0.4	0.1	0.8	34.4
Housing associations	7.8	252.6	1.8	–	–	–	262.2
Manufacturing	45.5	25.1	24.2	16.6	12.2	8.6	132.2
Motor trade and garages	24.2	55.5	24.3	3.5	0.7	1.7	109.9
PFI	–	32.0	1,179.0	13.3	20.9	4.8	1,250.0
Professional services	73.0	15.4	21.7	14.2	0.7	3.4	128.4
Property and construction:							
Commercial investment	16.5	80.6	1,039.8	174.8	4.8	158.0	1,474.5
Residential investment	8.1	0.7	111.4	18.5	7.0	7.8	153.5
Commercial development	1.6	2.5	177.0	72.9	2.4	54.0	310.4
Residential development	5.9	1.9	62.3	14.8	2.9	11.1	98.9
Public sector entities	172.9	0.3	–	–	–	–	173.2
Renewable energy	611.0	–	–	–	–	9.3	620.3
Retail and wholesale trade	69.7	402.5	27.8	11.9	1.1	19.3	532.3
Services	398.6	127.5	36.1	30.3	0.6	33.8	626.9
Transport, storage and communication	24.8	15.5	3.9	6.6	1.3	28.7	80.8
Utilities	42.9	1.2	1.3	1.0	–	0.6	47.0
Business banking	1.1	41.8	7.9	3.0	0.5	0.5	54.8
Other	6.9	2.4	1.4	2.2	–	2.1	15.0
	2,060.2	1,357.5	2,949.3	432.9	80.6	406.5	7,287.0
Non-core							
Accomodation, food and licensed services	–	–	38.3	–	–	259.4	297.7
Football clubs	–	–	–	–	–	15.1	15.1
Housing associations	–	830.2	45.0	–	–	–	875.2
Professional services	–	–	–	–	–	0.3	0.3
Property and construction:							
Commercial investment	24.0	23.3	214.2	66.5	50.1	1,344.7	1,722.8
Residential investment	–	–	77.0	26.4	56.7	131.4	291.5
Commercial development	–	–	–	–	–	6.4	6.4
Renewable energy	28.1	–	–	–	–	–	28.1
Transport, storage and communication	–	–	–	–	–	–	–
	52.1	853.5	374.5	92.9	106.8	1,757.3	3,237.1
Total exposure	2,112.3	2,211.0	3,323.8	525.8	187.4	2,163.8	10,524.1

	Stand-ardised	*Strong*	*Good*	*Satis-factory*	*Weak*	*Default*	*Total*
30 June 2012							
Core							
Accomodation, food and licensed services	308.4	114.0	156.0	24.7	17.1	3.7	623.9
Care	180.0	34.1	65.3	30.9	2.8	–	313.1
Education	71.8	46.6	9.1	1.4	–	–	128.9
Financial services	88.9	67.0	24.6	3.8	–	2.3	186.6
Football clubs	–	41.5	–	0.5	0.1	0.1	42.2
Housing associations	279.4	–	0.5	–	–	–	279.9
Manufacturing	70.5	20.8	43.4	17.9	21.2	1.2	175.0
Motor trade and garages	29.4	39.5	23.0	10.0	0.8	3.7	106.4
PFI	0.1	4.0	1,297.5	–	–	14.9	1,316.5
Professional services	68.6	71.0	17.9	9.8	2.5	3.9	173.7
Property and construction:							
Commercial investment	5.7	141.9	1,049.4	187.0	95.8	48.9	1,528.7
Residential investment	10.5	6.3	114.8	10.0	8.1	3.6	153.3
Commercial development	24.4	13.0	140.7	81.4	39.3	11.7	310.5
Residential development	1.5	2.6	79.1	12.7	11.9	4.9	112.7
Public sector entities	197.2	–	–	–	–	–	197.2
Renewable energy	567.7	–	–	–	–	9.4	577.1
Retail and wholesale trade	107.5	374.5	31.0	22.1	–	5.2	540.3
Services	458.2	110.2	62.0	39.2	20.7	18.5	708.8
Transport, storage and communication	136.9	53.0	10.2	8.3	14.1	5.7	228.2
Utilities	86.1	1.5	0.3	11.5	–	0.6	100.0
Business banking	0.7	33.5	7.9	4.5	0.7	0.3	47.6
Other	8.9	1.7	1.4	4.2	–	2.1	18.3
	2,702.4	1,176.7	3,134.1	479.9	235.1	140.7	7,868.9
Non-core							
Accomodation, food and licensed services	47.5	–	–	–	36.0	161.2	244.7
Football clubs	–	–	–	15.0	–	4.2	19.2
Housing associations	910.2	–	–	–	–	–	910.2
Professional services	–	–	–	–	–	–	–
Property and construction:							
Commercial investment	13.9	18.0	323.6	284.4	949.2	476.1	2,065.2
Residential investment	–	39.5	137.9	27.6	44.4	79.2	328.6
Commercial development	–	–	–	–	–	–	–
Renewable energy	28.9	–	–	–	–	–	28.9
Transport, storage and communication	6.3	–	–	–	–	–	6.3
	1,006.8	57.5	461.5	327.0	1,029.6	720.7	3,603.1
Total exposure	3,709.2	1,234.2	3,595.6	806.9	1,264.7	861.4	11,472.0

The Standardised category relates to sectors which for purposes of capital calculations, are not rated with a regulatory approved rating model due to the sector having insufficient numbers of customers and/or low defaults. These typically belong to the public sector entities and renewable energy sectors, and to the following customer types within other sectors: other energy efficiency schemes, leveraged (more highly geared businesses, for example, comprising of Management Buy-Outs or firms that have made business acquisitions to expand their operation) of which we have a relatively small portfolio, newly established companies with an insufficient number of published financial accounts, project finance and charities.

The movement of balances into the Default category in the period remains reflective of the continued challenging commercial property environment and the Bank's focus on the expected outlook for this sector, consequential forbearance strategies and the completion of the Bank's review of its default and credit risk impairment strategy.

Collateral

The Bank uses various forms of collateral including guarantees to mitigate credit risk. Collateral is regularly reviewed to ensure continued effectiveness as part of the credit review process. Property collateral for corporate lending is categorised as security for property development or investment customers (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 customer, other security is taken in modest proportion to the total portfolio. This includes debentures or floating charges and guarantees (often supported by tangible security, where appropriate, including property, life policies and stocks & shares) and cash cover.

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

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

The table below analyses the fair value of the property collateral held against assets in the property and construction sectors. Property valuations are obtained when the facility is first approved and the current lending procedures require collateral to be revalued every two years or more frequently in higher risk situations (typically annually or when a material change has occurred that is likely to affect the value and recoverability of the debt). In certain circumstances, such as syndicates, the Bank may be unable to obtain regular revaluations or may exercise discretion to not seek a revaluation for a longer period of time. However, the Bank has adopted a review and challenge process on valuations to assure itself on current valuations held in the Bank's systems. The values held in the Bank's systems are indexed using the appropriate regional and asset type indexes where available, otherwise the average national index is applied:

	30 June 2013			*30 June 2012*		
	Exposure	*Collateral*	*Impairment provision*	*Exposure*	*Collateral*	*Impairment provision*
Core						
Non-default loans with <= 1 year & all defaulted exposures regardless of term						
Less than 50%	72.1	72.0	0.1	68.7	68.7	–
50% to 60%	53.7	53.7	–	98.8	98.8	–
60% to 70%	132.1	132.1	–	86.5	86.5	–
70% to 80%	112.0	107.3	4.8	98.9	98.9	–
80% to 90%	42.6	37.4	5.2	62.1	59.7	2.4
90% to 100%	50.1	42.9	7.2	20.7	19.8	0.9
Greater than 100%	204.8	126.5	59.4	140.0	95.3	16.4
Unsecured	33.9	–	7.5	16.6	–	6.2
	701.3	571.9	84.2	592.3	527.7	25.9

	30 June 2013			30 June 2012		
	Exposure	*Collateral*	*Impairment provision*	*Exposure*	*Collateral*	*Impairment provision*
Non-default loans with > 1 year						
Less than 50%	206.4	206.4	–	270.6	270.6	–
50% to 60%	297.9	297.9	–	225.5	225.5	–
60% to 70%	424.4	424.4	–	361.4	361.4	–
70% to 80%	264.9	264.9	–	269.3	269.3	–
80% to 90%	32.0	32.0	–	60.7	60.7	–
90% to 100%	16.6	16.6	–	73.1	73.1	–
Greater than 100%	42.7	27.7	–	126.4	100.4	–
Unsecured	51.1	–	–	125.9	–	–
	1,336.0	1,269.9	–	1,512.9	1,361.0	–
	2,037.3	1,841.8	84.2	2,105.2	1,888.7	25.9
Non-core						
Non-default loans with <= 1 year & all defaulted exposures regardless of term						
Less than 50%	2.6	1.0	1.6	6.6	6.1	0.5
50% to 60%	27.0	25.6	1.4	–	–	–
60% to 70%	49.8	43.7	6.1	0.8	0.8	–
70% to 80%	13.3	13.0	0.3	31.5	31.5	–
80% to 90%	62.8	60.4	2.4	0.3	0.3	–
90% to 100%	31.1	27.8	3.3	19.9	19.9	–
Greater than 100%	1,173.1	750.9	402.8	739.1	475.1	168.7
Unsecured	212.4	–	153.7	41.2	–	37.7
	1,572.1	922.4	571.6	839.4	533.7	206.9
Non-default loans with > 1 year						
Less than 50%	39.2	39.2	–	71.3	71.3	–
50% to 60%	37.9	37.9	–	83.9	83.9	–
60% to 70%	111.3	111.3	–	180.4	180.4	–
70% to 80%	74.3	74.3	–	104.9	104.9	–
80% to 90%	63.1	63.1	–	132.9	132.9	–
90% to 100%	47.5	47.5	–	112.3	112.3	–
Greater than 100%	32.4	18.4	–	700.4	603.7	–
Unsecured	42.9	–	–	168.3	–	–
	448.6	391.7	–	1,554.4	1,289.4	–
	2,020.7	1,314.1	571.6	2,393.8	1,823.1	206.9

In the table, collateral is constrained to a maximum of 100% of the exposure to each customer to correctly reflect the maximum protection available to the Bank.

Of the above at 30 June 2013, £46.1m (30 June 2012: £40.0m) is not held as first charge.

Impairment

Corporate customers are placed on a watchlist and treated as impaired when they show signs of unsatisfactory performance and require close control. Strong indicators that a customer should be placed on watchlist include but are not limited to:

- unsatisfactory account operation – both lending facility and current accounts;
- considerable reduction in value of collateral;
- deteriorating balance sheet position and/or material losses/cashflow pressures;
- breach of covenants;

- refinance risk at maturity;
- application of forbearance strategies; and
- business performance is assessed to have deteriorated to the extent that there is a real risk of loss of principal, interest or fees.

After a period of satisfactory performance and dependent on the Bank's satisfaction that the triggers which led to inclusion on the watchlist no longer apply, customers who stop exhibiting higher risk traits are removed from the watchlist.

Removal from the watchlist usually requires the customer's management information to show that trading is achieving the revised plan with objective evidence that this will continue.

The Bank also reviews on a monthly basis all higher risk loans (including those accounts subject to forbearance) and considers the potential loss which might arise were the borrowers to fail (notwithstanding that continued trading remains the expectation).

Objective evidence of impairment will include but is not limited to:

- an instalment on a loan account being overdue, or having been in excess of its limit (or being overdrawn without an agreed limit) for 90 days or more;
- an event likely to result in insolvency which may involve bankruptcy, or the appointment of an administrative receiver, liquidator or administrator; or
- if the Bank considers that at some point (normally taken within the next 12 months) the facility is unlikely to be repaid in full and actions such as an issue of formal demand will be required in order to achieve full repayment.

Credit risk impairment will be required on some or all of the entire shortfall between the security held and the loan balance outstanding and represents an assessment of the likely net loss after realisation of any security.

For credit risk impairment purposes, a property valuation or selling agent's recommendation is discounted to take into account selling and legal costs and also to build in a contingency to cover potential reductions in the selling price based upon the type of security and entity and the existence or otherwise of a contracted sale. In some cases, calculation of the credit risk impairment is based on an up to date assessment (often following an independent business review by a firm of accountants) of likely receivables from the business or a formal estimated outcome statement from an insolvency practitioner where the business has failed.

Provisioning adjustments are also recorded, as appropriate, against loans whose interest terms have changed such that revised future cashflows discounted at the original interest rate are less than the current carrying amount.

The collective unidentified impairment provision (CUIP) provides cover for the performing portfolio using a formulaic approach based on default experience across the portfolio. The unidentified impairment reflects trigger events that have occurred but not yet been captured and cannot, therefore be allocated to individual loans.

The table below shows:

- impaired customer balances as a percentage of gross customer balances; and
- credit protection, ie impairment provisions and fair value adjustments as a percentage of impaired customer balances.

	30 June 2013		30 June 2012	
	Core	*Non-core*	*Core*	*Non-core*
Gross customer balances	5,812.6	3,197.4	5,849.5	3,483.4
Impaired customer balances	687.9	1,893.8	525.9	1,897.1
Impaired as a % of gross customer balances	11.8%	59.2%	9.0%	54.5%
Credit protection				
Impairment provisions	272.7	576.4	83.4	81.4
Fair value adjustments	–	198.6	–	250.2
	272.7	775.0	83.4	331.6
Credit protection as a % of impaired customer balances	39.6%	40.9%	15.9%	17.5%

The comparative figures for impaired customer balances in the table above has been re-presented to reflect the changes made to impairment criteria in the December 2012 and June 2013 financial statements.

The level of cover as a percentage of impaired non-core customer balances has increased to 40.9% in June 2013 from 17.5% in June 2012 following a further increase in the level of impairment provisions. The increased impairment provisions for corporate core loans has also increased causing the cover to rise to 39.6% in June 2013 from 15.9% in June 2012.

Forbearance

If the Bank is confident of a customer's ability and commitment to address their financial difficulties, it may agree to grant concessions to the original contractual terms. Such concessions typically include:

- restructuring, waiving or reserving rights in the event of covenant breaches;
- postponement of principal payments;
- restructures of principal payments;
- extension of loan maturities;
- partial or full capitalisation of interest payments; or
- swap restructures.

In addition to the above, other forbearance concessions are considered to be objective evidence of impairment and include:

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

The table below analyses the exposures subject to forbearance:

	30 June 2013			30 June 2012		
	Forborne	*Non-forborne*	*Total*	*Forborne*	*Non-forborne*	*Total*
Core						
Default	244.8	161.8	406.6	49.2	91.4	140.6
On watchlist	138.8	178.2	317.0	285.7	118.5	404.2
Neither default nor on watchlist	77.5	6,485.9	6,563.4	194.4	7,129.7	7,324.1
	461.1	6,825.9	7,287.0	529.3	7,339.6	7,868.9
Non-core						
Default	1,145.5	611.6	1,757.1	344.0	376.7	720.7
On watchlist	107.1	32.0	139.1	941.9	296.0	1,237.9
Neither default nor on watchlist	31.5	1,309.4	1,340.9	89.9	1,554.6	1,644.5
	1,284.1	1,953.0	3,237.1	1,375.8	2,227.3	3,603.1
	1,745.2	8,778.9	10,524.1	1,905.1	9,566.9	11,472.0

Impairment provisions are made for accounts subject to forbearance which are in default and on the watchlist.

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

1.4.2 ***Investment securities***

At the balance sheet date, the Bank has a total investment securities portfolio of £5,102.6m (30 June 2012: £4,999.3m) of which £20.0m (30 June 2012: £42.3m) is considered impaired and against which £20.0m (30 June 2012: £42.3m) of provisions are held.

The following tables analyse the gross balance by impairment classification and type of investment security:

	Loans and receivables	*Available for sale*	*Fair value through income or expense*	*Held for trading*	*Total*
30 June 2013					
Analysis of balance per note 12					
Gross balance	30.6	3,449.7	1,622.3	–	5,102.6
Less: allowance for losses	–	(20.0)	–	–	(20.0)
	30.6	3,429.7	1,622.3	–	5,082.6
Analysis of credit risk exposure					
Not impaired	30.6	3,429.7	1,622.3	–	5,082.6
Impaired	–	20.0	–	–	20.0
Gross credit risk exposure	30.6	3,449.7	1,622.3	–	5,102.6
Less: allowance for losses	–	(20.0)	–	–	(20.0)
Net credit risk exposure	30.6	3,429.7	1,622.3	–	5,082.6

	Loans and receivables	*Available for sale*	*Fair value through income or expense*	*Held for trading*	*Total*
30 June 2012					
Analysis of balance per note 12					
Gross balance	483.0	3,259.9	817.4	439.0	4,999.3
Less: allowance for losses	–	(42.3)	–	–	(42.3)
	483.0	3,217.6	817.4	439.0	4,957.0
Analysis of credit risk exposure					
Not impaired	483.0	3,217.6	817.4	439.0	4,957.0
Impaired	–	42.3	–	–	42.3
Gross credit risk exposure	483.0	3,259.9	817.4	439.0	4,999.3
Less: allowance for losses	–	(42.3)	–	–	(42.3)
Net credit risk exposure	483.0	3,217.6	817.4	439.0	4,957.0

1.4.2.1 *Collateral*

Policies are in place with regard to the management and valuation of collateral. Repos and secured lending positions are revalued daily. Margin calls on collateralised swaps are predominantly made daily, save for several arrangements which permit calls on a weekly basis. Eligible financial collateral for Basel II reporting purposes includes gilts held under reverse repo agreements and cash held under both repo agreements and collaterised swap arrangements. The guarantees relied upon are either parental guarantees held against subsidiary exposures within bank groups or sovereign guarantees.

1.4.2.2 *Impaired assets*

Investment securities are considered past due where the contractual interest or principal payments are in arrears and it is determined that the Bank will be able to collect all principal and interest outstanding according to the contractual terms of the agreements.

Investment securities are considered impaired where it is determined that the Bank will be unable to collect all principal and interest outstanding, according to the contractual terms of the agreements.

At the balance sheet date, the Bank assesses its investment securities for objective evidence that an impairment loss has occurred. Particular consideration is given to evidence of any significant difficulty of the issuer or measurable decrease in the estimated cash flows from the investments.

1.4.2.3 *Not impaired*

The Bank only invests in treasury assets which comply with the treasury credit risk policy. Within the treasury investment security portfolio 100% (30 June 2012: 98%) of exposures have an external credit rating equivalent to Fitch A or above.

1.4.3 ***Loans and advances to banks***

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

1.5 Eurozone risk

The Bank remains a UK focused retail and commercial operation. It has no sovereign exposure to 'peripheral' eurozone countries (Portugal, Ireland, Italy, Greece and Spain). As at 30 June 2013 the Bank had a £306.6m (30 June 2012: £304.9m) gross exposure to the Government of Finland, £91.2m (30 June 2012: £50.1m) to the Swedish Export Credit Corporation, £110.0m (30 June 2012: £nil) to KfW (a development bank owned by the German Federal Government) and £116.5m (30 June 2012: £nil) to FMS Wertmanagement (the German Federal Government's winding up institution for the nationalised Hypo Real Estate Holding AG), repayable in over one year. It held no other material non-UK sovereign debt.

Other than a £25k (30 June 2012: £25k) exposure to the London subsidiary of a Greek bank, the Bank has no direct exposure to Greek financial institutions or any other counterparty types.

1.5.1 *Direct exposures*

The analyses on the following pages set out the Bank's exposures to financial institutions in European countries, both by asset maturity and by asset type.

The Bank has exposures to financial institutions in the following European countries at 30 June 2013:

Country	*Repayable within 30 days*	*Repayable within 1 year but more than 30 days*	*Repayable in over 1 year*	*Total gross exposure*	*Credit risk mitigation*	*Total net exposure*
30 June 2013						
Austria	–	–	–	–	–	–
Belgium	–	–	–	–	–	–
Denmark	6.2	–	–	6.2	–	6.2
Finland	–	–	9.0	9.0	–	9.0
France	212.0	24.8	58.4	295.2	(11.3)	283.9
Germany	25.9	21.0	338.9	385.8	(323.1)	62.7
Ireland	0.1	–	–	0.1	–	0.1
Netherlands	18.1	35.1	259.5	312.7	–	312.7
Norway	–	–	–	–	–	–
Spain	–	–	–	–	–	–
Sweden	1.4	–	–	1.4	–	1.4
Switzerland	45.3	420.0	83.0	548.3	(362.4)	185.9
	309.0	500.9	748.8	1,558.7	(696.8)	861.9

Country	*Repayable within 30 days*	*Repayable within 1 year but more than 30 days*	*Repayable in over 1 year*	*Total gross exposure*	*Credit risk mitigation*	*Total net exposure*
30 June 2012						
Austria	–	4.2	–	4.2	(4.2)	–
Belgium	–	22.8	11.2	34.0	(34.0)	–
Denmark	57.2	–	–	57.2	–	57.2
Finland	–	–	–	–	–	–
France	151.4	70.2	158.2	379.8	(59.3)	320.5
Germany	161.0	32.2	187.5	380.7	(174.0)	206.7
Ireland	0.1	–	–	0.1	–	0.1
Netherlands	0.1	54.4	264.7	319.2	–	319.2
Norway	–	–	70.6	70.6	–	70.6
Spain	–	1.8	71.3	73.1	(23.0)	50.1
Sweden	10.7	10.0	114.9	135.6	–	135.6
Switzerland	93.5	3.1	660.1	756.7	(373.6)	383.1
	474.0	198.7	1,538.5	2,211.2	(668.1)	1,543.1

For the purposes of the above table, exposures to counterparties which comprise subsidiaries of larger banking groups within which Treasury maintains additional counterparty relationships are aggregated at the group level with the associated risk country being that of the ultimate parent entity. As at 30 June 2013 an exposure of £5.7m (30 June 2012: £8.5m) to an Irish subsidiary of a major American bank group was accordingly reported as exposure to the American based parent and is thus excluded from the analysis above. This exposure is fully guaranteed by the group holding company.

Credit risk mitigation takes the form of UK gilt collateral held in relation to reverse repo transactions, cash collateral held in relation to sold repo and derivative transactions, and sovereign/sub-sovereign guarantees in relation to specific debt security holdings.

The table below shows the Bank's exposure to financial institutions in European countries by asset type.

Country	*Bank and money market balances*	*Bonds*	*Derivatives*	*Other*	*Total net exposure*
30 June 2013					
Denmark	0.6	–	–	5.6	6.2
Finland	–	9.0	–	–	9.0
France	–	50.9	21.0	212.0	283.9
Germany	1.4	18.0	18.7	24.6	62.7
Ireland	0.1	–	–	–	0.1
Netherlands	18.1	294.6	–	–	312.7
Norway	–	–	–	–	–
Spain	–	–	–	–	–
Sweden	0.2	–	–	1.2	1.4
Switzerland	0.4	–	55.2	130.3	185.9
	20.8	372.5	94.9	373.7	861.9

Country	*Bank and money market balances*	*Bonds*	*Derivatives*	*Other*	*Total net exposure*
30 June 2012					
Denmark	49.4	–	–	7.8	57.2
Finland	–	–	–	–	–
France	0.1	100.4	19.7	200.3	320.5
Germany	128.0	25.0	20.8	32.9	206.7
Ireland	0.1	–	–	–	0.1
Netherlands	0.1	319.1	–	–	319.2
Norway	–	70.6	–	–	70.6
Spain	–	50.1	–	–	50.1
Sweden	20.2	114.9	0.5	–	135.6
Switzerland	20.6	–	40.8	321.7	383.1
	218.5	680.1	81.8	562.7	1,543.1

The other asset types comprise repo, reverse repo, foreign exchange transactions, post collateral and exposure within the Bank's securitisation vehicles.

In addition to the above exposures to financial institutions:

- in the overseas European Economic Area (EEA as defined by the European Banking Authority) and Switzerland, corporate customer exposures at 30 June 2013 totalled

£172.9m (30 June 2012: £172.3m). There are no exposures to retail customers based outside of the UK and Channel Islands;

- gross exposure to European multilateral development banks (not included in the above table given the supranational status associated with these institutions) stood at £1,764.7m (30 June 2012: £1,333.5m) before credit risk mitigation (£971.1m post credit risk mitigation (30 June 2012: £793.3m)) of which £868.7m matures within a year (30 June 2012: £576.0m); and
- ABS/MBS exposures of £10.8m and £2.8m (30 June 2012: £14.8m and £3.5m) to Spanish and Belgian special purpose entities respectively were outstanding as at 30 June 2013.

The Bank continues to monitor developments daily across all countries as they affect the Treasury portfolio. As a result of proactive management actions taken throughout the eurozone crisis in order to reduce the associated risk within the Treasury portfolio the focus for existing exposures is with counterparties in Northern Europe (eg Germany, the Netherlands, Finland, Norway and Sweden) where economies are more robust. Credit quality and liquidity within the portfolio remains strong given the prevalence of shorter dated debt securities issued by AAA rated supranational financial institutions, government agencies and sovereign or state owned banks. Ongoing activity with financial institutions within the peripheral eurozone is currently restricted to Treasury's nostro accounts and selective vostro overdraft arrangements.

Treasury operates a risk based approach which monitors counterparty limits and exposure via a credit risk register. Both the counterparties and assets held are monitored against a Board approved matrix of risk tolerance and associated indicators. The credit risk register is updated for rating actions, market events and financial results as they are announced which may influence a change in risk status and possible escalation requiring management actions and inclusion on the watchlist.

The Treasury risk team reviews the entire portfolio and watchlists monthly for appropriate risk status bandings and any associated management actions.

As at 30 June 2013 there were no red (highest risk) eurozone exposures outstanding (30 June 2012: £25m).

1.5.2 ***Indirect exposures***

Treasury risk management monitoring extends beyond the direct risk incurred through counterparty trading, to the underlying exposures (eg to peripheral eurozone countries) which Treasury's counterparties may maintain on their own balance sheets. In analysing each counterparty's secondary exposure we assess the vulnerability and impact on that firm should it suffer different degrees of losses.

Where secondary sovereign exposure or contagion risk is deemed to undermine the performance of the counterparty, remedial management actions are taken in respect of Treasury's counterparty limits and exposure, often ahead of any associated rating actions.

2. Liquidity risk

In the period to 30 June 2013, the Bank has continued to maintain a sufficiently strong liquidity position, with a liquid asset ratio of 13.2% at the balance sheet date (30 June 2012: 12.4%). In addition, during the first half of 2013, the Bank proactively managed its liquidity position, maintaining a regulatory liquidity buffer, and has continued to restructure existing exposures to further improve the funding profile and ensure its financial obligations are met as and when they fall due. From a management perspective, liquidity is monitored on a daily basis via a suite of liquidity risk metrics supported by cashflow forecasts and stress tested forecasts.

2.1 **Liquidity framework**

The Bank's liquidity risk management framework comprises:

- a defined risk appetite, controls and governance in the Bank's liquidity management policies;
- 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;
- liquidity risk quantification and mitigation techniques and processes;
- 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;
- ongoing development and enhancement of the Bank's liquidity risk appetite framework; and
- a process to attribute the cost, benefit and risks of liquidity to specific business lines via the Bank's funds transfer pricing mechanism.

2.2 **Liquidity risk**

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

- survival periods which measure the degree of sufficiency 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, 94% (30 June 2012: 101%) – the ratio of customer loans to customer deposits;
- encumbrance ratio, 29% (30 June 2012: 25%) – 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.

2.3 **Liquidity risk management overview**

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 Committee (LMC), the Assets and Liabilities 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 reviewed by LMC, 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 and at weekly LMCs which operate to oversee the operational liquidity management. A range of indicators, details

of cashflows and media coverage are monitored to attempt to detect early signs of liquidity risk either in the market or specific to the Bank. The LMC, 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 FCA and PRA BIPRU regulations and industry guidelines.

2.3.1 ***Liquid asset portfolios***

The Bank holds a number of marketable asset pools that can be utilised for liquidity management through the Treasury operation. These asset pools have reduced over the period whilst remaining in excess of regulatory minimum as a result of the Bank's announcements and credit rating downgrades in the first half of 2013. These include:

- liquid asset buffer (LAB); the highest quality debt and comprise of cash at the Bank of England, gilts and central government and multilateral development bank bonds. The table below shows the market value and composition of the LAB:

	30 June 2013	*30 June 2012*
Qualifying stock		
Operational balances with central banks	5,060.4	4,050.9
Gilts	272.5	967.4
Central government and multilateral development bank bonds	804.7	880.2
	6,137.6	5,898.5

- non-buffer assets, these assets are not as highly liquid as LAB assets, however they exist to diversify the liquid asset pool; and
- own retained asset pool, the Bank has securitised part of its asset balance sheet and retained the issued notes. These assets are able to be used to obtain funding from third parties and form part of the Bank's contingent funding plans.

The Bank uses any combination of these asset pools to manage its liquidity position, with LAB and non-buffer assets used predominantly for short term cashflow movements, with the own retained asset pool creating longer term or contingent liquidity. Regular realisation through repo transactions and outright sales provide assurance that these asset pools are marketable, or otherwise realisable.

2.3.2 ***Wholesale funding***

The majority of the Bank's funding comes from retail and corporate customer accounts. The Bank's primary objective in respect of wholesale funding is to supplement retail and corporate 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 also has access to a variety of long term wholesale funding sources outstanding including securitisations, covered bonds and Euro Medium Term Notes. The majority of these programmes are being restructured due to the downgrades received by the Bank from rating agencies in the first half of 2013. The Bank will consider further issuance from these programmes after these restructures are complete and if market conditions permit. The Bank

has a small presence in the shorter term wholesale liability markets which reduced in the first half of 2013 following downgrades to the Bank.

2.4 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 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.

	Carrying value	*Gross nominal outflow*	*Less than 1 month*	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 years*
30 June 2013							
Contractual cash flows							
Non-derivative liabilities							
Deposits by banks	3,517.8	3,809.5	1,210.5	1,903.7	248.1	447.2	–
Customer accounts	34,166.3	35,303.5	23,441.5	2,262.8	4,738.0	4,861.2	–
Customer accounts – capital bonds	756.0	713.6	21.6	33.1	276.1	382.8	–
Debt securities in issue	4,610.0	5,871.4	4.0	194.1	378.8	4,370.9	923.6
Other borrowed funds	1,248.1	2,247.8	7.2	4.5	124.4	702.7	1,409.0
Amounts owed to other Co-operative Group undertakings	123.9	123.9	123.9	–	–	–	–
	44,422.1	48,069.7	24,808.7	4,398.2	5,765.4	10,764.8	2,332.6
Derivative liabilities							
Net outflow	662.7	1,382.2	16.8	41.2	154.7	482.3	687.2
	45,084.8	49,451.9	24,825.5	4,439.4	5,920.1	11,247.1	3,019.8
Other liabilities	532.8	–	–	–	–	–	–
Total recognised liabilities	45,617.6	49,451.9	24,825.5	4,439.4	5,920.1	11,247.1	3,019.8
Unrecognised loan commitments	4,475.5	4,475.5	4,388.9	85.6	1.0	–	–
Total liabilities	50,093.1	53,927.4	29,214.4	4,525.0	5,921.1	11,247.1	3,019.8
Behavioural adjustments							
Customer accounts	–	–	(18,705.5)	2,602.1	(1,504.0)	17,607.4	–
Total liabilities – behavioural	50,093.1	53,927.4	10,508.9	7,127.1	4,417.1	28,854.5	3,019.8

	Carrying value	*Gross nominal outflow*	*Less than 1 month*	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 years*
30 June 2012							
Contractual cash flows							
Non-derivative liabilities							
Deposits by banks	4,416.0	4,614.6	1,732.1	476.7	1,566.7	839.1	–
Customer accounts	33,054.7	33,210.1	23,083.8	2,784.1	5,421.7	1,920.5	–
Customer accounts – capital bonds	1,141.7	1,121.5	39.3	66.0	302.8	709.1	4.3
Debt securities in issue	4,146.8	5,315.4	83.0	317.3	223.3	3,437.1	1,254.7
Other borrowed funds	1,257.1	1,965.1	7.2	4.4	82.8	933.9	936.8
Amounts owed to other Co-operative Group undertakings	97.7	97.7	97.7	–	–	–	–
	44,114.0	46,324.4	25,043.1	3,648.5	7,597.3	7,839.7	2,195.8

	Carrying value	*Gross nominal outflow*	*Less than 1 month*	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 years*
Derivative liabilities							
Net outflow	983.1	391.3	319.9	23.1	42.7	38.7	(33.1)
	45,097.1	46,715.7	25,363.0	3,671.6	7,640.0	7,878.4	2,162.7
Other liabilities	332.9	–	–	–	–	–	–
Total recognised liabilities	45,430.0	46,715.7	25,363.0	3,671.6	7,640.0	7,878.4	2,162.7
Unrecognised loan commitments	5,265.5	5,265.5	4,909.8	317.4	38.3	–	–
Total liabilities	50,695.5	51,981.2	30,272.8	3,989.0	7,678.3	7,878.4	2,162.7
Behavioural adjustments							
Customer accounts	–	–	(19,900.2)	(23.2)	1,720.0	18,203.4	–
Total liabilities – behavioural	50,695.5	51,981.2	10,372.6	3,965.8	9,398.3	26,081.8	2,162.7

2.5 Encumbrance

The Bank aims to have sufficient eligible and unencumbered assets available to meet the needs of its secured funding programmes. Details of the Bank's encumbered assets are shown in note 34d Fair value of transferred assets and associated liabilities.

During the period between 30 June 2012 and 30 June 2013, encumbrance was reduced by capital repayments of securitised and covered bond notes totalling £1,055.3m and increased by £689.5m relating to investment securities sold under repurchase agreements, a net decrease of £365.8m. Additional assets have been encumbered since the period end; for further details, see note 35.

3. Market risk

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

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

3.1 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 Bank Market Risk Committee (BMRC) 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 retail and CABB 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 BMRC and ALCO review the balance sheet risk positions and the utilisation of wholesale market risk limits.

3.1.1 *Non-treasury interest rate risk*

The Bank (excluding wholesale) uses a gap report and earnings approach for managing interest rate risk, focusing in detail on the sensitivity of assumed changes in interest rates on net interest income for one year.

BMRC 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) are 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 the first half of 2013 as customers continue to favour variable rate mortgages (where the introductory rate is linked to Bank of England base rate) and administered and fixed rate savings. Basis risk is monitored by BMRC 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. The maximum sensitivity for the period shown below equates to approximately a £6.0m (30 June 2012: £5.3m) decrease in income if rates increased by 1%.

	30 June 2013	*30 June 2012*
Net greater than 12 month gap position		
At the period end	(341)	(300)
Average for the period	(434)	(207)
Maximum sensitivity for the period	(600)	(533)
Minimum sensitivity for the period	(341)	(111)

3.1.2 ***Treasury interest rate risk***

Treasury executes short term funding and hedging transactions with the wholesale markets on behalf of the Bank and its customers. There are two prime measures of risk supplemented by additional controls such as maturity and stop loss limits.

3.1.2.1 *Value at risk (VaR)*

VaR measures the daily maximum potential gain or loss due to market volatility within a statistical confidence level of 95% and a one day holding period. The VaR methodology employed is historical simulation using a time series of one year to latest day and was £0.4m at 30 June 2013 for the trading portfolios (30 June 2012: £0.2m). The VaR methodology has inherent limitations in that market volatility in the past may not be a reliable predictor of the future, and may not reflect the time required to hedge or dispose of the position, hence VaR is not used as the sole measure of risk.

3.1.2.2 *PV100*

This illustrates the change in valuation on a fixed income portfolio experienced given a 1% increase and decrease in interest rates, representing the treasury banking book and treasury trading book. PV100 is the effect on the net present value (NPV) of the wholesale portfolio to a parallel shift of 100 basis points upon the base yield curve. The effects of a 1% increase in interest rates are a loss of £6.8m (30 June 2012: gain of £9.2m) and a 1% decrease results in a gain of £8.3m (30 June 2012: loss of £7.6m).

3.2 **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.

The table below provides an analysis of the Bank's assets and liabilities by currency:

	30 June 2013					*30 June 2012*				
	£	*$*	*€*	*Other*	*Total*	*£*	*$*	*€*	*Other*	*Total*
Assets										
Cash and balances at central banks	5,402.1	–	–	–	5,402.1	4,316.6	–	–	–	4,316.6
Loans and advances to banks	1,607.7	29.3	97.8	2.7	1,737.5	1,896.2	61.3	400.3	1.9	2,359.7
Loans and advances to customers	32,528.0	38.7	128.5	20.7	32,715.9	33,798.6	43.4	146.0	20.4	34,008.4
Fair value adjustments for hedged risk	217.0	–	–	–	217.0	368.2	–	–	–	368.2
Investment securities										
Loans and receivables	30.6	–	–	–	30.6	388.9	22.2	71.9	–	483.0
Available for sale	3,429.7	–	–	–	3,429.7	3,108.5	36.2	72.9	–	3,217.6
At FV through income or expense	1,622.3	–	–	–	1,622.3	782.2	28.7	6.5	–	817.4
Held for trading	–	–	–	–	–	411.3	–	27.7	–	439.0
Derivative financial instruments	804.3	–	–	–	804.3	910.1	0.1	0.6	–	910.8
Equity shares	5.7	–	–	–	5.7	5.7	–	–	–	5.7
Investments in joint ventures	4.3	–	–	–	4.3	3.4	–	–	–	3.4
Goodwill	–	–	–	–	–	0.6	–	–	–	0.6
Intangible fixed assets	29.9	–	–	–	29.9	37.9	–	–	–	37.9
Investment properties	153.0	–	–	–	153.0	172.2	–	–	–	172.2
Property, plant and equipment	48.4	–	–	–	48.4	72.2	–	–	–	72.2
Amounts owed by other Co-operative Group undertakings	0.5	–	–	–	0.5	288.9	–	–	–	288.9
Other assets	43.8	–	0.5	0.1	44.4	51.1	0.2	0.4	–	51.7
Prepayments and accrued income	16.9	–	–	–	16.9	17.6	–	–	–	17.6
Current tax assets	266.3	–	–	–	266.3	37.3	–	–	–	37.3
Deferred tax assets	103.5	–	–	–	103.5	109.9	–	–	–	109.9
Total assets	46,314.0	68.0	226.8	23.5	46,632.3	46,777.4	192.1	726.3	22.3	47,718.1
Liabilities										
Deposits by banks	3,265.4	78.1	174.3	–	3,517.8	3,375.4	155.9	884.6	0.1	4,416.0
Customer accounts	34,084.1	33.5	46.0	2.7	34,166.3	32,968.0	46.1	38.2	2.4	33,054.7
Customer accounts – capital bonds	756.0	–	–	–	756.0	1,141.7	–	–	–	1,141.7
Debt securities in issue	4,610.0	–	–	–	4,610.0	4,102.3	6.4	38.1	–	4,146.8
Derivative financial instruments	662.7	–	–	–	662.7	983.0	0.1	–	–	983.1
Other borrowed funds	1,218.1	–	30.0	–	1,248.1	1,228.8	–	28.3	–	1,257.1
Amounts owed to other Co-operative Group undertakings	123.9	–	–	–	123.9	97.7	–	–	–	97.7
Other liabilities	88.1	0.2	0.2	–	88.5	89.9	0.2	0.5	–	90.6
Accruals and deferred income	33.9	–	–	–	33.9	26.4	–	–	–	26.4
Provisions for liabilities and charges	293.0	–	–	–	293.0	104.4	–	–	–	104.4
Deferred tax liabilities	117.4	–	–	–	117.4	111.5	–	–	–	111.5
Total liabilities	45,252.6	111.8	250.5	2.7	45,617.6	44,229.1	208.7	989.7	2.5	45,430.0
Net on balance sheet position	1,061.4	(43.8)	(23.7)	20.8	1,014.7	2,548.3	(16.6)	(263.4)	19.8	2,288.1

At 30 June 2013, the Bank's net currency position was the equivalent of £1.8m (30 June 2012: £6.9m) and represented a potential loss of £0.1m given a 3% depreciation in sterling (30 June 2012: £0.2m). The Bank manages its currency positions against both an overall limit and individual currency limits.

Capital management
For the period ended 30 June 2013
All the amounts are stated in £m unless otherwise indicated

Capital resources

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.

Basel III rules in the EU (collectively known as CRD IV) will be implemented on a transitional basis from 1 January 2014 to full implementation in 2022 (at the earliest). During the transitional period to full implementation of Basel III the Bank will have the opportunity to generate additional capital from earnings and to implement management actions in order to mitigate the impact of Basel III and meet capital ratios.

In March 2013, the Financial Policy Committee (FPC) directed the Prudential Regulation Authority (PRA) to ensure that by December 2013 major UK banks hold capital resources equivalent to at least 7% of their risk-weighted assets, using a Basel III definition of Common Equity Tier 1 but after taking deductions to reflect the FPC's assessment of expected future losses and future costs of conduct redress, and adjusting for a more prudent calculation of risk weights.

The Bank has developed and agreed a Recapitalisation Plan ('the Plan'), as announced on 4 November 2013, which has been discussed with the relevant regulatory bodies. The key objective of the Plan is to significantly strengthen the Bank's Basel III end point Common Equity Tier 1 capital and to refocus its strategy around its strength in core relationship banking providing current accounts, residential mortgages and savings products to individuals and business banking. The main deliverables of this plan include:

- an increase in Common Equity Tier 1 capital of £1.5 billion as follows:
    1. Approximately £1.14 billion from the Exchange Offer and open equity issue;
    2. a further cash contribution to the Bank in 2014 of £333 million committed by The Co-operative Banking Group;
- reduction in the non-core asset portfolio; and
- a simplification and restructuring programme supporting the Core Business specifically focusing on the existing cost base.

The PRA sets Basel II capital requirements and receives information on these requirements for the Bank. The Bank expects its Core Tier 1 ratio to continue to be above the regulatory minimum. Whilst the Bank has recently moved below its individual capital guidance, it continues to meet the Pillar 1 requirements.

The Bank is currently required to disclose its regulatory capital on a Basel II basis. The following disclosures:

- reconcile the Bank's total equity per the balance sheet to its Basel II Core Tier 1 capital; and
- analyse the Bank's Basel II capital resources, capital ratios and risk weighted assets.

The Bank's Basel II regulatory capital is analysed into two tiers:

Tier 1 capital

Tier 1 capital includes share capital, retained earnings, and non-cumulative irredeemable preference shares. Retained earnings exclude gains or losses on cashflow hedges and available for sale assets.

Tier 2 capital

Tier 2 capital includes subordinated debt issues and perpetual subordinated bonds (PSBs). The rights of payment to the holders of this debt are subordinated to the claims of depositors and other creditors of the Bank. More information on these can be found in the 2012 financial statements.

Revaluation reserves relating to net gains on equity held in the available for sale financial assets category are included in Tier 2 capital.

	30 June 2013	*30 June 2012*
Reconciliation of equity per balance sheet to Core Tier 1 capital		
Total equity per balance sheet	1,014.7	2,288.1
Regulatory adjustments:		
Minority interests	(0.3)	(0.9)
Available for sale reserve	(5.9)	(72.5)
Cashflow hedging reserve	(24.8)	(75.5)
Core Tier 1 capital before regulatory deductions	983.7	2,139.2
Capital resources		
Core Tier 1 capital before regulatory adjustments:		
Permanent share capital	410.0	410.0
Retained earnings	1,304.1	1,733.7
Minority interests	32.8	32.0
Losses for the period	(772.0)	(45.3)
Share premium account	8.8	8.8
Total Core Tier 1 capital before regulatory adjustments	983.7	2,139.2
Regulatory adjustments from Core Tier 1 capital:		
Intangible assets	(115.6)	(30.6)
50% of excess of expected losses over impairment (net of tax)	(58.8)	(111.7)
50% of securitisation positions	(21.0)	(0.7)
Total Core Tier 1 capital after regulatory adjustments	788.3	1,996.2
Other Tier 1 capital:		
Non-cumulative irredeemable preference shares	60.0	60.0
Regulatory adjustments from other Tier 1 capital:		
50% of tax on excess of expected losses over impairment	17.8	36.2
50% of material holdings	(2.2)	(1.7)
Total Tier 1 capital after regulatory adjustments	863.9	2,090.7
Tier 2 capital before regulatory adjustments:		
Revaluation reserves	2.0	1.8
Collective provisions	0.9	0.7
Subordinated notes and perpetual subordinated bonds	1,116.8	1,126.1
Excess on limits for lower Tier 2 capital	(361.7)	–
Total Tier 2 capital before regulatory adjustments	758.0	1,128.6
Regulatory adjustments from Tier 2 capital:		
50% of excess of expected losses over impairment (gross of tax)	(76.6)	(147.9)
50% of securitisation positions	(21.0)	(0.7)
50% of material holdings	(2.2)	(1.7)
Total Tier 2 capital after regulatory adjustments	658.2	978.3
Total capital resources	1,522.1	3,069.0

The Bank contracts with CFSMS, a fellow Banking Group subsidiary, to build certain assets, including IT developments. Whilst these intangible assets are on the balance sheet of CFSMS, at 30 June 2013 the share attributable to the Bank has been deducted from the Bank's capital resources. The £115.6m includes £91.8m of intangibles included on the CFSMS balance sheet. This is in line with the Bank's regulatory reporting to the PRA.

£361.7m of lower Tier 2 capital is currently ineligible due to gearing rules, as lower Tier 2 capital cannot exceed 50% of Tier 1 capital after deductions.

Capital allocation

The allocation of capital among specific operations and activities is driven by optimisation of the return achieved on the capital allocated, and is based upon the regulatory capital. Capital allocation is undertaken independently of those responsible for capital management, and is reviewed by ALCO.

Notes to the financial information
For the period ended 30 June 2013
All amounts are stated in £m unless otherwise indicated

1. Principal activities and segmental information

The Bank and its subsidiary undertakings provide an extensive range of banking and financial services in the United Kingdom.

In the period under review, the Bank was managed through two distinct divisions:

- **Core** – The 'core' business represents activity consistent with the strategy and risk appetite for the Bank. This includes the Retail, core Corporate and Business Banking and Treasury/other segments.

  The Retail Banking business (trading as The Co-operative Bank, Britannia and **smile**) offers a range of financial products and services to individuals and households throughout the UK. Retail also includes Platform (the intermediary mortgage business).

  Core Corporate and Business Banking (CABB) comprises corporate banking, business banking and business services, and effectively consists of all the key business to business elements of the Bank.

  Included in the Treasury/other segment are the results of the treasury activities of the business and the results of Unity Trust Bank.

- **Non-core** – Non-core business lines include activities not congruent with the current strategy of the Bank, which are targeted for run down or exit. These non-core lines contain the majority of the impairment risk for the Bank, and predominantly include the Corporate non-core, Optimum (the closed book of intermediary and acquired loan book assets) and Illius (the residential property company) businesses which originated from the non-member Britannia business prior to merger.

This level of information has been presented to the Board throughout the period. Revenues are attributed to the segment in which they are generated. Transactions between the reportable segments are on normal commercial terms and internal charges and transfer pricing adjustments have been reflected in each segment.

	Core				*Non-core*			
	Retail	*CABB core*	*Treasury/ other*	*Total Core*	*Corporate non-core*	*Other non-core*	*Total Non-core*	*Total*
Period to 30 June 2013								
Interest margin	203.5	58.4	6.6	268.5	(8.9)	(10.6)	(19.5)	249.0
Non-interest income	65.0	23.8	28.3	117.1	1.0	(11.3)	(10.3)	106.8
Operating income	268.5	82.2	34.9	385.6	(7.9)	(21.9)	(29.8)	355.8
Operating expenses	(242.8)	(43.7)	(16.3)	(302.8)	(2.6)	(12.0)	(14.6)	(317.4)
Impairment losses on loans and advances	(24.8)	(140.0)	(0.7)	(165.5)	(294.3)	(36.2)	(330.5)	(496.0)
Operating (loss)/profit	0.9	(101.5)	17.9	(82.7)	(304.8)	(70.1)	(374.9)	(457.6)
Significant items (notes 2, 3 and 6)								(346.0)
Share of post tax profits from joint ventures								0.3
Financial Services Compensation Scheme levies								0.1
Fair value amortisation								(8.2)
Loss before taxation								(811.4)
Income tax								39.4
Loss for the period								(772.0)

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

Reconciliation to statutory income statement	*Period to 30 June 2013*
Interest margin	
Total interest margin for reportable segments	249.0
Fair value amortisation	(4.2)
Net interest income	244.8
Non-interest income	
Total non-interest income for reportable segments	106.8
Fair value amortisation	0.3
Non-interest income	107.1
Operating expenses	
Total operating expenses for reportable segments	(317.4)
Fair value amortisation	(4.3)
Operating expenses	(321.7)
Fair value amortisation	
Total interest unwind for reportable segments	(8.2)
Interest margin unwind	4.2
Non-interest income unwind	(0.3)
Operating expenses unwind	4.3
Fair value amortisation	–

	Core				*Non-core*			
	Retail	*CABB core*	*Treasury/ other*	*Total Core*	*Corporate non-core*	*Other non-core*	*Total Non-core*	*Total*
Period to 30 June 2012								
Interest margin	196.6	54.0	7.1	257.7	(11.5)	3.0	(8.5)	249.2
Non-interest income	68.4	32.2	26.0	126.6	1.2	8.1	9.3	135.9
Operating income	265.0	86.2	33.1	384.3	(10.3)	11.1	0.8	385.1
Operating expenses	(214.8)	(38.6)	(13.1)	(266.5)	(2.8)	(12.6)	(15.4)	(281.9)
Impairment losses on loans and advances	(18.2)	(17.5)	(0.5)	(36.2)	(56.9)	(1.5)	(58.4)	(94.6)
Impairment gains on investments	–	–	2.7	2.7	–	–	–	2.7
Operating profit/(loss) before group recharges	32.0	30.1	22.2	84.3	(70.0)	(3.0)	(73.0)	11.3
Group recharges	(8.2)	(1.1)	(0.3)	(9.6)	(0.1)	(0.4)	(0.5)	(10.1)
Operating profit/(loss) after re-allocating group recharges	23.8	29.0	21.9	74.7	(70.1)	(3.4)	(73.5)	1.2
Significant items (notes 3 and 6)								(79.3)
Share of post tax profits from joint ventures								0.6
Financial Services Compensation Scheme levies								(0.8)
Fair value amortisation								19.7
Loss before taxation								(58.6)
Income tax								13.3
Loss for the period								(45.3)

Reconciliation to statutory income statement	*Period to 30 June 2012*
Interest margin	
Total interest margin for reportable segments	249.2
Fair value amortisation	22.0
Net interest income	271.2
Non-interest income	
Total non-interest income for reportable segments	135.9
Fair value amortisation	–
Non-interest income	135.9
Operating expenses	
Total operating expenses for reportable segments (including group recharges)	(292.0)
Fair value amortisation	(2.3)
Operating expenses	(294.3)
Fair value amortisation	
Total interest unwind for reportable segments	19.7
Interest margin unwind	(22.0)
Operating expenses unwind	2.3
Fair value amortisation	–

30 June 2013	*Retail*	*Corporate core*	*Corporate non-core*	*Optimum*	*Treasury*	*Total*
Segment assets	17,797.1	5,314.0	2,267.7	7,562.2	11,245.2	44,186.2
Unallocated assets						1,633.9
Total assets for reportable segments						45,820.1
Statutory reclassifications						812.2
Consolidated total assets						46,632.3
Segment liabilities	27,969.4	6,140.9	–	–	9,791.5	43,901.8
Unallocated liabilities						724.6
Total liabilities for reportable segments						44,626.4
Statutory reclassifications						991.2
Consolidated total liabilities						45,617.6

30 June 2012	*Retail*	*Corporate core*	*Corporate non-core*	*Optimum*	*Treasury*	*Total*
Segment assets	17,826.5	5,330.3	3,120.6	7,884.3	10,553.7	44,715.4
Unallocated assets						1,816.2
Total assets for reportable segments						46,531.6
Statutory reclassifications						1,186.5
Consolidated total assets						47,718.1
Segment liabilities	26,453.8	6,683.0	–	–	10,168.6	43,305.4
Unallocated liabilities						930.9
Total liabilities for reportable segments						44,236.3
Statutory reclassifications						1,193.7
Consolidated total liabilities						45,430.0

The 2012 comparatives include balance sheet reclassifications of deferred tax assets and liabilities as shown in note 28.

2. Net interest income

	Period to 30 June 2013			*Period to 30 June 2012*		
	Before significant items	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
Interest receivable and similar income						
On financial assets not at fair value through income or expense:						
On loans and advances to customers	643.1	(29.0)	614.1	693.6	–	693.6
On loans and advances to banks	15.4	–	15.4	15.7	–	15.7
On investment securities	75.3	–	75.3	77.3	–	77.3
	733.8	(29.0)	704.8	786.6	–	786.6
On financial assets at fair value through income or expense:						
Net expense on financial instruments hedging assets	(59.4)	(10.0)	(69.4)	(63.1)	–	(63.1)
Net interest income on financial instruments not in a hedging relationship	41.2	–	41.2	21.2	–	21.2
	715.6	(39.0)	676.6	744.7	–	744.7

Significant items are provisions of £29.0m (2012: £nil) for potential customer redress following identification of a technical breach of the Consumer Credit Act and £10.0m (2012: £nil) in relation to past sales of interest rate swaps.

Included within interest receivable is £7.2m (2012: £11.0m) relating to profit on sale of investment securities – available for sale and £3.7m (2012: £nil) relating to the provision for the processing of first payments on certain mortgages.

Interest income accrued on impaired financial assets during the year was £22.6m (2012: £26.9m). Interest due to unwinding of discount on impairment provisions relating to impaired financial assets amounted to £5.3m (2012: £3.6m).

	Period to 30 June 2013			*Period to 30 June 2012*		
	Before significant items	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
Interest expense and similar charges						
On financial liabilities not at fair value through income or expense:						
On customer accounts	255.3	–	255.3	268.2	–	268.2
On bank and other deposits	127.5	–	127.5	121.4	–	121.4
On subordinated liabilities	40.1	–	40.1	39.6	–	39.6
On perpetual subordinated debt	20.8	–	20.8	16.8	–	16.8
	443.7	–	443.7	446.0	–	446.0
On financial liabilities at fair value through income or expense:						
Net interest expense on financial instruments hedging liabilities	9.5	–	9.5	9.2	–	9.2
Net interest expense on financial instruments not in a hedging relationship	17.6	–	17.6	18.3	–	18.3
	470.8	–	470.8	473.5	–	473.5

The 2012 comparatives for interest receivable and similar income and interest expense and similar charges reflect reclassifications within interest categories.

3. Net fee and commission income

	Period to 30 June 2013			*Period to 30 June 2012*		
	Before significant items	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
Fee and commission income						
On items not at fair value through income or expense	116.0	(94.0)	22.0	127.9	(40.0)	87.9
On trust or fiduciary activities that result from holding or investing in assets on behalf of others	0.2	–	0.2	0.1	–	0.1
	116.2	(94.0)	22.2	128.0	(40.0)	88.0

	Period to 30 June 2013			Period to 30 June 2012		
	Before significant items	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
Fee and commission expense						
On items not at fair value through income or expense	34.3	–	34.3	35.0	–	35.0
On items at fair value through income or expense	1.9	–	1.9	6.2	–	6.2
	36.2	–	36.2	41.2	–	41.2

Significant items consist of a provision for potential customer redress of £53.0m (2012: £40.0m) relating to past sales of payment protection insurance, £26.0m (2012: £nil) for potential customer redress relating to alleged failings in the introduction of third party sales of card and identity protection products and £15.0m (2012: £nil) for potential customer redress in relation to arrears charges.

4. Net trading income

	Period to 30 June 2013	*Period to 30 June 2012*
Foreign exchange	1.1	4.0
Other interest rate instruments	–	5.3
	1.1	9.3

Foreign exchange net trading income includes gains less losses from spot forward and forward contracts, options, futures and translated foreign currency assets and liabilities.

Other interest rate instruments includes the result of transacting in government securities, money market instruments, interest rate and currency swaps, options and other derivatives.

5. Other operating income

	Period to 30 June 2013	*Period to 30 June 2012*
Profit on sale of investment securities – loans and receivables (note 12)	40.4	21.1
Profit on sale of loans and advances to banks	–	9.7
Rent receivable from investment properties (note 17)	4.5	4.3
Change in fair value of investment properties (note 17)	(18.9)	0.1
Other	–	4.6
	26.0	39.8

The profit on sale of investment securities arose from the restructuring of a portfolio of assets. Profit on smaller disposals in the normal course of business are included in net interest income.

6. Operating expenses

	Period to 30 June 2013			*Period to 30 June 2012*		
	Before significant items	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
Staff costs:						
Wages and salaries	93.7	1.2	94.9	97.3	7.3	104.6
Social security costs	7.2	0.4	7.6	7.5	0.6	8.1
Pension costs – defined benefit plans	0.1	–	0.1	0.1	–	0.1
Pension costs – defined contribution plans	13.6	0.4	14.0	18.5	0.7	19.2
Other staff costs	16.9	4.3	21.2	14.7	8.3	23.0
	131.5	6.3	137.8	138.1	16.9	155.0
Administrative expenses	158.7	166.8	325.5	128.9	22.4	151.3
Depreciation of property, plant and equipment	6.0	–	6.0	7.8	–	7.8
Amortisation of intangible fixed assets	3.0	–	3.0	3.0	–	3.0
Impairment of intangible fixed assets	2.0	–	2.0	–	–	–
Profit on sale of property, plant and equipment	–	–	–	(0.4)	–	(0.4)
Impairment of property, plant and equipment	–	9.9	9.9	–	–	–
Operating lease rentals	15.6	–	15.6	14.7	–	14.7
Property provisions for liabilities and charges provided in the period (note 27)	3.6	–	3.6	1.0	–	1.0
Property provisions for liabilities and charges released during the period (note 27)	(0.4)	–	(0.4)	(0.3)	–	(0.3)
Other provisions for liabilities and charges provided in the period (note 27)	–	30.0	30.0	0.1	–	0.1
Other provisions for liabilities and charges released during the period (note 27)	(0.1)	–	(0.1)	–	–	–
Direct expenses from investment properties that generated rental income in the period	1.7	–	1.7	1.4	–	1.4
Direct expenses from investment properties that did not generate rental income in the period	0.1	–	0.1	–	–	–
	321.7	213.0	534.7	294.3	39.3	333.6

Significant items relate to £14.7m (2012: £19.3m) of costs incurred on a programme of investment and integration, £10.0m (2012: £20.0m) of costs incurred as a result of the bid for the Lloyds Bank branches, £148.4m (2012: £nil) of recharged costs relating to impairment of intangible fixed assets, £9.9m (2012: £nil) of impairment of property, plant and equipment and £30.0m (2012: £nil) of provisions made for potential customer redress relating to the processing of first payments on certain mortgages.

7. Income tax

	Period to 30 June 2013			*Period to 30 June 2012*		
	Before significant items	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
Current tax – current period	(22.7)	(80.4)	(103.1)	(9.7)	(17.0)	(26.7)
Current tax – prior period	–	–	–	(13.2)	–	(13.2)
Deferred tax – current period (note 28)	7.6	–	7.6	30.1	(2.4)	27.7
Write off of prior period deferred tax asset (note 28)	56.1	–	56.1	–	–	–
Deferred tax – prior period (note 28)	–	–	–	(1.1)	–	(1.1)
	41.0	(80.4)	(39.4)	6.1	(19.4)	(13.3)

Further information on deferred income tax is presented in note 28. The tax on the Bank's loss before taxation differs from the theoretical amount that would arise using the corporation tax rate in the UK as follows:

	Period to 30 June 2013	*Period to 30 June 2012*
Loss before taxation	(811.4)	(58.6)
Tax calculated at a rate of 23.25% (30 June 2012: 24.5%)	(188.7)	(14.4)
Effects of:		
Preference share interest not deductible for tax purposes	0.7	0.7
Expenses not deductible for tax purposes	2.9	0.3
Depreciation of expenditure not qualifying for capital allowances	2.9	0.1
Profits taxed at lower rates	0.1	0.2
Non-taxable income	(0.7)	(0.6)
Adjustments to tax charge in respect of prior periods	–	0.5
Change in rate of deferred tax	1.0	(0.2)
Losses in period where no deferred tax asset recognised	86.2	–
Write off of prior year deferred tax asset (note 28)	56.1	–
Other differences	0.1	0.1
	(39.4)	(13.3)

The tax credit for the half year ended 30 June 2013 is lower than expected due to losses in the current period for which a deferred tax asset has not been recognised, and a write-off of prior year deferred tax assets in respect of tax losses and fair value adjustments.

8. (Losses)/earnings per share

Basic earnings per share is calculated by dividing the net (loss)/profit attributable to equity shareholders of the Bank by the weighted average number of ordinary shares in issue during the period.

	Period to 30 June 2013			*Period to 30 June 2012*		
	Before significant items	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
(Loss)/profit attributable to equity shareholders of the Bank	(506.7)	(265.6)	(772.3)	13.8	(59.9)	(46.1)
Ordinary shares in issue (millions)						
At the beginning and end of the period	8,200.0	8,200.0	8,200.0	8,200.0	8,200.0	8,200.0
Weighted average number of ordinary shares in issue (millions)	8,200.0	8,200.0	8,200.0	8,200.0	8,200.0	8,200.0
Basic (losses)/earnings per share (expressed in pence per share)	(6.18)	(3.24)	(9.42)	0.17	(0.73)	(0.56)

9. Cash and balances at central banks

	30 June 2013	*30 June 2012*
Cash in hand	271.3	248.0
Balances with the Bank of England other than mandatory reserve deposits	5,060.4	4,030.3
Included in cash and cash equivalents	5,331.7	4,278.3
Mandatory reserve deposits with the Bank of England	70.4	38.3
	5,402.1	4,316.6

Mandatory reserve deposits are not available for use in the Bank's day to day operations, are non-interest bearing and are not included in cash and cash equivalents.

10. Loans and advances to banks

	30 June 2013	*30 June 2012*
Items in course of collection from other banks	111.4	208.2
Placements with other banks	562.2	1,242.0
Included in cash and cash equivalents	673.6	1,450.2
Other loans and advances to banks	1,063.9	909.5
	1,737.5	2,359.7

11. Loans and advances to customers

	30 June 2013	*30 June 2012*
Gross loans and advances	33,785.5	34,349.5
Less: allowance for losses	(1,069.6)	(341.1)
	32,715.9	34,008.4

Loans and advances to customers include £144.2m (30 June 2012: £148.0m) of financial assets at fair value through income or expense designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency. Of these, £55.1m (30 June 2012: £56.4m) are secured by real estate collateral.

Loans and advances to customers include £10,276.7m (30 June 2012: £9,316.9m) securitised under the Bank's securitisation and covered bond programmes. The Bank remains exposed to substantially all of the risks and rewards of ownership of these assets. Included within deposits by banks (note 21) are £nil (30 June 2012: £61.2m) of loans from external third parties and within debt securities in issue (note 23) are £4,056.7m (30 June 2012: £3,796.5m) of fixed and floating rate notes, all secured on these mortgage assets.

Concentration of exposure

The Bank's exposure is virtually all within the UK. There is a detailed analysis of the concentration of exposure within the risk management disclosures, on pages 321 and 322.

Allowance for losses on loans and advances

	Individual retail	*Individual corporate*	*Collective retail*	*Collective corporate*	*Total*
Period to 30 June 2013					
At the beginning of the period	10.6	433.6	176.4	22.4	643.0
(Release)/charge against profits	(3.7)	355.9	64.2	78.0	494.4
Amounts written off	(3.5)	(37.0)	(21.8)	(0.3)	(62.6)
Unwind of discount allowance	–	(3.5)	(1.8)	–	(5.3)
Interest charged on impaired loans	–	0.1	–	–	0.1
At the end of the period	3.4	749.1	217.0	100.1	1,069.6
Period to 30 June 2012					
At the beginning of the period	9.0	105.1	165.7	12.2	292.0
Charge against profits	2.8	68.7	18.1	6.2	95.8
Amounts written off	(2.8)	(24.8)	(14.8)	(0.7)	(43.1)
Unwind of discount allowance	–	(1.9)	(1.7)	–	(3.6)
Interest charged on impaired loans	–	–	–	–	–
At the end of the period	9.0	147.1	167.3	17.7	341.1

The net impairment charge in the income statement is £496.0m (30 June 2012: £94.6m). This includes a net cost of £0.2m (30 June 2012: net gain of £1.2m) relating to amounts recovered by the Bank against amounts previously written off and costs incurred in relation to those recoveries. The recoveries have been made from the mortgagors and from other parties involved in the origination or acquisition of the mortgages.

The impairment charge also includes a provision of £1.4m (30 June 2012: £nil) made against fair value adjustments for hedged risk during the year (as shown in the fair value adjustments for hedged risk tables).

There are a number of reasons for the increase in the overall impairment charge. Firstly, in the first half of 2013, the amount of assets designated as non-core has increased, the Bank has continued to review its loan book on a case-by-case basis and there has been a change in the work out approach on a significant number of assets. Secondly, there have been further improvements to our credit risk management approach,

improving the data on which impairment assessments are made and resulting in increased impairments. This has taken into account the continuing impacts of the corporate real estate environment, prolonged real wage deflation and the lower apparent crystallisation of losses while base rate continues to be low. Impairments which occur in the ordinary course of the business due to changes in customer circumstances have also been incurred in both the core and non-core business.

Loans and advances to customers include finance lease receivables:

	30 June 2013	*30 June 2012*
Gross investment in finance leases may be analysed as follows:		
No later than one year	18.2	23.4
Later than one year and no later than five years	59.5	62.1
Later than five years	59.7	83.2
	137.4	168.7
Unearned future finance income on finance leases	(36.7)	(46.2)
Net investment in finance leases	100.7	122.5
The net investment in finance leases may be analysed as follows:		
No later than one year	12.3	16.8
Later than one year and no later than five years	42.1	41.3
Later than five years	46.3	64.4
	100.7	122.5

There are no unguaranteed residual values for any of the finance leases.

The Bank enters into finance lease and hire purchase arrangements with customers in a wide range of sectors including transport, retail and utilities. The accumulated allowance for uncollectible minimum lease payments receivable is £0.6m (30 June 2012: £0.1m).

Fair value adjustments for hedged risk

The Bank has entered into interest rate swaps that protect it from changes in interest rates on the floating rate liabilities that fund its portfolio of fixed rate mortgages. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed rate mortgages.

	30 June 2013	*30 June 2012*
Gross fair value adjustments for hedged risk	255.4	368.2
Less: impairment provision	(38.4)	–
	217.0	368.2

Impairment provision on fair value adjustments for hedged risk

	30 June 2013	*30 June 2012*
At the beginning of the period	37.0	–
Charge against profits	1.4	–
At the end of the period	38.4	–

12. Investment securities

	30 June 2013	*30 June 2012*
Loans and receivables		
Unlisted	30.6	483.0
	30.6	483.0
Less: allowance for losses	–	–
	30.6	483.0
Included in cash and cash equivalents	–	–

The movement in investment securities – loans and receivables excluding interest amounts is summarised as follows:

	30 June 2013	*30 June 2012*
At the beginning of the period	294.7	803.3
Disposals and maturities	(282.5)	(358.6)
Exchange adjustments	–	(4.0)
Fair value movements through income or expense	(10.1)	0.6
Amortisation	28.5	38.1
Release of impairment provision	–	2.7
At the end of the period	30.6	482.1

Impairment analysis of investment securities – loans and receivables

	30 June 2013	*30 June 2012*
At the beginning of the period	–	2.7
Release during the period	–	(2.7)
At the end of the period	–	–

Investment securities – loans and receivables have decreased during the period due to sales and maturities. Included within other operating income (note 5) is £40.4m (30 June 2012: £21.1m) of profit relating to sales of these investments.

	30 June 2013	*30 June 2012*
Available for sale		
Listed	3,209.4	2,866.6
Unlisted	240.3	393.3
	3,449.7	3,259.9
Less: allowance for losses	(20.0)	(42.3)
	3,429.7	3,217.6
Included in cash and cash equivalents	125.0	260.0

The movement in investment securities – available for sale excluding interest amounts is summarised as follows:

	30 June 2013	*30 June 2012*
At the beginning of the period	3,775.5	3,405.5
Acquisitions	1,184.6	2,514.6
Disposals and maturities	(1,478.5)	(2,787.7)
Exchange adjustments	8.3	(6.4)
Fair value movements through equity	(44.4)	159.3
Fair value movements through income or expense	(23.5)	(79.4)
Amortisation	(22.7)	(4.5)
Release and utilisation of impairment provision	19.0	–
At the end of the period	3,418.3	3,201.4

Impairment analysis of investment securities – available for sale

	30 June 2013	*30 June 2012*
At the beginning of the period	39.0	42.5
Utilised during the period	(19.0)	–
Exchange adjustments	–	(0.2)
At the end of the period	20.0	42.3

Investment securities – available for sale have decreased during the period due to sales and maturities. The £19.0m utilised during the period relates to a provision on an investment that was sold in the period.

	30 June 2013	*30 June 2012*
Fair value through income or expense		
Listed	1,622.3	817.4
	1,622.3	817.4
Less: allowance for losses	–	–
	1,622.3	817.4
Included in cash and cash equivalents	–	–

The movement in investment securities – fair value through income or expense excluding interest amounts is summarised as follows:

	30 June 2013	*30 June 2012*
At the beginning of the period	1,830.6	339.5
Reclassified from held for trading	447.8	–
Acquisitions	688.0	622.1
Disposals and maturities	(1,351.5)	(163.4)
Exchange adjustments	1.3	(0.2)
Fair value movements through income or expense	(16.3)	7.9
At the end of the period	1,599.9	805.9

	30 June 2013	*30 June 2012*
Held for trading		
Listed	–	439.0
	–	439.0
Less: allowance for losses	–	–
	–	439.0
Included in cash and cash equivalents	–	–

The movement in investment securities – held for trading excluding interest amounts may be summarised as follows:

	30 June 2013	*30 June 2012*
At the beginning of the period	954.3	–
Reclassified to fair value through income or expense	(447.8)	–
Acquisitions	12.1	773.3
Disposals and maturities	(516.0)	(342.0)
Exchange movements	4.5	–
Fair value movements through income or expense	(7.1)	5.4
	–	436.7

Investment securities – held for trading have decreased during the period due to sales and maturities and reclassifications to investment securities – fair value through income or expense.

Analysis of investment securities by issuer

	30 June 2013	*30 June 2012*
Investment securities issued by public bodies:		
Government securities	2,022.4	1,263.9
Other public sector securities	1,498.7	–
	3,521.1	1,263.9
Investment securities issued by other issuers:		
Bank and building society certificates of deposits	240.3	340.6
Other debt securities:		
Other floating rate notes	1,290.6	2,869.5
Mortgage backed securities	30.6	483.0
	1,321.2	3,352.5
	5,082.6	4,957.0

Other floating rate notes (FRNs) relate to sterling denominated FRNs with maturities ranging from nine months to five years from the balance sheet date.

13. Derivative financial instruments

The Bank, as principal, has entered into various derivatives either as a trading activity, which includes proprietary transactions and customer facilitation, or as a hedging activity for the management of interest rate risk, equity risk and foreign exchange rate risk. Positive and negative fair values have not been netted as the Bank does not have a legal right of offset.

Derivatives held for trading purposes

Trading transactions are wholly interest rate related contracts including swaps, caps and floors, forward rate agreements and exchange traded futures. Trading transactions include derivatives where the Bank enters into a transaction to accommodate a customer together with the corresponding hedge transaction.

Non-trading derivatives

Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions of the Bank. Derivatives used to manage interest rate related positions include swaps, caps and floors, forward rate agreements and exchange traded futures. The foreign exchange rate positions are managed using forward currency transactions and swaps. Equity risk is managed using equity swaps.

During the period the Bank has entered into fair value hedges to mitigate price movements due to interest rate sensitivities.

	30 June 2013		*30 June 2012*	
	Fair value		*Fair value*	
	Assets	*Liabilities*	*Assets*	*Liabilities*
Derivatives held for trading purposes				
Interest rate derivatives:				
Interest rate swaps	–	–	179.4	162.9
Over The Counter (OTC) interest rate options	–	–	1.3	1.3
Total derivative assets/liabilities held for trading purposes	–	–	180.7	164.2
Derivatives held for non-trading purposes				
Derivatives designated as cashflow hedges:				
Interest rate swaps	75.7	43.7	183.1	69.0
Derivatives designated as fair value hedges:				
Interest rate swaps	92.0	376.7	109.2	571.4
Cross currency interest rate swaps	–	40.1	0.2	59.6
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	173.4	175.1	52.3	52.0
Embedded derivatives – options	68.0	–	58.5	1.0
Forward currency transactions	334.9	23.8	257.1	62.4
OTC interest rate options	1.0	3.2	–	3.2
Equity swaps	59.3	0.1	69.7	0.3
Total derivative assets/liabilities held for non-trading purposes	804.3	662.7	730.1	818.9
Total recognised derivative assets/liabilities	804.3	662.7	910.8	983.1

The derivatives designated as cashflow hedges are interest rate swaps used to hedge interest rate risk in the Bank's retail operations. Cash flows are hedged by quarterly time periods for durations up to ten years. During the period there were no forecast transactions for which hedge accounting had previously been used but are no longer expected to occur.

The number of non-margin exchange traded contracts held by the Bank as at 30 June 2013 was nil (2012: nil).

In line with industry standards, credit valuation adjustments (CVAs) and debit value adjustments (DVAs) are applied to non-collateralised swaps representing the fair value measurement of counterparty risk. The net credit adjustment across the portfolio was £5.7m as at 30 June 2013 (2012: £3.3m). CVAs and DVAs are not applied to derivatives that are fully cash collateralised.

14. Equity shares

	30 June 2013	*30 June 2012*
Investment securities – unlisted	5.7	5.7
Included above are the following trade investments:		
Vocalink Limited – 4,416,165 ordinary shares of £1 each (2012: 4,416,165)	5.6	5.6

Equity shares are classified as available for sale.

15. Goodwill

	30 June 2013	*30 June 2012*
Net book amount		
At the beginning of the period	–	0.6
At the end of the period	–	0.6

The Bank's goodwill was recognised in 2009 and related to the transfer of engagements of Britannia Building Society.

Each year the Bank tests the asset for impairment by comparing its recoverable amount, determined in accordance with IAS 36, with its carrying amount. In the second half of 2012, the directors concluded that the carrying value should be written down to £nil.

16. Intangible fixed assets

	30 June 2013			*30 June 2012*		
	Internally generated intangible assets	*Other intangible assets*	*Total*	*Internally generated intangible assets*	*Other intangible assets*	*Total*
Cost						
At the beginning of the period	11.6	46.0	57.6	13.5	46.0	59.5
Additions	–	–	–	0.2	–	0.2
At the end of the period	11.6	46.0	57.6	13.7	46.0	59.7
Accumulated amortisation and impairment						
At the beginning of the period	7.2	15.5	22.7	8.0	10.8	18.8
Charge for the period	0.8	2.2	3.0	0.6	2.4	3.0
Impairment	–	2.0	2.0	–	–	–
At the end of the period	8.0	19.7	27.7	8.6	13.2	21.8
Net book value						
At the end of the period	3.6	26.3	29.9	5.1	32.8	37.9
At the beginning of the period	4.4	30.5	34.9	5.5	35.2	40.7

Internally generated intangible assets consist of software development costs.

Other intangible assets consist of a core deposit intangible of £44.0m (30 June 2012: £44.0m) and a brand intangible of £nil (30 June 2012: £2.0m). The brand intangible has been fully impaired in the period.

17. Investment properties

	30 June 2013	*30 June 2012*
Fair value		
At the beginning of the period	173.0	172.7
Additions	0.2	0.1
Disposals	(1.3)	(0.7)
Changes in fair value (note 5)	(18.9)	0.1
At the end of the period	153.0	172.2

All investment properties are held to generate rental income until such time that the Bank considers it appropriate to realise its investment.

Investment properties are carried at fair value, measured under level 3 of the fair value hierarchy. Fair value is calculated by management using a discounted cashflow model applying HPI movements to date on a segmented portfolio basis and applying future expected cashflows over the lifecycle of the portfolio. Model assumptions include occupancy rate, House Price Index, forced sale discount and discount rate.

The key variable within the model is the forced sale discount of 11.9% which has been applied to the portfolio and is based on a sample of valuations undertaken in the period by appropriately qualified independent valuers. A movement of +/-1% in the absolute rate would change the fair value by +/- £1.5m.

The Bank lets investment properties on assured shorthold tenancy agreements, most of which are for contract periods of no more than 12 months. The future minimum lease receipts under non-cancellable operating leases are £1.3m (30 June 2012: £2.0m). The Bank has not recognised any contingent rent in the period (30 June 2012: £nil). None of the lease agreements are individually significant.

Included in other operating income for the period is £4.5m (30 June 2012: £4.3m) of rental income relating to investment properties (note 5).

18. Property, plant and equipment

30 June 2013	*Land and buildings*	*Leasehold improvements*	*Computers and other equipment*	*Total*
Cost				
At the beginning of the period	55.4	24.9	102.9	183.2
Additions	–	–	0.2	0.2
Disposals	–	–	(1.9)	(1.9)
At the end of the period	55.4	24.9	101.2	181.5
Accumulated depreciation and impairment				
At the beginning of the period	7.8	18.3	93.0	119.1
Charge for the period	0.6	2.3	3.1	6.0
Impairment	9.9	–	–	9.9
Disposals	–	–	(1.9)	(1.9)
At the end of the period	18.3	20.6	94.2	133.1
Net book value				
At the end of the period	37.1	4.3	7.0	48.4
At the beginning of the period	47.6	6.6	9.9	64.1

30 June 2012	*Land and buildings*	*Leasehold improvements*	*Computers and other equipment*	*Total*
Cost				
At the beginning of the period	55.7	25.0	115.3	196.0
Additions	–	–	0.2	0.2
Disposals	(0.2)	–	0.2	–
At the end of the period	55.5	25.0	115.7	196.2
Accumulated depreciation				
At the beginning of the period	6.6	13.4	95.9	115.9
Charge for the period	0.6	2.6	4.6	7.8
Disposals	–	–	0.3	0.3
At the end of the period	7.2	16.0	100.8	124.0
Net book value				
At the end of the period	48.3	9.0	14.9	72.2
At the beginning of the period	49.1	11.6	19.4	80.1

	30 June 2013	*30 June 2012*
The net book value of land and buildings comprises:		
Freehold	36.6	47.8
Leasehold	0.5	0.5
	37.1	48.3

19. Other assets

	30 June 2013	*30 June 2012*
Amounts recoverable within one year:		
Trade debtors	27.1	24.4
Other assets	17.3	27.3
	44.4	51.7

20. Prepayments and accrued income

	30 June 2013	*30 June 2012*
Amounts recoverable within one year:		
Other	8.3	10.5
Amounts recoverable after more than one year:		
Other	8.6	7.1
	16.9	17.6

21. Deposits by banks

	30 June 2013	*30 June 2012*
Items in course of collection	47.2	47.7
Deposits from other banks	3,470.6	4,368.3
	3,517.8	4,416.0

Included within deposits from other banks are liabilities of £3,461.8m (30 June 2012: £3,654.9m) secured on investment securities with a carrying value of £4,901.7m (30 June 2012: £4,715.2m) which have been sold under sale and repurchase agreements (note 34d).

22. Customer accounts – capital bonds

	30 June 2013	*30 June 2012*
Retail	756.0	1,141.7

Capital bonds are fixed term customer accounts with returns based on the movement in an index (e.g. FTSE 100) over the term of the bond.

The capital bonds have been designated on initial recognition at fair value through income or expense and are carried at their fair value.

The fair values for the capital bonds are obtained on a monthly basis from the swap counterparties. These external valuations are reviewed independently using valuation software to ensure the fair values are priced on a consistent basis.

None of the change in the fair value of the capital bonds is attributable to changes in the liability's credit risk.

The maximum amount the Bank would contractually be required to pay at maturity for all the capital bonds is £756.0m (30 June 2012: £1,147.1m).

The Bank uses swaps to create economic hedges against all of its capital bonds. The loss on capital bonds in the income statement for the period is £9.4m (30 June 2012: £11.0m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the period is a gain of £0.3m (30 June 2012: £0.2m).

23. Debt securities in issue

	30 June 2013	*30 June 2012*
Certificates of deposit	36.3	381.3
Commercial paper	–	8.1
Fixed and floating rate notes	4,573.7	3,757.4
	4,610.0	4,146.8

The Bank has entered into cross currency interest rate swaps that protect it from changes in exchange rates and interest rates on its debt securities in issue. Changes in the fair values of these swaps are largely offset by changes in the sterling equivalent carrying value of the debt securities in issue.

Debt securities in issue include fixed and floating rate notes, the majority of which are secured on portfolios of variable and fixed rate mortgages. The notes are redeemable in part from time to time, such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets. There is no requirement for the Bank to make good any shortfall out of general funds. The maturity date of the notes matches the maturity date of the underlying assets.

24. Other borrowed funds

	30 June 2013	*30 June 2012*
Step up callable subordinated notes 2019	37.8	150.0
60,000,000 9.25% non-cumulative irredeemable preference shares of £1 each	60.0	60.0
Floating rate subordinated notes 2016	23.9	20.5
5.625% fixed rate subordinated notes 2021	8.7	150.0
9.25% fixed rate subordinated notes 2021	275.0	275.0
7.875% fixed rate subordinated notes 2022	235.4	–
Fixed rate subordinated notes 2024	164.9	169.5
Fixed rate subordinated notes 2033	117.1	123.7
Perpetual subordinated bonds	296.5	285.9
Issue costs, discounts and accrued interest	28.8	22.5
	1,248.1	1,257.1

The other borrowed funds balances include fair value adjustments for hedged risk (including merger fair value adjustments) of £68.5m (30 June 2012: £88.8m).

Exchange Offer

On 17 June 2013 the Bank announced a Recapitalisation Plan. The details of the Recapitalisation Plan were materially changed on 4 November 2013. As a consequence of the Recapitalisation Plan the investors in preference shares, perpetual subordinated bonds and other subordinated bonds will have their holdings converted as described within the basis of preparation section of this financial information.

Conditional on the successful completion of the Exchange Offer:

- Interest accrued on subordinated bonds will be capitalised; and
- Interest payable on preference shares and perpetual subordinated bonds is as detailed below.

Step up callable subordinated notes 2019

The notes were issued on 1 April 2004 at a discount of 0.946%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an interest rate of 5.875% per annum to (but excluding) 2 April 2014, and thereafter the interest rate will be determined by reference to the gross redemption yield on the five year benchmark gilt, and a margin of 2.25%. Interest is payable annually in arrears on 2 April.

The Bank may redeem all, but not less than all, of the notes at their principal amount on 2 April 2014.

On 19 December 2012 the Bank invited investors to exchange their holdings in the above instrument for a new subordinated note, which resulted in the redemption of £112.2m of the notes (representing 74.8% of the amount outstanding), leaving £37.8m outstanding.

60,000,000 9.25% non-cumulative irredeemable preference shares of £1 each

The preference shares carry the right to a fixed non-cumulative preferential dividend on the capital for the time being paid up, at the rate of 9.25% per annum exclusive of any associated tax credit. The dividends are payable on 31 May and 30 November each year and take priority over dividends to any other class of share in the capital of the Bank.

On a return of capital on winding up, the assets of the Bank shall be applied in repaying the preference share capital in priority to any payments to the holders of any other class of shares in the capital of the Bank. The amount receivable by the holders of the preference shares shall be the greater of the capital paid up or the

average quoted price during the three months immediately preceding the date of the notice convening the meeting to consider the resolution to wind up.

The holders of the preference shares shall have the right to vote at a general meeting of the Bank only if and when, at the date of the notice convening the meeting, the dividend due to them has been in arrears for six months or more or if a resolution is to be proposed at the meeting abrogating or varying their rights or privileges or for the winding up of the Bank or other return of capital and then only on that resolution.

Under the terms of the Exchange Offer, the Bank will pay the half yearly dividend (ordinarily payable on 30 November) to preference share holders upon, but conditional on, successful completion of the Exchange Offer.

Floating rate subordinated notes 2016

The notes were issued on 18 May 2006 at a discount of 0.14%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes are denominated in euros and interest is calculated at three months EURIBOR plus a margin of 0.28%. From 18 May 2011 interest has been calculated at three months EURIBOR plus a margin of 0.78%. The first interest coupon was paid in August 2006.

The notes were hedged with a cross currency swap converting the exposure into sterling which paid a floating rate of three months LIBOR with a margin on interest coupon of 0.34125% and received a floating rate of three months EURIBOR plus a margin on interest coupon of 0.28%. The cross currency swap matured on 18 May 2011.

On 28 April 2011 the Bank redeemed €149.2m of the notes (representing 81% of the amount outstanding) leaving €34.9m outstanding. The Bank had the option to call the outstanding notes in whole but not in part on the interest payment date falling on or nearest to May 2011, and now at any interest payment date thereafter subject to prior consent of the Prudential Regulatory Authority (PRA).

5.625% fixed rate subordinated notes 2021

The notes were issued on 16 November 2006 at a discount of 0.189%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.625% up to and including the interest payment date on 16 November 2016, when the interest basis changes to floating rate. During the fixed rate period, interest is payable semi-annually in arrears on 16 May and 16 November.

From 17 November 2016, the notes carry a floating interest rate of three months LIBOR plus a margin of 1.75%. Interest is payable quarterly in arrears on 16 February, 16 May, 16 August and 16 November, commencing on the interest payment date falling in February 2017 up to and including the maturity date.

The Bank may redeem all, but not less than all, of the notes at the principal amount on 16 November 2016, and on any quarterly interest payment date thereafter.

On 19 December 2012 the Bank invited investors to exchange their holdings in the above instrument for a new subordinated note, which resulted in the redemption of £141.3m of the notes (representing 94.2% of the amount outstanding) leaving £8.7m outstanding.

9.25% fixed rate subordinated notes 2021

On 28 April 2011 the Bank issued £275.0m fixed rate subordinated notes due 2021, issued at par.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 9.25% up to (but excluding) 28 April 2021. Interest is payable annually in April.

There is no option to redeem the notes early.

7.875% fixed rate subordinated notes 2022

On 19 December 2012 the Bank issued £235.4m fixed rate subordinated notes due 2022, issued at par.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 7.875% up to 18 December 2022. Interest is payable annually in arrears in December.

There is no option to redeem the notes early.

Fixed rate subordinated notes 2024

The notes were issued on 17 March 2004 at a discount of 1.148%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.75% to 2 December 2019 (reset date). During this period the notes are hedged with interest rate swaps that convert the interest rate payable into floating rates at six months LIBOR plus a margin of 0.72%. The fixed receipt leg of the swap is received annually to match the payment to the noteholders. The floating payment leg of the swap is payable semi-annually in June and December. The interest rate swaps mature on 2 December 2019.

From the reset date the interest rate will be calculated based on the five year benchmark gilt rate plus a margin of 1.94%. The five year benchmark gilt rate being the gross redemption yield determined by the UK government security having a maturity date falling on or nearest the fifth anniversary of the determination date (the determination date being two days prior to the reset date), converted to an annualised yield. The Gross Redemption Yield being calculated on the basis set out by the UK Debt Management Office in the publication 'Formulae for Calculating Gilt Prices from Yields'. From the reset date the interest will be paid annually in arrears until maturity or redemption.

The notes are callable in whole but not in part, at the principal amount, on 2 December 2019, subject to the prior consent of the PRA.

Fixed rate subordinated notes 2033

The notes were issued on 28 March 2002 at a discount of 0.93%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.875% to maturity. Interest is payable semi-annually in March and September.

Of the notes, £100m are hedged with interest rate swaps that have a floating payment leg at six months LIBOR payable in March and September. The fixed interest rate receivable legs on the swaps are £25m at 5.405% and £75m at 5.225%. The semi-annual interest receivable leg on the swap is matched to the dates on the notes.

Perpetual subordinated bonds

Perpetual subordinated bonds (PSBs) with a par value of £110m were issued in 1992 at a discount of 0%. PSBs with a par value of £200m were issued in 2005 at a discount of 0%.

Both the £110m and £200m PSBs are unsecured obligations of the Bank and in the event of the winding up of the Bank, the claims of the bondholders will be subordinated in right of payment of all creditors (including subordinated creditors) of the Bank, and *pari passu* with the non-cumulative preference shares.

The PSBs with a par value of £110m carry an annual interest rate of 13%. Interest is payable semi-annually in January and July.

The PSBs with a par value of £200m carry an annual interest rate of 5.5555% up until the reset date. This coupon is payable semi-annually in June and December. From the reset date of 14 December 2015 the interest rate will be amended to the rate for three month deposits in sterling plus a margin of 2.05% per annum. The interest payments will then be made quarterly in arrears in March, June, September and December, with the interest resetting at each interest payment date.

During the period up until the reset date the PSBs are hedged with an interest rate swap that converts the interest rate payable into floating rates at six months LIBOR plus a margin of 1.175%. The semi-annual interest receivable and payable on the swap is aligned to the interest payment dates of the notes. The interest rate swap matures on 14 December 2015.

Given prior relevant supervisory consent, the Bank may elect to repay all, but not less than all, of these PSBs on 14 December 2015 or on any interest payment date thereafter at their principal amount.

Payment of interest

13% PSBs

On 12 July 2013, the Bank announced that further to the 17 June 2013 Recapitalisation Plan announcement that the discretionary coupon on 31 July 2013 will be deferred. The interest payment deferred and interest accrued up to the date of completion, will be paid at the time of, but conditional on, successful completion of the Exchange Offer.

5.5555% PSBs

Interest accrued since the last coupon payment (14 June 2013), up to the date of completion, will be paid at the time of, but conditional on, successful completion of the Exchange Offer.

25. Other liabilities

	30 June 2013	*30 June 2012*
Amounts falling due within one year:		
ATM creditor	59.1	56.9
Other creditors	25.2	29.4
Amounts falling due after one year:		
Other creditors	4.2	4.3
	88.5	90.6

Other creditors of the Bank include finance lease obligations as follows:

	Present value of lease payments		*Future minimum lease payments*	
	30 June 2013	*30 June 2012*	*30 June 2013*	*30 June 2012*
Due within one year	–	–	–	–
Due between one year and five years	0.1	0.1	0.1	0.1
Due after five years	1.3	1.1	1.6	1.7
	1.4	1.2	1.7	1.8

The future minimum lease payments have been discounted at LIBOR over the term of the lease to give the present value of these payments.

26. Accruals and deferred income

	30 June 2013	*30 June 2012*
Amounts falling due within one year:		
Other	33.8	24.4
Amounts falling due after one year:		
Other	0.1	2.0
	33.9	26.4

27. Provisions for liabilities and charges

Period to 30 June 2013	*Property*	*FSCS levies*	*PPI*	*Other*	*Total*
At the beginning of the period	7.3	38.6	116.0	0.8	162.7
Income statement movements:					
Provided in the period – net interest income	–	–	–	42.7	42.7
Provided in the period – operating expense	3.6	0.1	–	30.0	33.7
Provided in the period – net fee and commission income	–	–	53.0	41.0	94.0
Released in the period – operating expense	(0.4)	(0.2)	–	(0.1)	(0.7)
Utilised during the period	(0.3)	(0.1)	(38.9)	(0.1)	(39.4)
At the end of the period	10.2	38.4	130.1	114.3	293.0
Provisions were analysed as follows:					
Amounts falling due within one year	2.5	25.6	106.6	101.3	236.0
Amounts falling due after one year	7.7	12.8	23.5	13.0	57.0
	10.2	38.4	130.1	114.3	293.0
Period to 30 June 2012					
At the beginning of the period	6.9	25.0	61.7	8.4	102.0
Income statement movements:					
Provided in the period – operating expense	1.0	0.8	–	0.1	1.9
Provided in the period – net fee and commission income	–	–	40.0	–	40.0
Released in the period – operating expense	(0.3)	–	–	–	(0.3)
Utilised during the period	(0.5)	–	(32.3)	(6.4)	(39.2)
At the end of the period	7.1	25.8	69.4	2.1	104.4
Provisions were analysed as follows:					
Amounts falling due within one year	3.1	10.9	69.4	2.1	85.5
Amounts falling due after one year	4.0	14.9	–	–	18.9
	7.1	25.8	69.4	2.1	104.4

Property

The Bank has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases using a discount rate of 3.8%.

Financial Services Compensation Scheme (FSCS) levies

The FSCS has provided compensation to customers of financial institutions following the collapse of deposit takers in 2008. The compensation paid out to consumers is currently funded through loans from HM Treasury. The Bank will be liable to pay a proportion of the outstanding borrowings that the FSCS has borrowed from HM Treasury. Additionally the Bank is obliged to pay its share of management expenses and compensation based upon the Bank's proportion of the total market protected deposits at 31 December of each year.

The ultimate FSCS levy to the industry as a result of the 2008 collapses cannot currently be estimated reliably as it is dependent on other factors that may affect amounts payable and the timing of amounts payable, including changes in interest rates, potential recoveries of assets by the FSCS and the level of protected deposits.

The Bank has provided £38.4m (30 June 2012: £25.8m) for its share of the levies raised by the FSCS including the interest on the loan from HM Treasury in respect of the levy years to 31 March 2014. The provision includes £26.8m in respect of the interest levy (30 June 2012: £25.8m). The Bank's interest levy provision calculation includes estimates of the total FSCS levy in each levy year and estimates of the Bank's market participation in each levy year. During 2012, the FSCS indicated that it expected to raise a capital levy to cover the estimated shortfall in the amounts recovered from the failed banks to repay HM Treasury loans made to the FSCS. The Bank has provided £11.6m (30 June 2012: £nil) in respect of its share of this levy.

PPI

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

The FSA issued a policy statement in August 2010 which amended the 'Disputes Resolution: Complaints' section of its Handbook, setting out new rules for handling complaints, including complaints of PPI mis-selling. The Bank must comply with the policy statement which requires complainants to receive adequate redress and the Bank to complete a proactive review of all past business to identify mis-sold policies where no complaint has been made. An additional provision of £53.0m (30 June 2012: £40.0m) has been recognised in the period (note 3), in respect of the total expected cost to the Bank of carrying out this work and paying compensation, making total provisions raised of £297.0m (30 June 2012: £134.3m).

Other provisions

Other provisions principally relate to the estimated costs of other customer redress issues. This includes a provision of £33.7m (30 June 2012: £nil) for potential customer redress relating to the processing of first payments on certain mortgages (of which £30 million is included in significant items), £26.0m (30 June 2012: £nil) for alleged failings in the introduction of third party sales of card and identity protection products, £15.0m (30 June 2012: £nil) for potential customer redress in relation to arrears charges and £10.0m (30 June 2012: £nil) for potential interest rate swap mis-selling. In addition, provisions of £29.0m (30 June 2012: £nil) have been recorded for potential customer redress following identification of a technical breach of the Consumer Credit Act.

28. Deferred tax

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 23% (30 June 2012: 24%).

The movements on the deferred tax accounts are as follows:

	30 June 2013		*30 June 2012*	
	Deferred tax asset	*Deferred tax liability*	*Deferred tax asset*	*Deferred tax liability*
Deferred tax at the beginning of the period	159.6	(121.4)	130.2	(103.8)
Income statement (charge)/credit	(67.7)	4.0	(20.0)	(7.7)
Prior year adjustments	–	–	1.1	–
Charged to equity:				
Cashflow hedges	11.6	–	(1.4)	–
Deferred tax at the end of the period	103.5	(117.4)	109.9	(111.5)
Components of net deferred tax:				
Deferred tax asset	111.5	–	116.8	–
Deferred tax liability	(8.0)	(117.4)	(6.9)	(111.5)
	103.5	(117.4)	109.9	(111.5)

The deferred tax asset above includes an offset for those deferred tax liabilities that are permissable to be offset.

The 2012 balance sheet comparatives have been re-presented to reflect that certain deferred tax liabilities cannot be offset against the deferred tax assets.

	30 June 2013		*30 June 2012*	
	Deferred tax asset	*Deferred tax liability*	*Deferred tax asset*	*Deferred tax liability*
Deferred tax comprises:				
Capital allowances on fixed assets	33.3	–	27.0	–
Capital allowances on assets leased to customers	1.5	–	(2.4)	–
Pensions and other post-retirement benefits	0.9	–	0.9	–
Fair value adjustments – The Co-operative Bank plc	48.8	–	81.8	–
Other temporary differences	27.0	–	24.6	–
Tax losses carried forward	–	–	2.4	–
Cashflow hedges	(7.4)	–	(23.8)	–
Unrealised appreciation on investments	(0.6)	–	(0.6)	–
Fair value adjustments – The Co-operative Bank subsidiaries	–	(117.4)	–	(111.5)
	103.5	(117.4)	109.9	(111.5)

Other temporary differences for the Bank of £27.0m (30 June 2012: £24.6m) include deferred tax assets/liabilities as a result of loss provisions on mortgage assets held by Special Purpose Entities (SPEs), taxation of SPEs under the securitisation regime and spreading of the tax effect of IFRS transitional adjustments.

The deferred tax (credit)/charge in the income statement comprises:

	Period to 30 June 2013	*Period to 30 June 2012*
Capital allowances on fixed assets	–	1.5
Capital allowances on assets leased to customers	(0.1)	(0.3)
Fair value adjustments	8.6	24.8
Other temporary differences	(0.9)	3.0
Tax losses carried forward	–	(2.4)
Write off of prior year deferred tax asset (note 7)	56.1	–
	63.7	26.6

Deferred tax assets expected to be recoverable after one year are £103.5m (30 June 2012: £109.9m). Deferred tax assets from prior year of £51.9m (30 June 2012: £nil) in respect of tax losses carried forward, and £4.2m (30 June 2012: £nil) in respect of fair value adjustments, and deferred tax assets of £86.5m (30 June 2012: £nil) in respect of current period losses have not been recognised, where doubt exists over the availability of sufficient future taxable profits.

Reductions in the UK corporation tax rate from 26% to 24% (effective from 1 April 2012) and to 23% (effective from 1 April 2013) were substantively enacted on 26 March 2012 and 3 July 2012 respectively. Further reductions to 21% (effective from 1 April 2014) and 20% (effective from 1 April 2015) were substantively enacted on 2 July 2013. This will reduce the Bank's future current tax charge accordingly. The deferred tax assets and liabilities at 30 June 2013 have been calculated based on the rate of 23% substantively enacted at the balance sheet date. The enacted 3% rate reduction will reduce the Bank's deferred tax assets by £13.5m and the deferred tax liability by £15.3m.

29. Pensions

Defined contribution basis

The Bank, along with other businesses within the Co-operative Group, participates in The Co-operative Pension Scheme (Pace). Pace is a hybrid scheme, consisting of a defined benefit section and a defined contribution section.

As a Co-operative Group wide pension scheme, Pace exposes the participating businesses to actuarial risks associated with the current and former employees of other Co-operative Group companies with the result that there is no consistent and reliable basis for allocating liabilities, assets and costs of individual companies participating in the scheme.

Therefore, pension costs in respect of the scheme are accounted for on a defined contribution basis and recognised as an expense in the income statement as incurred, based on a fixed percentage as agreed with the Trustees.

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 key aspects of Pace are illustrated below. These amounts are not recognised within this financial information and are therefore disclosed for information purposes.

Scheme information

Risks arising in Pace are identified at the The Co-operative Group level, with the impact of any changes to contribution assessed under the Bank's risk management framework. The Bank is therefore exposed to potential future increases in required contributions and capital held for pension risk.

The Pace Trustee, in consultation with the Co-operative Group, is responsible for the risk management arrangements for Pace agreeing suitable contribution rates, investment strategy and for taking appropriate professional advice as required.

Contribution payments

The level of funding for the Pace scheme is agreed between The Co-operative Group and the Pace Trustee.

The Co-operative Group expects to contribute a further c£45m to Pace by 31 December 2013. The Bank expects to contribute a further c£17m by 31 December 2013.

On an accounting basis the Pace scheme is in surplus, however, on a funding basis the scheme is in a deficit position. Following the last actuarial triennial valuation, the Group agreed a recovery plan with the Trustee of the scheme to contribute £20m p.a. over 8 years to repay £248m deficit agreed as at 5 April 2010. Although there is no formal allocation of defined benefit liabilities between the participating employers of the scheme, the Bank currently pays 40% (2012: 40%) of the total deficit recovery contributions. Based on advice from a qualified actuary, the contributions in respect of future service in the defined benefit section, payable by the participating entities up to 6 October 2012, were 16.7% of pensionable salaries. Thereafter, this was reduced to 16.0% of pensionable salaries to reflect an increase in member contributions. The next triennial valuation is currently in progress, the results of which are expected in 2014.

There is no contractual agreement or stated Co-operative Group policy for charging the net defined benefit cost for the scheme as a whole measured in accordance with IAS 19R to individual Co-operative Group entities. Therefore, the Bank, in its individual financial information, cannot recognise the net defined benefit cost so charged. The net defined benefit cost of the pension scheme is recognised fully by the sponsoring employer, which is Co-operative Group Limited.

The Bank also pays contributions in respect of the employed members of the defined contribution sections of the scheme of either 2% or 8% of pensionable salaries.

Key assumptions of the Group pension scheme

The key aspects of The Co-operative Group's Pace scheme are as follows:

	30 June 2013	*30 June 2012*
The principal assumptions used to determine the liabilities of the Pace scheme are:		
Discount rate	4.60%	4.65%
Rate of increase in salaries	5.10%	4.70%
Future pension increases where capped at 5.0% per annum	3.60%	3.20%
Future pension increases where capped at 2.5% per annum	2.50%	2.50%
Assumptions used to determine net pension cost for the Pace scheme are:		
Discount rate	4.60%	4.60%
Rate of increase in salaries	4.80%	4.80%

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the Pace scheme at June 2013 is:

	Male	*Female*
Life expectancy:		
Member currently aged 65 (current life expectancy)	22.4	24.0
Member currently aged 45 (life expectancy at age 65)	24.2	25.9

The amounts recognised in the balance sheet of The Co-operative Group are as follows:

	30 June 2013	*30 June 2012*
Fair value of plan assets	7,189.9	6,593.1
Present value of funded obligations	(6,988.4)	(6,212.6)
	201.5	380.5
Present value of unfunded obligations	(4.5)	(4.4)
	197.0	376.1

The asset allocations at the period end were as follows:

	30 June 2013	*30 June 2012*
Equities	2,357.1	1,977.9
Liability driven investments	3,473.8	3,296.6
Alternative growth	956.9	923.0
Property	297.8	329.7
Other	104.3	65.9

The table below shows the value of the assets in each category which have a quoted market price:

	30 June 2013	*30 June 2012*
Equities	2,357.1	1,987.0
Liability driven investments	2,541.9	2,451.6
Alternative growth	–	–
Property	–	–
Other	103.2	65.8

Britannia pension scheme

Defined contribution basis

The Britannia scheme is a hybrid scheme, consisting of a defined benefit section and a defined contribution section. Following the transfer of engagements of Britannia Building Society, CFSMS Management Services Limited (CFSMS), a fellow Banking Group Subsidiary became principal employer of the scheme. The pension cost shown in these accounts is the actual contribution paid by the Bank. The scheme closed on 6 October 2012 with active members at the date of closure being invited to join the Co-operative Pension Scheme (Pace) for future pension accrual. No future service contributions are payable to the scheme due to the closure of the scheme to future accrual during 2012. A fixed allowance for running expenses of £1.0 million per annum is currently payable.

Nature of benefits

The funded element of the defined benefit section pays out pensions at retirement based on service to 6 October 2012 and final pay for employees who commenced employment prior to 1 September 2001, when it closed to new members. The unfunded element is a no charge supplementary arrangement for certain executive directors. Benefits under the unfunded arrangements are valued on the same assumptions as the funded defined benefits and are disclosed as unfunded obligations.

Scheme information

Risks arising in the Britannia scheme are identified in CFSMS, with the impact of any changes to contribution rates assessed under the Bank's risk management framework. The Bank is therefore exposed to potential future increases in required contributions and capital held for pension risk.

The Britannia scheme trustee, is responsible for the risk management arrangements for the scheme, agreeing suitable contribution rates, investment strategy and for taking appropriate professional advice as required.

Contribution rates

There is no contractual agreement or stated policy for charging the net defined benefit cost for the scheme as a whole, as measured in accordance with IAS 19R, to individual entities. Therefore, the Bank, in its individual financial information, cannot recognise the net defined benefit cost so charged. The net defined benefit cost of the pension scheme is recognised fully by the principal employer, CFSMS.

The key aspects of the defined benefit section of the Britannia scheme are as follows:

	30 June 2013	*30 June 2012*
The principal assumptions used to determine the liabilities of the defined benefit section of the scheme are:		
Discount rate	4.60%	4.60%
Rate of increase in salaries	4.80%	4.80%
Future pension increases where capped at 5.0% per annum	3.30%	3.30%
Future pension increases where capped at 2.5% per annum	2.50%	2.50%
Assumptions used to determine net pension cost for the Britannia defined benefit scheme are:		
Discount rate	4.60%	4.60%
Rate of increase in salaries	4.80%	4.80%

The average life expectancy (in years) for mortality tables used to determine defined benefit scheme liabilities for the former Britannia Building Society scheme at June 2013 is:

	Male	*Female*
Life expectancy:		
Member currently aged 65 (current life expectancy)	22.4	24.6
Member currently aged 45 (life expectancy at age 60)	24.2	26.5

The amounts recognised in the balance sheet of CFSMS are as follows:

	30 June 2013	*30 June 2012*
Fair value of plan assets	609.5	584.2
Present value of funded obligations	(593.2)	(624.3)
	16.3	(40.1)
Pension surplus not recognised under IAS 19R	(16.3)	–
Present value of unfunded obligations	(2.9)	(3.0)
	(2.9)	(43.1)

The asset allocations at the period end were as follows:

	30 June 2013	*30 June 2012*
Equities	150.3	146.1
Liability driven investments	281.9	333.0
Alternative growth	126.4	87.6
Property	50.9	17.5

The table below shows the value of the assets in each category which have a quoted market price.

	30 June 2013	*30 June 2012*
Equities	150.3	146.1
Liability driven investments	281.9	267.0

The above disclosure for assets and obligations are estimates which have been calculated by projecting forward from the 31 December 2012 position. The projections assume that all experience without exception has been in line with the assumptions made at 31 December 2012.

Bank (unfunded) pension scheme

The Bank also operates a small unfunded pension scheme.

	30 June 2013	*30 June 2012*
Rate of increase of pensions in payment	3.3%	3.3%
Rate of increase in salaries	4.8%	4.8%
Discount rate	4.6%	4.6%

The assumptions used by the actuary were the best estimates chosen from a range of possible actuarial assumptions which, due to the timescales covered, may not necessarily be borne out in practice.

The values of the assets and liabilities of the unfunded pension scheme were:

	30 June 2013	*30 June 2012*
Present value of unfunded obligations	(4.0)	(4.0)
Deficit in scheme	(4.0)	(4.0)
Related deferred tax asset	0.9	0.9
Net pension liability	(3.1)	(3.1)
Analysis of amount charged to income statement:		
Interest on pension scheme liabilities	0.1	0.1
	0.1	0.1

Changes in the present value of the scheme liabilities are as follows:

	30 June 2013	*30 June 2012*
Opening defined benefit liabilities	4.0	3.9
Interest on liabilities	0.1	0.1
Benefits paid	(0.1)	–
Closing defined benefit liabilities	4.0	4.0

Amounts recognised in the statement of comprehensive income was £nil (30 June 2012: £nil).

The amounts for the current year are as follows:

	30 June 2013	*30 June 2012*
Defined benefit obligation	(4.0)	(4.0)
Scheme assets	–	–
Deficit in scheme	(4.0)	(4.0)
Experience adjustment on scheme liabilities	–	–
Experience adjustment on scheme assets	–	–

30. Contingent liabilities and commitments

The tables below give the contract amounts and risk weighted amounts of contingent liabilities and commitments. The contract amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The risk weighted amounts have been calculated in accordance with the PRA rules.

The contingent liabilities detailed below arise in the normal course of banking business and it is not practical to quantify their future financial effect.

	Contract amount 30 June 2013	*Risk weighted amount 30 June 2013*	*Contract amount 30 June 2012*	*Risk weighted amount 30 June 2012*
Contingent liabilities:				
Guarantees and irrevocable letters of credit	146.3	107.1	221.0	178.6
Other commitments:				
Documentary credits and short term trade related transactions	1.2	0.2	6.1	1.1
Forward asset purchases and forward deposits placed	96.7	1.0	140.4	4.5
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments) (i)	4,377.6	845.2	5,118.9	1,230.1
	4,475.5	846.4	5,265.4	1,235.7

Notes

(i) Undrawn loan commitments include revocable commitments which are unused credit card limits of £2,031.1m (2012: £2,119.7m).

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Bank's day to day operations. Mandatory reserve deposits are also held with the Bank of England in accordance with statutory requirements.

See note 34d for further details of assets pledged.

Commitments under operating leases

The Bank leases various properties and equipment under non-cancellable operating lease arrangements. The leases have various terms, ranging from six months to 999 years. None of these leases are individually material and none have any material clauses. The table below discloses the minimum operating lease payments the Bank is required to make over the remaining lives of the leases.

	Land and buildings 30 June 2013	*Equipment 30 June 2013*	*Land and buildings 30 June 2012*	*Equipment 30 June 2012*
Falling due:				
Within one year	21.6	0.2	23.0	0.3
Between one and five years	59.7	0.3	68.3	0.5
In five years or more	79.9	–	80.4	–
	161.2	0.5	171.7	0.8

The Bank leases a number of branch and office premises under operating leases. The leases typically run for a period of up to 25 years, with an option to renew the lease after that period. Lease payments are generally reviewed every three to five years to reflect market rentals.

The total value of future minimum sub-lease payments expected to be received under non-cancellable sub-leases for the Bank was £8.8m (2012: £10.3m).

Former Britannia Building Society pension scheme guarantee

Following the transfer of engagements of Britannia Building Society, the Britannia pension scheme transferred to CFS Management Services Ltd (CFSMS). Under the terms of this transfer the Bank entered into a deed of guarantee to provide assurance to the trustees of the pension scheme to support CFSMS in meeting its funding obligations to the scheme should CFSMS be unable to pay its obligations as they fall due.

Intra-group guarantee

The Bank has an indemnification agreement, accounted for as an intra-group guarantee under IFRS 4, with CFSMS in which the Bank has agreed to indemnify CFSMS against all and any liability, loss, damage, costs and expense arising from the agreement.

Other

Given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies, the media and politicians, there is a risk that certain aspects of the Bank's current or historic business, including, inter alia, mortgages and relationship banking, may be determined by the Financial Conduct Authority (FCA) and other regulatory bodies or the courts as not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment in their opinion.

31. Investments in Group undertakings

Subsidiary undertakings

The Bank has, except in the case of Unity Trust Bank plc, a direct interest in the ordinary share capital of the following principal subsidiary undertakings trading in the businesses indicated. All subsidiary undertakings are included in the consolidated Bank results.

Principal subsidiary undertakings which are registered in England and operating in the UK:

		Bank holding 30 June 2013	*Bank holding 30 June 2012*
Unity Trust Bank plc (held through subsidiary undertaking)	Banking	27%	27%
Co-operative Commercial Limited	Investment company	100%	100%
First Roodhill Leasing Limited	Leasing	100%	100%
Second Roodhill Leasing Limited	Leasing	100%	100%
Third Roodhill Leasing Limited	Leasing	100%	100%
Fourth Roodhill Leasing Limited	Leasing	100%	100%
Britannia Treasury Services Limited	Holding company	100%	100%
Britannia Asset Management Limited	Holding company	100%	100%
Britannia Development and Management Company Limited	Property investment	100%	100%
Illius Properties Limited	Property investment	100%	100%
Moorland Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	100%	100%

See note 34d for further details of the covered bond transactions.

The accounting policy for Special Purpose Entities (SPEs) is disclosed on page 292.

Unity Trust Bank plc is considered to be a subsidiary undertaking of The Co-operative Bank p.l.c. as The Co-operative Bank p.l.c. elects a majority of the directors and appoints the chair and managing director. This provides the power to control.

Britannia Treasury Services Limited has the following principal wholly owned subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Mortgage Agency Services Number One Limited	Mortgage and syndicated lending
Mortgage Agency Services Number Two Limited	Mortgage lending
Mortgage Agency Services Number Four Limited	Mortgage lending
Mortgage Agency Services Number Five Limited	Mortgage lending
Mortgage Agency Services Number Six Limited	Mortgage lending
Western Mortgage Services Limited	Mortgage book administration
Platform Group Holdings Limited	Holding company

Platform Group Holdings Limited has the following principal wholly owned subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Platform Consumer Services Limited	Mortgage lending
Platform Funding Limited	Mortgage origination
Platform Home Loans Limited	Mortgage origination and servicing

Platform Consumer Services Limited is the only direct subsidiary of Platform Group Holdings Limited.

Registered in the Isle of Man and operating overseas:

Britannia International Limited	Deposit taking

Registered in Scotland and operating in the UK:

Britannia Life Direct Limited	Direct sales of financial services

Securitisation vehicles

The results of the following securitisation vehicles are consolidated into the results of the Bank:

Leek Finance Number Seventeen plc	Securitisation company
Leek Finance Number Eighteen plc	Securitisation company
Leek Finance Number Nineteen plc	Securitisation company
Leek Finance Number Twenty plc	Securitisation company
Leek Finance Number Twenty One plc	Securitisation company
Leek Finance Number Twenty Two plc	Securitisation company
Meerbrook Finance Number One Limited	Securitisation company
Meerbrook Finance Number Two Limited	Securitisation company
Meerbrook Finance Number Three Limited	Securitisation company
Meerbrook Finance Number Four Limited	Securitisation company
Meerbrook Finance Number Six Limited	Securitisation company
Silk Road Finance Number One plc	Securitisation company
Silk Road Finance Number Two plc	Securitisation company
Silk Road Finance Number Three plc	Securitisation company
Cambric Finance Number One plc	Securitisation company
Calico Finance Number One Limited	Securitisation company

All securitisation vehicles are registered in England and operate in the UK, with the exception of Calico Finance Number One Limited, which is registered and operates in the Republic of Ireland.

All of the above companies are related parties to the Bank. See note 32 for the related party disclosures.

See note 34d for further details of securitisation vehicles.

Joint ventures

The Bank's investment in joint ventures is £4.3m (30 June 2012: £3.4m).

The Bank owns 49% of the ordinary shares in Britannia Personal Lending Limited, a company registered in England and operating in the UK. The company trades in the business of unsecured personal lending.

The Bank's interest in Britannia Personal Lending Limited is as follows:

	30 June 2013	*30 June 2012*
Current assets	5.7	11.9
Long term assets	9.5	14.1
	15.2	26.0
Current liabilities	9.2	16.8
Long term liabilities	1.7	5.8
Equity	4.3	3.4
	15.2	26.0
Income	0.6	0.7
Expenses	(0.2)	0.1
Profit before tax	0.4	0.8
Taxation	(0.1)	(0.2)
Profit after tax	0.3	0.6

Joint ventures are accounted for using the equity method.

32. Related party transactions

Parent, subsidiary and ultimate controlling party

The Co-operative Banking Group Limited owns 100% of the issued ordinary share capital of the Bank and is the Bank's immediate holding company. The Co-operative Banking Group Limited is incorporated in England and is registered under the Industrial and Provident Societies Acts. The ultimate holding organisation is The Co-operative Group Limited, which is incorporated in England and registered under the Industrial and Provident Societies Acts. The financial statements of the immediate and ultimate holding organisations are available from 1 Angel Square, Manchester, M60 0AG.

Further details of subsidiary undertakings and joint ventures are disclosed in note 31.

A number of banking transactions are entered into with related parties in the normal course of business on normal commercial terms. These include loans and deposits. Key management, as defined by IAS 24 (Related Party Disclosures), are considered to be Board and executive members of the Bank, and Board and executive members of the Bank's immediate and ultimate holding organisations. The volume of related party transactions, outstanding balances at the period end, and related income and expense for the period are as follows:

Directors, key management personnel and close family

	30 June 2013	*30 June 2012*
Loans outstanding at the beginning of the period	2.6	2.2
Net movement	(1.1)	0.1
Loans outstanding at the end of the period	1.5	2.3
Deposits and investments at the beginning of the period	2.4	1.9
Net movement	(0.8)	0.3
Deposits and investments at the end of the period	1.6	2.2

Directors' loans

	Mortgages 30 June 2013	*Personal loans 30 June 2013*	*Credit cards 30 June 2013*	*Mortgages 30 June 2012*	*Personal loans 30 June 2012*	*Credit cards 30 June 2012*
Number of directors with loan type	3	1	3	5	2	5
Total value of directors' loans	0.7	–	–	1.6	–	–

	Interest and fees received from other Co-operative Group undertakings Period to 30 June 2013	*Interest and fees paid to other Co-operative Group undertakings Period to 30 June 2013*	*Interest and fees received from other Co-operative Group undertakings Period to 30 June 2012*	*Interest and fees paid to other Co-operative Group undertakings Period to 30 June 2012*
Parent undertakings	2.6	0.3	2.2	–
Fellow subsidiary undertakings	0.3	–	0.5	–
	2.9	0.3	2.7	–

	Loans owed by other Co-operative Group undertakings 30 June 2013	*Loans owed to other Co-operative Group undertakings 30 June 2013*	*Loans owed by other Co-operative Group undertakings 30 June 2012*	*Loans owed to other Co-operative Group undertakings 30 June 2012*
Parent undertakings	0.5	45.1	8.4	1.6
Fellow subsidiary undertakings	–	78.8	280.5	96.1
	0.5	123.9	288.9	97.7

Recharges from CFSMS

During the period, operating costs of £481.2m (30 June 2012: £311.8m) incurred on its behalf were charged at cost to the Bank by CFSMS, a fellow subsidiary of the Co-operative Banking Group Limited. £148.4m (30 June 2012: £nil) of these recharges related to the impairment of intangible assets relating to the development of new banking systems. At 30 June 2013, the Bank owed £2.5m to CFSMS (30 June 2012: £280.1m owed by CFSMS).

Key management compensation

	Period to 30 June 2013	*Period to 30 June 2012*
Salaries and short term benefits	1.5	1.4
Termination benefits	–	1.4
	1.5	2.8

33. Share capital

	No. of shares (millions) 30 June 2013	*Share capital 30 June 2013*	*No. of shares (millions) 30 June 2012*	*Share capital 30 June 2012*
Authorised capital (ordinary shares of 5p each)				
At the beginning and end of the period	8,200	410.0	8,200	410.0
Allotted, called up and fully paid (ordinary shares of 5p each)				
At the beginning and end of the period	8,200	410.0	8,200	410.0
Share premium account at the beginning and the end of the period		8.8		8.8

The shareholders have one vote for every share held.

34. Fair values of financial assets and liabilities

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. As a wide range of valuation techniques are available, it may be inappropriate to compare this fair value information to that of independent market or other financial institutions. Assumptions changes and different valuation methodologies can have significant impacts, particularly on fair values which are based on unobservable inputs.

The tables below analyse the balance sheet carrying values of financial assets and liabilities by classification.

Balance sheet categories 30 June 2013	*Held for trading*	*Designated at fair value*	*Loans and receivables*	*Available for sale*	*Liabilities at amortised cost*	*Cashflow hedges*	*Total*
Assets							
Cash and balances at central banks	–	–	5,402.1	–	–	–	5,402.1
Loans and advances to banks	–	–	1,737.5	–	–	–	1,737.5
Loans and advances to customers	–	144.2	32,571.7	–	–	–	32,715.9
Fair value adjustments for hedged risk	–	–	217.0	–	–	–	217.0
Investment securities	–	1,622.3	30.6	3,429.7	–	–	5,082.6
Derivative financial instruments	–	728.6	–	–	–	75.7	804.3
Equity shares	–	–	–	5.7	–	–	5.7
Amounts owed by other Co-operative Group undertakings	–	–	0.5	–	–	–	0.5
Total financial assets	–	2,495.1	39,959.4	3,435.4	–	75.7	45,965.6
Non-financial assets							666.7
Total assets							46,632.3

	Held for trading	*Designated at fair value*	*Loans and receivables*	*Available for sale*	*Liabilities at amortised cost*	*Cashflow hedges*	*Total*
Liabilities							
Deposits by banks	–	–	–	–	3,517.8	–	3,517.8
Customer accounts	–	–	–	–	34,166.3	–	34,166.3
Customer accounts – capital bonds	–	756.0	–	–	–	–	756.0
Debt securities in issue	–	–	–	–	4,610.0	–	4,610.0
Derivative financial instruments	–	619.0	–	–	–	43.7	662.7
Other borrowed funds	–	–	–	–	1,248.1	–	1,248.1
Amounts owed to other Co-operative Group undertakings	–	–	–	–	123.9	–	123.9
Total financial liabilities	–	1,375.0	–	–	43,666.1	43.7	45,084.8
Non-financial liabilities							532.8
Total liabilities							45,617.6
Total equity							1,014.7
Total liabilities and equity							46,632.3

Balance sheet categories 30 June 2012	*Held for trading*	*Designated at fair value*	*Loans and receivables*	*Available for sale*	*Liabilities at amortised cost*	*Cashflow hedges*	*Total*
Assets							
Cash and balances at central banks	–	–	4,316.6	–	–	–	4,316.6
Loans and advances to banks	–	–	2,359.7	–	–	–	2,359.7
Loans and advances to customers	–	148.0	33,860.4	–	–	–	34,008.4
Fair value adjustments for hedged risk	–	–	368.2	–	–	–	368.2
Investment securities	439.0	817.4	483.0	3,217.6	–	–	4,957.0
Derivative financial instruments	180.7	547.0	–	–	–	183.1	910.8
Equity shares	–	–	–	5.7	–	–	5.7
Amounts owed by other Co-operative Group undertakings	–	–	288.9	–	–	–	288.9
Total financial assets	619.7	1,512.4	41,676.8	3,223.3	–	183.1	47,215.3
Non-financial assets							502.8
Total assets							47,718.1
Liabilities							
Deposits by banks	–	–	–	–	4,416.0	–	4,416.0
Customer accounts	–	–	–	–	33,054.7	–	33,054.7
Customer accounts – capital bonds	–	1,141.7	–	–	–	–	1,141.7
Debt securities in issue	–	–	–	–	4,146.8	–	4,146.8
Derivative financial instruments	164.3	778.8	–	–	–	40.0	983.1
Other borrowed funds	–	–	–	–	1,257.1	–	1,257.1
Amounts owed to other Co-operative Group undertakings	–	–	–	–	97.7	–	97.7
Total financial liabilities	164.3	1,920.5	–	–	42,972.3	40.0	45,097.1
Non-financial liabilities							332.9
Total liabilities							45,430.0
Total equity							2,288.1
Total liabilities and equity							47,718.1

The 2012 comparatives include balance sheet reclassifications of deferred tax assets and liabilities as shown in note 28.

a. **Use of financial instruments**

The use of financial instruments is essential to the Bank's business activities, and financial instruments constitute a significant proportion of the Bank's assets and liabilities. The main financial instruments used by the Bank, and the purposes for which they are held, are outlined below:

Loans and advances to customers and customer accounts

The provision of banking facilities to customers is the prime activity of the Bank, and loans and advances to customers and customer accounts are major constituents of the balance sheet. Loans and advances to customers include retail mortgages, corporate loans, credit cards, unsecured retail lending and overdrafts. Customer accounts include retail and corporate current and saving accounts.

Loans and advances to banks and investment securities

Loans and advances to banks and investment securities underpin the Bank's liquidity requirements and generate incremental net interest and trading income. Held for trading investments were traded solely for short term profit.

Deposits by banks and debt securities in issue

The Bank issues medium term notes within an established euro medium term note programme and also issues certificates of deposit and commercial paper as part of its normal treasury activities. These

sources of funds, alongside other borrowed funds, are invested in marketable investment grade debt securities and short term wholesale market placements and are used to fund customer loans.

Other borrowed funds

The Bank utilises a broad spread of capital funds. In addition to ordinary share capital and retained earnings, when appropriate, the Bank issues preference shares and perpetual and fixed term subordinated notes.

Derivatives

A derivative is a financial instrument that derives its value from an underlying rate or price such as interest rates, exchange rates and other market prices. Derivatives are an efficient means of managing market risk and limiting counterparty exposure. The Bank uses them mainly for hedging purposes and to meet the needs of customers.

The most frequently used derivative contracts are interest rate swaps, exchange traded futures and options, caps and floors, currency swaps and forward currency transactions. Terms and conditions are determined by using standard industry documentation. Derivatives are subject to the same market and credit risk control procedures as are applied to other wholesale market instruments and are aggregated with other exposures to monitor total counterparty exposure which is managed within approved limits for each counterparty.

Foreign exchange

The Bank undertakes foreign exchange dealing to facilitate customer requirements and to generate incremental income from short term trading in the major currencies. Structured risk and trading related risk are managed formally within position limits which are set by the Assets and Liabilities Committee, to which authority is delegated by the Board.

b. **Valuation of financial instruments carried at fair value**

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

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

	Fair value at end of the reporting period using:			
	Level 1	*Level 2*	*Level 3*	*Total*
30 June 2013				
Non-derivative financial assets				
Held for trading:				
Investment securities	–	–	–	–
Designated at fair value:				
Loans and advances to customers	–	134.0	10.2	144.2
Investment securities	1,622.3	–	–	1,622.3
Available for sale financial assets:				
Investment securities	3,189.5	240.2	–	3,429.7
Equity shares	–	–	5.7	5.7
Derivative financial instruments	–	774.5	29.8	804.3
Total assets carried at fair value	4,811.8	1,148.7	45.7	6,006.2
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	–	756.0	–	756.0
Derivative financial instruments	–	635.9	26.8	662.7
Total liabilities carried at fair value	–	1,391.9	26.8	1,418.7

	Fair value at end of the reporting period using:			
	Level 1	*Level 2*	*Level 3*	*Total*
30 June 2012				
Non-derivative financial assets				
Held for trading:				
Investment securities	439.0	–	–	439.0
Designated at fair value:				
Loans and advances to customers	–	136.4	11.6	148.0
Investment securities	817.4	–	–	817.4
Available for sale financial assets:				
Investment securities	2,826.8	390.8	–	3,217.6
Equity shares	–	–	5.7	5.7
Derivative financial instruments	–	864.1	46.7	910.8
Total assets carried at fair value	4,083.2	1,391.3	64.0	5,538.5
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	–	1,141.7	–	1,141.7
Derivative financial instruments	–	973.1	10.0	983.1
Total liabilities carried at fair value	–	2,114.8	10.0	2,124.8

The carrying values of financial instruments measured at fair value are determined in compliance with the accounting policies on pages 287 to 304 and according to the following hierarchy:

Level 1 – Quoted market prices in active markets

Financial instruments with quoted prices for identical instruments in active markets. The best evidence of fair value is a quoted market price in an actively traded market.

Level 2 – Valuation techniques using observable inputs

Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

The valuation techniques used to value these instruments employ only observable market data and relate to the following assets and liabilities:

Loans and advances to customers

Loans and advances to customers include corporate loans of £134.0m (30 June 2012: £136.4m) which are fair valued through income or expense using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

Investment securities – available for sale

Fair value is based on available market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

Derivative financial instruments

OTC (ie non-exchange traded) derivatives are valued using valuation models which are based on observable market data. Valuation models calculate the present value of expected future cash flows, based upon 'no arbitrage' principles. The Bank enters into vanilla foreign exchange and interest rate swap derivatives, for which modelling techniques are standard across the industry. Examples of inputs that are generally observable include foreign exchange spot and forward rates, and benchmark interest rate curves.

Customer accounts – capital bonds

The estimated fair value of customer accounts – capital bonds is based on independent third party valuations using forecast future movements in the appropriate indices.

Level 3 – Valuation techniques using unobservable inputs

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

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

Loans and advances to customers

Loans and advances to customers include 25 year fixed rate mortgages of £10.2m (30 June 2012: £11.6m) which are fair valued through income or expense using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk. A reasonable change in the assumptions would not result in any material change in the valuation.

Equity shares

Equity shares primarily relate to investments held in Vocalink Limited which are unquoted shares. The valuation of these shares is based on the Bank's percentage shareholding and the net asset value of the company according to its most recently published financial statements.

Derivative financial instruments

Derivative financial instruments in the form of interest rate swaps have been entered into between the Bank and its subsidiaries, and external counterparties.

The purpose of the swaps is to convert the fixed and base rate linked revenue receipts of the pool of mortgage assets to the same LIBOR linked basis as the intercompany loan. Under this swap arrangement the Bank's subsidiaries pay to the swap counterparty, the monthly mortgage revenue receipts of the pool of assets and receives from the swap counterparty LIBOR plus a contractual spread on the same notional balance, the spread being sufficient to cover the intercompany loan and any expenses. The Bank has a 'back to back' swap that is the mirror image of the subsidiaries' swaps.

The swaps are valued based on an assumed amortisation profile of the pool of assets to the bond maturity date (assuming some annual prepayment), an assumed profile of customer receipts over this period, and LIBOR prediction using forward rates. Swap cash flows are discounted to present value using mid-yield curve zero coupon rates, ie no adjustment is made for credit losses, nor for transaction or any other costs.

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

	Fair value at the beginning of the period	*Purchases*	*Sales*	*Unrealised income or expense*	*Fair value at the end of the period*
30 June 2013					
Loans and advances to customers	11.2	(0.6)	–	(0.4)	10.2
Derivative assets	35.4	9.4	–	(15.0)	29.8
Equity shares	5.7	–	–	–	5.7
Derivative liabilities	(12.4)	(16.1)	–	1.7	(26.8)
	39.9	(7.3)	–	(13.7)	18.9
30 June 2012					
Loans and advances to customers	12.4	–	–	(0.8)	11.6
Derivative assets	25.4	–	–	21.3	46.7
Equity shares	5.7	–	–	–	5.7
Derivative liabilities	(13.3)	–	–	3.3	(10.0)
	30.2	–	–	23.8	54.0

Unrealised income or expense is recognised through net interest income.

c. **Fair values of financial instruments not carried at fair value**

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

- financial assets classified as loans and receivables; and

- financial liabilities classified as held at amortised cost,

unless there is no significant difference between carrying and fair values.

	30 June 2013		*30 June 2012*	
	Carrying value	*Fair value*	*Carrying value*	*Fair value*
Financial assets				
Loans and receivables				
Loans and advances to banks	1,737.5	1,737.5	2,359.7	2,359.8
Loans and advances to customers	32,571.7	28,999.9	33,860.4	34,121.3
Fair value adjustments for hedged risk	217.0	217.0	368.2	368.2
Investment securities	30.6	20.2	483.0	557.4
Financial liabilities				
Financial liabilities at amortised cost				
Deposits by banks	3,517.8	3,519.2	4,416.0	4,416.0
Customer accounts	34,166.3	34,153.5	33,054.7	33,257.3
Debt securities in issue	4,610.0	5,141.8	4,146.8	4,877.7
Other borrowed funds	1,248.1	851.2	1,257.1	1,221.8

In 2013, the Bank reviewed and improved the methods used to calculate the fair values. The 2012 comparatives (with the exception of loans and advances to customers, fair value adjustment for hedged risk and customer accounts) have been re-presented accordingly to reflect these changes in methods.

Key considerations in the calculation of fair values for loans and receivables and financial liabilities at amortised cost are as follows:

Loans and advances to banks/deposits by banks

Loans and advances to banks include interbank placements and items in the course of collection.

The amortised cost value of all loans and advances to banks are deemed to be a close approximation of their fair value (there is a 0.01% difference) due to their short maturity. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity.

Loans and advances to customers

The fair value of loans and advances to customers is calculated by segmenting the overall balance into Retail, Optimum and Corporate.

(i) **Retail**

Fixed rate loans and advances to customers are revalued to fair value based on future interest cash flows (at funding rates) and principal cash flows discounted using an appropriate market rate. Forecast principal repayments are based on redemption at the earlier of maturity or repricing date with some overlay for historical behavioural experience where relevant. The eventual timing of future cash flows may be different from the forecast due to unpredictable customer behaviour. It is assumed there is no fair value adjustment required in respect of interest rate movement on variable rate assets.

(ii) **Optimum**

Fair values have been calculated using an origination spread income approach. Under this approach, value is measured by determining discounted expected cashflows from the portfolio and applying an origination spread which reflects the difference between current market rates

for products with similar characteristics and risk profiles and the actual rates the portfolio is generating.

(iii) **Corporate**

As part of the implementation of the Bank's exit strategy, certain assets have either already been sold after the half year end or plans to sell are well advanced. For these assets, the fair value can therefore be determined from the actual sale price achieved or expected to be received.

For other Corporate assets an expected cashflow income approach has been used. Under this approach, value is measured by determining expected cashflows from the portfolio and then considering credit costs, funding costs and tax to derive equity cashflows which are discounted at an appropriate blended cost of capital.

The fair value of loans and advances to customers is significantly lower than the carrying value as a result of changes to the fair values of the Corporate and Optimum portfolios, which reflect the improved methodology referenced above and enhanced market price information for the Corporate book. The 2012 comparatives for loans and advances to customers have not been re-presented to reflect the change in methods referred to on page 385.

Investment securities

Fair value is based on available market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

Customer accounts

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on future interest cash flows (at funding rates) and principal cash flows, discounted using an appropriate market rate.

Debt securities in issue and other borrowed funds

The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

The fair value of debt securities in issue is significantly above the carrying value as a result of the carrying value being net of merger fair value adjustments. The fair value of other borrowed funds is significantly less than the carrying value as quoted market prices of issued debt capital have fallen. Since the period end, the other borrowed funds have been suspended from trading on the London Stock Exchange and current market prices are no longer available.

d. **Fair value of transferred assets and associated liabilities**

Securitisation vehicles

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

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

The Bank retains substantially all of the risks and rewards of ownership. The Bank benefits to the extent to which surplus income generated by the transferred mortgage portfolios exceeds the administration costs of those mortgages. The Bank continues to bear the credit risk of these mortgage assets.

The results of the securitisation vehicles listed in note 31 are consolidated into the results of the Bank. The table below shows the carrying values and fair values of the assets transferred to securitisation vehicles (where the notes are held externally) and their associated liabilities. The carrying values presented below are the carrying amounts as recorded in the subsidiaries:

	Carrying amount of transferred assets not derecognised	*Carrying amount of associated liabilities*	*Fair value of transferred assets not derecognised*	*Fair value of associated liabilities*	*Net position*
30 June 2013					
Leek Finance Number Seventeen plc	605.6	659.9	463.9	650.6	(186.7)
Leek Finance Number Eighteen plc	720.4	810.4	554.4	790.1	(235.7)
Leek Finance Number Nineteen plc	699.7	801.5	529.6	785.3	(255.7)
Silk Road Finance Number One plc	1,611.5	1,630.8	1,611.5	1,647.2	(35.7)
Silk Road Finance Number Two plc	646.2	637.1	647.3	645.0	2.3
Silk Road Finance Number Three plc	641.1	652.2	640.3	661.9	(21.6)
	4,924.5	5,191.9	4,447.0	5,180.1	(733.1)

Transferred assets include securitised gilts and loans and advances to customers that have not been derecognised by the seller. The associated liabilities include the fixed and floating rate notes.

The difference between the fair value and carrying value of the mortgages that have been securitised within Leek 17, 18 and 19 is significantly higher than the fair value to carrying value difference for the associated liabilities. This is because it is expected that the notes will be repaid at par at the call date of the Leek liabilities whereas most of the mortgages will continue to be held on the Bank's balance sheet for a significant period after the notes have repaid and these mortgages have an interest rate which is below the equivalent market rate at the balance sheet date for loans of a similar nature.

The securitisation vehicles receive cash daily in relation to the transferred loans and advances and semi-annually for the transferred gilts. These amounts will be held within loans and advances to banks until the associated liabilities' payments are due. Payments are made quarterly for all associated liabilities except for the variable funding notes associated with the transferred gilts, which are paid semi-annually. The amounts held within loans and advances to banks are not included in the table above but will be used in part to cover the repayments made on the associated liabilities.

	Carrying amount of transferred assets not derecognised	*Carrying amount of associated liabilities*	*Fair value of transferred assets not derecognised*	*Fair value of associated liabilities*	*Net position*
30 June 2012					
Leek Finance Number Seventeen plc	627.1	664.9	632.5	621.3	11.2
Leek Finance Number Eighteen plc	745.5	819.2	761.5	754.2	7.3
Leek Finance Number Nineteen plc	727.8	813.0	741.1	760.1	(19.0)
Meerbrook Finance Number Six Limited	81.2	61.1	80.4	13.2	67.2
Silk Road Finance Number One plc	1,957.6	1,970.8	1,957.6	1,974.5	(16.9)
Silk Road Finance Number Two plc	780.3	746.8	782.5	763.1	19.4
	4,919.5	5,075.8	4,955.6	4,886.4	69.2

Covered Bond Limited Liability Partnerships

Moorland Covered Bonds LLP was established as a result of a £1.4bn covered bond retained issuance. Loans and advances to customers of £1.9bn were transferred to Moorland Covered Bonds LLP. The transfer was funded by a loan of £1.4bn and capital contribution of £0.5bn. During October 2011 the

£1.4bn loan was repaid. Following additional capital contribution repayment and on achieving Regulated Covered Bond status there was a public issuance of notes in November 2011 totalling £0.6bn. As a result of these changes, at 30 June 2013, the Bank held a loan of £0.6bn (30 June 2012: £0.6bn) and a capital contribution of £1.1bn (30 June 2012: £1.5bn) with Moorland Covered Bonds LLP.

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

	Carrying amount of transferred loans and advances to customers	*Carrying amount of fixed and floating rate notes*	*Fair value of transferred loans and advances to customers*	*Fair value of fixed and floating rate notes*	*Net position*
30 June 2013					
Moorland Covered Bonds LLP	1,638.5	600.0	1,603.7	617.0	986.7

	Carrying amount of transferred loans and advances to customers	*Carrying amount of fixed and floating rate notes*	*Fair value of transferred loans and advances to customers*	*Fair value of fixed and floating rate notes*	*Net position*
30 June 2012					
Moorland Covered Bonds LLP	2,071.2	600.0	2,152.9	643.7	1,509.2

Assets pledged

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

	Carrying amount of assets not derecognised	*Carrying amount of associated liabilities*	*Fair value of assets not derecognised*	*Fair value of associated liabilities*	*Net position*
30 June 2013					
Investment securities sold under repurchase agreements	4,901.7	3,461.8	4,861.5	2,697.2	2,164.3

	Carrying amount of assets not derecognised	*Carrying amount of associated liabilities*	*Fair value of assets not derecognised*	*Fair value of associated liabilities*	*Net position*
30 June 2012					
Investment securities sold under repurchase agreements	4,715.2	3,654.9	4,243.6	3,654.9	588.7

Associated liabilities are included within deposits by banks.

The Bank has loans and advances to banks of £165.0m (30 June 2012: £550.0m) under reverse sale and repurchase agreements and against which gilts are held with a fair value of £157.1m (30 June 2012: £548.4m). These transactions are conducted under terms that are usual and customary to standard stock lending, securities borrowing and reverse purchase agreements. The Bank is permitted to sell or repledge the assets received as collateral in the absence of their default. The Bank is obliged to return equivalent securities. At 30 June 2013 the fair value of collateral repledged amounted to £157.1m (30 June 2012: £548.4m). The Bank does not adjust for the fair value of securities received under reverse sale and repurchase agreements.

35. Post balance sheet events

Adjusting events

It is a requirement of IAS 10 (Events after the balance sheet date) that this financial information reflects events arising since 30 June 2013 that provide evidence of conditions that existed at that date. Accordingly, it is the Board's responsibility to ensure that the Bank has ensured that any such matters that are material have been taken into account in preparing this information.

As a consequence, it is necessary to reflect certain changes to the unaudited results for the six months ended 30 June 2013 that have arisen between those results being approved on 28 August 2013 and 4 November 2013, the date of approval of this financial information:

- The latest forecasts produced in support of the Bank's Recapitalisation Plan show that it is probable that tax losses of £103.5m will be recoverable in future periods, and this amount has been recognised as a deferred tax asset.
- In the light of recent developments, provisions have been increased by £73.0m in respect of conduct risks relating to payment protection insurance, potential customer redress in relation to the processing of first payments on certain mortgages and potential customer redress in relation to arrears charges.

In addition, provisions have been made for £29.0m for potential customer redress following identification of a technical breach of the Consumer Credit Act.

Non adjusting events

Since the period end, the Bank has encumbered an additional £2.2bn of assets for the purpose of strengthening the liquidity position of the Bank, raising and retaining funding balances of £2.9bn at 28 August 2013 (the date of approval of the unaudited interim results), and a further £0.6bn at 4 November 2013 (the date of publication of this audited financial information).

Included in the funding balances raised and retained are £0.8bn of Britannia International (IOM) deposits and £0.2bn of Guernsey deposits collateralised since the period end.

PART B – ACCOUNTANT'S REPORT ON AUDITED FINANCIAL INFORMATION FOR THE SIX MONTHS ENDED 30 JUNE 2013

The Directors
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP
4 November 2013

Dear Sirs

The Co-operative Bank p.l.c. (the 'Company')

We report on the financial information set out on pages 278 to 389 for the six months ended 30 June 2013. This financial information has been prepared for inclusion in the Prospectus dated 4 November 2013 of the Company on the basis of the accounting policies set out on pages 292 to 304 of the Prospectus. This report is in accordance with paragraph 11.1 of Annex XI of the Prospectus Directive Regulation and is given for the purpose of complying with that paragraph and for no other purpose. We have not audited or reviewed the financial information for the six months ended 30 June 2012 which has been included for comparative purposes only, and accordingly do not express an opinion thereon.

Responsibilities

The Directors of the Company are responsible for preparing the financial information on the basis of preparation set out on pages 287 to 291 of the Prospectus and in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS).

It is our responsibility to form an opinion on the financial information and to report our opinion to you.

Save for any responsibility arising under Prospectus Rule 5.5.4R (2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with paragraph 13.1 of Annex XI of the Prospectus Directive Regulation, consenting to its inclusion in the Prospectus.

Basis of opinion

We conducted our work in accordance with Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of the significant estimates and judgments made by those responsible for the preparation of the financial information and whether the accounting policies are appropriate to the entity's circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

Opinion on financial information

In our opinion, the financial information gives, for the purposes of the Prospectus dated 4 November 2013, a true and fair view of the state of affairs of the Company as at 30 June 2013 and of its losses, cash flows and recognised gains and losses for the six months ended 30 June 2013 in accordance with the basis of preparation and in accordance with International Financial Reporting Standards as set out on pages 287 to 304 of the Prospectus.

Emphasis of matter – Going concern

In forming our conclusion on the financial information, which is not modified, we have considered the adequacy of the disclosures made in the Basis of Preparation section of the financial information set out on pages 289 to 291 of the Prospectus concerning the Company's ability to continue as a going concern; in that section the Directors set out the risks associated with the successful execution of the recapitalisation plan. These conditions indicate the existence of a material uncertainty which may cast significant doubt on the Company's ability to continue as a going concern. The financial information does not include the adjustments that would result if the Company was unable to continue as a going concern.

Declaration

For the purposes of Prospectus Rule 5.5.4R (2)(f) we are responsible for this report as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with paragraph 1.2 of Annex XI of the Prospectus Directive Regulation.

Yours faithfully

KPMG Audit Plc

PART C – UNAUDITED PRO FORMA FINANCIAL INFORMATION AS AT 30 JUNE 2013

The unaudited pro forma balance sheet as at 30 June 2013 has been prepared to show the pro forma impact of the Liability Management Exercise, on assets, liabilities and equity, as if it had taken place as at 30 June 2013. It has been prepared for illustrative purposes only in accordance with Annex II of the Prospectus Directive (Directive 2003/71/EC as amended) and should be read in conjunction with the notes set out below. Because of its nature, it addresses a hypothetical situation and therefore does not represent the Bank's actual financial position as at 30 June 2013, nor it is indicative of the results that may or may not be expected to be achieved in the future.

The successful completion of the Liability Management Exercise is expected to be earnings enhancing as a result of interest savings on Existing Securities surrendered in the Liability Management Exercise, net of coupon payments on New Securities issued in the Liability Management Exercise.

Balance sheet as at 30 June 2013

		Adjustments			
	As at 30 June 2013[1]	*Liquidity Management Exercise*[2]	*Additional New Ordinary Shares Offer*[3]	*Expenses of the Liquidity Management Exercise*[4]	*Unaudited pro forma*
			(£millions)		
Cash and balances at central banks	5,402.1	–	125.0	(43.0)	5,484.1
Other assets	41,230.2	–	–	–	41,230.2
Total assets	46,632.3	–	125.0	(43.0)	46,714.3
Liabilities					
Other borrowed funds	1,248.1	(1,042.1)	–	–	206.0
Other liabilities	44,369.5	–	–	–	44,369.5
Total liabilities	45,617.6	(1,042.1)	–	–	44,575.5
Total equity	1,014.7	1,042.1	125.0	(43.0)	2,138.8
Total liabilities and equity	46,632.3	–	125.0	(43.0)	46,714.3

Notes:

(1) The financial information as at 30 June 2013 has been extracted, without material adjustment, from the Interim Financial Information set out in "*Part A*" of Section 16 (*Financial Information*) of this Prospectus. The accounting policies adopted in preparing the pro forma balance sheet as at 30 June 2013 are consistent with the accounting policies adopted in preparing the Interim Financial Information. No account has been taken of actual changes in the trading or financial position of the Bank since 30 June 2013.

(2) The Liability Management Exercise is assumed to generate £1,042.1 million of capital on the basis of full participation in the Liability Management Exercise.

(3) £125.0 million of New Ordinary Shares will be issued as a result of the Additional New Ordinary Shares Offer.

(4) The expenses of the Liability Management Exercise to be borne by the Bank are estimated at approximately £51.0 million (inclusive of VAT), of which approximately £8.0 million was recorded in the six months ended 30 June 2013. The remaining balance of approximately £43.0 million will be paid by the Bank out of cash resources. A portion of these expenses may be allocated to the Bank T2 Notes rather than wholly against total equity. This allocation has not yet been determined.

(5) No adjustment has been made to reflect the legally binding and irrevocable commitment, provided to Bank by Co-operative Banking Group on 4 November 2013, conditional only upon the successful completion of the Liability Management Exercise, to contribute £333.0 million of capital to the Bank during 2014.

PART D – ACCOUNTANT'S REPORT ON UNAUDITED PRO FORMA FINANCIAL INFORMATION OF THE BANK

The Directors
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

4 November 2013

Dear Sirs

The Co-operative Bank p.l.c. (the "Company")

We report on the pro forma financial information (the 'Pro forma financial information') set out in Section 16 of Part C of the Prospectus dated 4 November 2013, which has been prepared on the basis described in notes 1-5, for illustrative purposes only, to provide information about how the Company and Co-operative Group Limited's Liability Management Exercise might have affected the financial information presented on the basis of the accounting policies adopted by the Company in preparing the financial statements for the period ended 30 June 2013. This report is required in order to enable the Company to comply with paragraph 7 of Annex II of the Prospectus Directive Regulation in relation to the Prospectus and is given for that purpose and for no other purpose.

Responsibilities

It is the responsibility of the directors of the Company to prepare the Pro forma financial information in accordance with Annex II of the Prospectus Directive Regulation.

It is our responsibility to form an opinion, as required by paragraph 7 of Annex II of the Prospectus Directive Regulation, as to the proper compilation of the Pro forma financial information and to report that opinion to you.

In providing this opinion we are not updating or refreshing any reports or opinions previously made by us on any financial information used in the compilation of the Pro forma financial information, nor do we accept responsibility for such reports or opinions beyond that owed to those to whom those reports or opinions were addressed by us at the dates of their issue.

Save for any responsibility arising under Prospectus Rule 5.5.4R (2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with paragraph 13.1 of Annex XI of the Prospectus Directive Regulation, consenting to its inclusion in the Prospectus.

Basis of Opinion

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. The work that we performed for the purpose of making this report, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the Pro forma financial information with the directors of the Company.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Pro forma financial information has been properly compiled on the basis stated and that such basis is consistent with the accounting policies of the Company.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in the United States of America or other jurisdictions and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

Opinion

In our opinion:

- the Pro forma financial information has been properly compiled on the basis stated; and
- such basis is consistent with the accounting policies of the Company.

Declaration

For the purposes of Prospectus Rule 5.5.4R (2)(f) we are responsible for this report as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with paragraph 1.2 of Annex XI of the Prospectus Directive Regulation.

Yours faithfully

KPMG Audit Plc

PART E – ACCOUNTANT'S REPORT ON LOSS FORECAST REPORT

The Directors
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

4 November 2013

Dear Sirs

The Co-operative Bank p.l.c.

We report on the statement contained in Section 12 of the document that "indeed, we do not expect to be profitable for some years and legacy issues will continue to have an impact on the Bank for some time", which constitutes *inter alia* a loss forecast of The Co-operative Bank p.l.c. ('the Company') and its subsidiaries ('the Group') for the year ending 31 December 2013 and the year ending 31 December 2014 (the 'Loss Forecast'). The Loss Forecast, and the material assumptions upon which it is based, are set out on page 213 of the Prospectus issued by the Company dated 4 November 2013. This report is required by paragraph 8.2 of Annex XI of the Prospectus Directive Regulation and is given for the purpose of complying with that paragraph and for no other purpose.

Responsibilities

It is the responsibility of the directors of the Company to prepare the Loss Forecast in accordance with the requirements of the Prospectus Directive Regulation.

It is our responsibility to form an opinion as required by the Prospectus Directive Regulation as to the proper compilation of the Loss Forecast and to report that opinion to you.

Save for any responsibility arising under Prospectus Rule 5.5.4R (2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with paragraph 13.1 of Annex XI of the Prospectus Directive Regulation, consenting to its inclusion in the Prospectus.

Basis of preparation of the Loss Forecast

The Loss Forecast has been prepared on the basis stated on page 213 of the Prospectus and is based on the audited interim financial results for the six months ended 30 June 2013, the unaudited management accounts for the eight months ended 31 August 2013, a forecast to 31 December 2013 and a forecast to 31 December 2014. The Loss Forecast is required to be presented on a basis consistent with the accounting policies of the Group.

Basis of opinion

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included evaluating the basis on which the historical financial information included in the Loss Forecast has been prepared and considering whether the Loss Forecast has been accurately computed based upon the disclosed assumptions and the accounting policies of the Group. Whilst the assumptions upon which the Loss Forecast are based are solely the responsibility of the directors of the Company, we considered whether anything came to our attention to indicate that any of the assumptions adopted by the directors of the Company which, in our opinion, are necessary for a proper understanding of the Loss Forecast have not been disclosed and whether any material assumption made by the directors of the Company appears to us to be unrealistic.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Loss Forecast has been properly compiled on the basis stated.

Since the Loss Forecast and the assumptions on which it is based relate to the future and may therefore be affected by unforeseen events, we can express no opinion as to whether the actual results reported will correspond to those shown in the Loss Forecast and differences may be material.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in the United States of America or other jurisdictions and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

Opinion

In our opinion, the Loss Forecast has been properly compiled on the basis stated and the basis of accounting used is consistent with the accounting policies of the Group.

Declaration

For the purposes of Prospectus Rule 5.5.4R (2)(f) we are responsible for this report as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with paragraph 1.2 of Annex XI of the Prospectus Directive Regulation.

Yours faithfully

KPMG Audit Plc

17
SUPERVISION AND REGULATION

SUPERVISION AND REGULATION

1. UK REGULATORS

Under the Financial Services Act 2012 (the **FS Act 2012**), a range of structural reforms to UK financial regulatory bodies were implemented, with the FSA being replaced from 1 April 2013 by the following bodies:

- the PRA;
- the FCA; and
- in addition, a new FPC has been established.

The PRA, a subsidiary of the Bank of England, has responsibility for micro-prudential regulation of financial institutions that manage significant risks on their balance sheets, including banks, insurers and some large investment firms. The FCA, has responsibility for conduct of business regulation in relation to all authorised firms and the prudential regulation of firms not regulated by the PRA. The FCA has also inherited the majority of the FSA's market regulatory functions, and it represents the UK's interests in markets regulation at the European Securities and Markets Authority. The Bank is regulated by both the PRA and the FCA.

The FPC, which sits within the Bank of England, is tasked with macroprudential regulation, or regulation of stability and resilience of the financial system as a whole.

This Section 17 (*Supervision and Regulation*) uses the terms **Relevant Regulator** and **Relevant Regulator(s)** to refer, as the context requires, to one or more of the FSA, PRA and/or FCA.

The PRA's general objective

The PRA has one general objective that it must advance in discharging its general functions. The PRA's general objective is promoting the safety and soundness of PRA-authorised persons. The PRA is required to advance this objective primarily by seeking to:

- ensure that the business of PRA-authorised persons is carried on in a way which avoids any adverse effect on the stability of the UK financial system; and
- minimise the adverse effect that the failure of a PRA-authorised person could be expected to have on the stability of the UK financial system.

The FCA's objectives

When discharging its general functions under FSMA, which include rule-making, preparing and issuing codes, giving general guidance or determining the general policy and principles (by reference to which it performs functions under FSMA) the FCA must, so far as is reasonably possible, act in a way which is compatible with its strategic objective of ensuring that relevant markets (as defined in section 1(f) FSMA) function well, and advances one or more of its operational objectives of:

- securing an appropriate degree of protection for consumers (the consumer protection objective);
- promoting effective competition in the interests of consumers in financial markets (the competition objective); and
- protecting and enhancing the integrity of the UK financial system (the integrity objective).

So far as it is compatible with its consumer protection and integrity objectives, the FCA must discharge its general functions in a way which promotes competition.

2. UK REGULATION

2.1 Overview of UK financial services legislation

Financial Services and Markets Act 2000

The cornerstone of the regulatory regime in the UK is FSMA which came into force on 1 December 2001. However, the framework for supervision and regulation of banking and financial services in the UK has been, and continues to be, heavily influenced by EU legislation.

FSMA prohibits any person from carrying on a "regulated activity" by way of business in the UK unless that person is authorised or exempt under FSMA. Regulated activities include: deposit-taking, mortgage activities (such as entering into, administering, or advising or arranging in respect of, the provision of regulated mortgage contracts), effecting and carrying out contracts of insurance as well as insurance mediation, and investment activities (such as dealing in investments as principal or as agent, arranging deals in investments, and managing investments).

FSMA also prohibits financial promotions in the UK unless the promotion is issued or approved by an authorised person or exempt from such requirements.

The relevant regulators are responsible for the authorisation and supervision of institutions that carry on regulated activities including the provision of regulated financial products and services in the UK as defined in FSMA. The Bank is authorised with permission to undertake, among other things, deposit-taking, mortgage and certain investment activities. As an authorised person under FSMA, the Bank is permitted to make financial promotions in the UK.

Authorised firms must at all times meet specified "threshold conditions", which were modified to reflect the regulatory new structure under the FS Act 2012. Dual-regulated firms, such as the Bank, need to meet both the PRA's threshold conditions and the FCA's threshold conditions. At a high level, the PRA threshold conditions require: (i) a firm's head office, and in particular its mind and management, to be in the UK if it is incorporated in the UK; (ii) a firm's business to be conducted in a prudent manner, and in particular that the firm maintains appropriate financial and non-financial resources; (iii) the firm itself to be fit and proper and appropriately staffed; and (iv) the firm and its group to be capable of being effectively supervised.

Financial services handbooks

FSMA (as amended by, amongst other legislation, the FS Act 2012) imposes an on-going system of regulation and control on banks. The detailed rules and prudential standards set by the Relevant Regulators are contained in the FCA and PRA's rule making instruments which are set out in an accessible form online in various parts of their respective handbooks (the **FCA Handbook** and **PRA Handbook**, together the **Financial Services Handbooks**).

Once authorised, and in addition to continuing to meet the threshold conditions for authorisation, firms are obliged to comply with the 'Principles for Businesses', which include maintenance of adequate systems and controls, treating customers fairly and communicating with customers in a manner that is clear, fair and not misleading. The 11 Principles for Businesses are set out in the Financial Services Handbooks.

Manuals of the Financial Services Handbooks which are of particular relevance to banks include the General Prudential sourcebook (**GENPRU**), BIPRU, the Senior Management Arrangements, Systems and Controls sourcebook and the Conduct of Business sourcebook.

2.2 Supervision and enforcement

Supervision

Each of the Relevant Regulators has wide powers, where relevant, to supervise and intervene in the affairs of a firm authorised and regulated under, or pursuant to, FSMA. These powers were extended under the FS Act 2012.

The nature and extent of a Relevant Regulator's supervisory relationship with a firm depends on how much of a risk the Relevant Regulator considers that firm could pose to its statutory objectives. The PRA's supervisory interventions will focus on reducing the likelihood of a PRA-authorised firm failing and on ensuring that, if it does fail, it does so in an orderly manner. The PRA has introduced the 'Proactive Intervention Framework' to support early identification of risks to a firm's viability (and enable appropriate supervisory actions to be taken to address such risks if necessary) on the basis of information collected.

When taking action the Relevant Regulator can, for instance, require firms to provide particular information or documents to it, require the production of a report by a "skilled person" appointed by either the authorised person or the Relevant Regulator, or formally investigate a firm. Where it will advance its objectives, the PRA has a broad power of direction over qualifying unregulated parent undertakings.

Enforcement

The Relevant Regulators have the power to take a range of enforcement actions, including the ability to sanction firms and individuals carrying out functions within them. Most notably enforcement actions may include restrictions on undertaking new business, public censure, restitution, fines and, ultimately, revocation of permission to carry on regulated activities or of an approved person's status. The Relevant Regulators can also vary or revoke the permissions of an authorised firm that has not engaged in regulated activities for 12 months, or fails to meet the threshold conditions.

Challenging the PRA and FCA

If the Bank wanted to challenge the decisions of the PRA or FCA then in many cases it could make formal representations and also bring a case to tribunal (the **Tribunal**). The amendments made to FSMA which introduced the PRA and the FCA made a number of amendments to the appeal process which have broadly reduced the powers of the Tribunal. Although the grounds of making a reference have remained unchanged, the courses of action available to the Tribunal in the event that it disagrees with the regulator have been reduced. Under the previous system, the Tribunal had the power to make its own decision in place of one made by a regulator with which it disagrees. That remains the position for a disciplinary reference or a reference in connection with specific third party rights, but the Tribunal no longer has the power to substitute its own decision for that of the regulator in a supervisory context.

2.3 Capital adequacy

The Bank is subject to capital adequacy guidelines for banks adopted by the PRA, which provide for a minimum ratio of total capital to risk weighted assets expressed as a percentage. The PRA's capital adequacy guidelines for banks are found in the GENPRU and BIPRU sourcebooks of the PRA's Handbook. They broadly implement EU directives on capital adequacy, a high level summary of the background to which is as follows.

European regulatory landscape

- In March 2000, the adoption by the EU of the Banking Consolidation Directive (directive 2006/48/EC) and the Capital Adequacy Directive (directive 2006/49/EC) (each as recast in July 2006 and subsequently amended, together commonly referred to as the Capital Requirements Directive (the **CRD**)) resulted in the consolidation of the main pan-European banking legislation. The principal intention underlying the original CRD was the harmonisation of banking regulation and supervision throughout the EU and Norway, Iceland and Liechtenstein, commonly known as the EEA.

- EU legislation transposing the Basel Accord, through the CRD, was partially implemented at the start of 2007, with more advanced techniques in relation to the calculation of capital requirements for credit risk and operational risk implemented at the start of 2008. The CRD has since been amended by Directive 2009/111/EC (known as **CRD II**). CRD II was

implemented in the UK on 31 December 2010. CRD II includes changes to the criteria for hybrid Tier 1 Capital, the control of large exposures and requirements relating to securitisation transactions. The requirements for hybrid capital to count as non-Core Tier 1 Capital were toughened, as were the relative permissible proportions of core, non-core and innovative Tier 1 Capital. However, CRD II provided for a certain proportion of existing instruments that do not comply with the new rules to continue to count as capital for a long transitional period. The CRD was further amended by Directive 2010/76/EU dated 24 November 2010 (known as **CRD III**), which further tightened the capital requirements for trading books and securitisations in accordance with the recommendations of the Basel Committee to amend the Basel framework. CRD III entered into force on 15 December 2010 and, following its implementation, the last of its provisions came into force in the UK on 16 April 2012.

- In Basel III, the Basel Committee approved significant changes to the Basel II framework (as agreed by the Basel Committee between 2011 and 2013) (such changes being commonly referred to as **Basel III**), including new capital and liquidity requirements intended to reinforce capital standards with heightened requirements for global systemically important banks and to establish minimum liquidity standards for credit institutions. In particular, the changes refer to, amongst other things, new requirements for the capital base, measures to strengthen the capital requirements for counterparty credit exposures arising from certain transactions and the introduction of a leverage ratio as well as short-term and longer-term standards for funding liquidity (referred to as the **Liquidity Coverage Ratio** and the **Net Stable Funding Ratio** respectively).

- It is intended that member countries will implement the new capital standards and the new Liquidity Coverage Ratio as soon as possible (with provisions for phased implementation, meaning that the measures will not apply in full until January 2019), and the Net Stable Funding Ratio from January 2018. The Basel III framework requires banks to meet a 7 per cent. ratio of Common Equity Tier 1 Capital to risk weighted assets. This minimum ratio is made up of 4.5 per cent. capital regulatory minimum plus 2.5 per cent. capital conservation buffer to absorb unexpected losses in periods of stress. The Basel III requirements are discussed in greater detail in the risk factor titled *"The Bank's business, operating results, financial position and/or its ability to implement its strategy may be adversely impacted by it not maintaining adequate regulatory capital and by future changes to its regulatory capital requirements"* in Section 2 (*Risk Factors*).

- The European Commission published corresponding proposals to implement Basel III through replacing the existing CRD with the PRR and the PRD (together, the PRR and the PRD are referred to as CRD IV) on 20 July 2011. The PRR and PRD draft legislation was approved by the European Council on 20 June 2013 and published on 26 June 2013. For more information on the CRD IV, see the risk factor titled *"The Bank's business, operating results, financial position and/or its ability to implement its strategy may be adversely impacted by it not maintaining adequate regulatory capital and by future changes to its regulatory capital requirements."* in Section 2 (*Risk Factors*).

UK implementation of the CRD IV

The PRR will have direct effect in the UK with effect from 1 January 2014. The UK regulators are currently consulting on the implementation of PRD (and the areas of the PRR in which it has discretion) in the UK, which must be implemented by 1 January 2014. For details on the UK's implementation of the CRD IV, see the risk factor titled "*The Bank's business, operating results, financial position and/or its ability to implement its strategy may be adversely impacted by it not maintaining adequate regulatory capital and by future changes to its regulatory capital requirements"* in Section 2 (*Risk Factors*).

2.4 **Controller regime (including shareholders)**

Under section 178 of FSMA, if a person intends to acquire or increase its "control" of UK authorised person (which includes the Bank), it must first notify the appropriate regulator (in the case of the Bank, this is the PRA). The PRA must then (after consulting with the FCA) decide whether to approve the acquisition or increase of control within 60 working days' of receipt of this notice (assuming it has been provided with a complete application). The PRA will not approve any new controller or any increase of control without being satisfied that the controller is financially sound and suitable to be a controller of, or acquire increased control of, the UK authorised person. Acquiring control for the purposes of FSMA includes where a person first holds 10 per cent. or more of the shares or voting power in an authorised person or its parent undertaking. A person will be treated as increasing his or her control over a UK authorised person, and therefore require further approval from the PRA, if the level of his or her shareholding or entitlement to voting power increases from a holding below certain thresholds to a holding above them. The thresholds are 10 per cent., 20 per cent., 30 per cent. or 50 per cent. of shares or voting power.

When determining a person's level of control, that person's holding of shares or entitlement to voting power will be aggregated with the holdings or entitlements of any person with whom he or she is "acting in concert".

Acquisition or increase of control without PRA approval is a criminal offence.

2.5 **Approved persons regime**

Certain key functions in the operation of a regulated firm (**controlled functions**) may only be carried out by persons who are approved for such tasks by either or both of the PRA or FCA under FSMA (**Approved Persons**).

Under FSMA, the Relevant Regulators have powers to regulate two types of individuals: those whose functions have a significant influence on the conduct of an authorised company's affairs and functions and those who deal with customers (or the property of customers).

The 'significant influence' controlled functions include governing functions such as being a director or non-executive director of an authorised person and significant management functions. The PRA or FCA (the Relevant Regulator being determined by the controlled function the individual is seeking approval for) will not grant Approved Person status to an individual unless it is satisfied that the individual has appropriate qualifications and/or experience and is fit and proper to perform those functions.

Approved Persons must comply with (i) the Fit and Proper Test for Approved Persons, and (ii) the Statements of Principle and Code of Practice for Approved Persons, each as set out in the Financial Services Handbooks bearing such title.

2.6 **Recovery and resolution regime**

In light of the crisis in the financial markets, the UK Banking Act 2009 received Royal Assent in February 2009 and certain provisions including those relating to the SRR (as defined below) came into force at that time.

The Banking Act empowers the Authorities where a bank is failing (or likely to fail) the threshold conditions for its authorisation (which includes, amongst other things, the conducting of its business in a prudent manner, which is assessed by reference to its financial and non-financial resources), to impose the special resolution regime (the **SRR**) on relevant entities. The SRR consists of three stabilisation options (which are designed to address a distressed bank which is failing or is likely to fail to meet the threshold conditions and which cannot be addressed through normal regulatory action or market based solutions), a bank insolvency procedure and a bank administration procedure, which may be commenced by the Authorities.

The stabilisation options provide for:

- the transfer of all or part of the failing bank's business (its shares or property, i.e. assets and liabilities) to a third party private sector purchaser. In this case, the Bank may be transferred as a single entity (together with all of its property, including its subsidiaries) or it may be split into a "good bank" and a "bad bank" (the latter of which would most likely be placed into administration). In either circumstance it is likely that the pre-resolution shares in the Bank will have no value and it is unlikely that shareholders would receive compensation in accordance with the No Creditor Worse Off (**NCWO**) principle, which requires that no creditor should be worse off in a resolution than that creditor would be on insolvency proceedings (assuming no resolution of the Bank has occurred);

- the transfer of all or part of the failing bank's business to a "bridge bank'' established and wholly owned and controlled by the Bank of England (this is likely to be a temporary option pending a future sale). The business of the Bank may be split into a "good bank" and a "bad bank" (which would most likely be placed into administration) with the assets of the "good bank" being transferred to the bridge bank for continued operation of the business. Note that were this to be applied to the Bank, it is likely that the pre-resolution shares in the Bank would have no value. It is unlikely that the shareholders would receive compensation in accordance with the NCWO principle; and

- temporary public ownership (nationalisation) of the failing bank or its UK-incorporated holding company. In the case of the Bank, this would be achieved by a share transfer order which would transfer the shares from shareholders to a nominee of HM Treasury, such as a company wholly owned and controlled by HM Treasury. It is unlikely that the shareholders would receive compensation in accordance with the NCWO principle. The option to transfer a failing bank to temporary public sector ownership is understood to be the option of last resort.

In each case, the Authorities have been granted wide powers under the Banking Act including powers to modify contractual arrangements in certain circumstances and powers for HM Treasury to disapply or modify laws (with possible retrospective effect) to enable the powers under the Banking Act to be used effectively. Use of any such powers in the case of a resolution of the Bank could impact on the holders' on-going holding of any shares they have in the Bank.

In addition, in June 2012, the European Commission published a legislative proposal for the establishment of an EU wide framework for the recovery and resolution of credit institutions and investment firms (the **RRD**). The proposed RRD, among other things, contemplates the introduction of a package of minimum early intervention and resolution-related tools and powers for relevant authorities. The resolution tools and powers referred to in the RRD include certain tools and powers which overlap in part with those available under the Banking Act and also certain further tools, such as provision for authorities to ensure mandatory write-down of capital instruments at the point of non-viability of the relevant institution. The proposals on capital write-down are expected to cover instruments already in issue when the RRD is implemented. The draft RRD currently contemplates that it will be implemented in Member States by 31 December 2014, except for certain bail-in provisions which are to be implemented by 1 January 2018. The draft RRD is not in final form and changes may be made to it in the course of the legislative process.

2.7 **Proposed legislation: structural and other reforms**

On 14 June 2012, HM Treasury issued a white paper ("*Banking reform: delivering stability and supporting a sustainable economy*") on how the Government intends to implement the measures recommended by the Independent Commission on Banking (**ICB**) in its final report of 12 September 2011, in which the ICB (which was established by the Government in June 2010) set out its recommendations for reforms to improve competition and stability in the UK banking sector. Broadly, the white paper covers the following areas: the ring-fencing of vital banking services from international and investment banking services; measures on loss absorbency and depositor preference; and proposals for enhancing competition in the banking sector.

On 19 June 2013, the Parliamentary Commission on Banking Standards published its final report ("*Changing banking for good*"). This was followed by the publication of the Government's response on 8 July 2013, accepting the overall conclusions of the report and all of its principal recommendations. Among other things, this included proposals for a new banking standards regime governing the conduct of bank staff, the introduction of a criminal offence for reckless misconduct by senior bank staff, and steps to improve competition in the banking sector. Depending on how the Government decides to implement these proposals, they may have a substantial impact on banks in the UK generally, including the Bank.

The Government has published the Banking Reform Bill. Following the Parliamentary Commission on Banking Standard's final report, published in June 2013, amendments to the Banking Reform Bill have been tabled before parliament. Measures contained in the Banking Reform Bill including (i) ring-fencing domestic retail banking services of UK banks, (ii) increasing UK banks' and building societies' loss-absorbing capacity (including by way of bail-in bonds) and (iii) increasing the ranking of insured depositors on a winding-up to rank ahead of all other unsecured creditors. On 1 October 2013, HM Treasury published amendments to the Banking Reform Bill which propose conferring upon the Bank of England the power to deploy a new stabilisation option (called the "bail-in option") in relation to banks. This would enable the Bank of England to take a range of actions for the purposes of stabilising a failing bank. Actions available under the bail-in option include the making of a resolution instrument with respect to a bank to cancel, reduce or defer the equity liabilities of the bank (including divesting shareholders of their shares in the bank), convert an instrument issued by the bank from one form or class to another (for example, a debt instrument into equity), and/or or transfer some or all of the securities of the bank to an appointed bail-in administrator. HM Treasury's amendments to the Banking Reform Bill are consistent with the range of tools that Member States will be required to make available to Resolution Authorities under the RRD. Though the RRD is still under negotiation, HM Treasury considers that the draft RRD is sufficiently advanced that the bail-in tools can be implemented in the UK without the risk of the need for substantial amendment following the coming into force of the RRD. Further amendments could be made as the Banking Reform Bill passes through the legislative process. The Government intends the Banking Reform Bill to receive Royal Assent by February 2014 and all relevant secondary legislation to be implemented by May 2015.

On 17 July 2013 HM Treasury and the Department for Business, Innovation and Skills published a consultation on proposed secondary legislation under the Banking Reform Bill. The draft secondary legislation included details on the scope of the ring-fence and proposed exemptions that will permit the deposits of larger organisations and high net worth individuals to be held outside the ring-fence. It proposed the establishment of a framework through which non-capital primary loss absorbing capacity requirements will be imposed by the regulator on systemic UK banks and building societies. Further secondary legislation on pensions and building societies will be published at a later date.

At the EU level, following the report of the Liikanen Group, which was published in October 2012, structural reform measures that are similar to some of those contained in the Banking Reform Bill are also under consideration. Further, in addition to the bail-in tools discussed above, the draft RRD provides, amongst other things, for Resolution Authorities to have the power to require institutions and groups to make structural changes to ensure legal and operational separation of "critical functions" from other functions where necessary, or to require institutions to limit or cease existing or proposed activities in certain circumstances. It is currently contemplated that the RRD will be implemented in Member States by 31 December 2014 except for certain bail in provisions which are to be implemented by 1 January 2018. The draft RRD is not in final form and changes may be made to it in the course of the legislative process.

2.8 **The UK Government**

The UK Government has no operational responsibility for the activities of the PRA, the FCA or the Bank of England. However, there are a variety of circumstances where the PRA, the FCA and the Bank of England will need to alert HM Treasury (the representative of the UK Government) about

possible problems, for example, where there may be a need for a support operation or a problem arises which could cause wider economic disruption.

2.9 **Consumer credit regulation**

The Consumer Credit Act 1974, as amended (**CCA**) regulates credit within the definition of "regulated agreement". A credit agreement is a regulated agreement if: (a) the borrower is or includes an "individual" as defined in the CCA; and (b) the credit agreement is not an exempt agreement under the CCA. Certain financial limits in respect of the credit provided applied to credit agreements entered into before 6 April 2008, or before 31 October 2008 in the case of buy-to-let mortgages satisfying prescribed conditions. Buy-to-let mortgages entered into on or after 31 October 2008 and satisfying prescribed conditions are exempt agreements under the CCA.

If requirements under the CCA as to licensing of lenders or brokers or entering into and documenting a credit agreement are not or have not been met, then the affected regulated agreement is unenforceable against the borrower without an order of the Office of Fair Trading (**OFT**) or court order or (for agreements entered into before 6 April 2007) is totally unenforceable, depending on the circumstances. Under sections 75 and 75A of the CCA, in certain circumstances a lender is liable to a customer in relation to misrepresentation and breach of contract by a supplier in a transaction financed by a credit agreement regulated by the CCA or treated as such, and the lender has a statutory indemnity from the supplier against liability under section 75, subject to any agreement between the lender and the supplier.

The Office of Fair Trading

The FS Act 2012 contains provisions enabling the transfer of consumer credit regulation (which includes new and existing second charge mortgages) from the OFT to the FCA. HM Treasury has announced that consumer credit regulation will be transferred to the FCA from 1 April 2014. The related secondary legislation was enacted in July 2013. Under FSMA, as amended by the FS Act 2012, the FCA may make rules under which and from dates to be specified: (a) carrying on certain credit-related regulated activities (including in relation to servicing credit agreements) otherwise than in accordance with permission from the FCA will render the credit agreement unenforceable without FCA approval; and (b) the FCA will have power to render unenforceable contracts made in contravention of its rules on cost and duration of credit agreements or in contravention of its product intervention rules. The FS Act 2012 also provides for formalised co-operation to exist between the FCA and the Financial Ombudsman Service (discussed below), particularly where issues identified potentially have wider implications, with a view to the FCA requiring firms to operate consumer redress schemes.

European regulatory landscape

In April 2008, the European Parliament and the Council of the European Union adopted a second directive on consumer credit (Directive 2008/48/EC) which provides that, subject to exemptions, loans not exceeding €75,000 must be regulated. This directive repeals and replaced the first consumer credit directive and required Member States to implement the directive by measures in force by 11 June 2010. Loan agreements secured by land mortgage are exempted from the consumer credit directives.

2.10 **Mortgage lending**

FSMA regulates mortgage credit within the definition of "regulated mortgage contract" and also regulates certain other types of home finance. A credit agreement is a regulated mortgage contract if it is entered into on or after 31 October 2004 and, at the time it is entered into: (a) the credit agreement is one under which the lender provides credit to an individual or to trustees; (b) the contract provides for the repayment obligation of the borrower to be secured by a first legal mortgage on land (other than timeshare accommodation) in the UK; and (c) at least 40 per cent. of that land is used, or is

intended to be used, as or in connection with a dwelling by the borrower or (in the case of credit provided to trustees) by an individual who is a beneficiary of the trust, or by a related person.

If prohibitions under FSMA as to authorisation or financial promotions are contravened, then the affected regulated mortgage contract (and, in the case of financial promotions, other credit secured on land) is unenforceable against the borrower without a court order. The FCA's Mortgages and Home Finance: Conduct of Business sourcebook (**MCOB**) sets out rules in respect of regulated mortgage contracts and certain other types of home finance. Under MCOB rules, an authorised firm (such as the Bank) is restricted from repossessing a property unless all other reasonable attempts to resolve the position have failed, which can include the extension of the term of the mortgage, product type changes and deferral of interest payments.

Any credit agreement intended to be a regulated mortgage contract or unregulated may instead be wholly or partly regulated by the CCA or treated as such. Any credit agreement intended to be regulated by the CCA or treated as such or unregulated may instead be a regulated mortgage contract. This is because of technical rules on determining whether the credit agreement or any part of it falls within the definition of "regulated mortgage contract" under FSMA, or within the definition of "regulated agreement" under the CCA, and technical rules on changes to credit agreements.

Mortgage Market Review

In December 2011, the FSA published a consultation paper that consolidates proposals arising out of its wide-ranging mortgage market review, which was launched in October 2009 the subject of a discussion paper to consider strengthening rules and guidance on, among other things, affordability assessments, product regulation, arrears charges and responsible lending. The FSA's aim was to ensure the continued provision of mortgage credit for the majority of borrowers who can afford the financial commitment of a mortgage, while preventing a re-emergence of poor lending practices as the supply of mortgage credit in the market recovers. In October 2012, the FSA published a policy statement and final rules that will come into force on 26 April 2014. These rules will require, among other things, an assessment of affordability in accordance with detailed requirements, with transitional arrangements where the borrower does not take on additional borrowing except for essential repairs or maintenance work, and will ban self-certificated loans. These rules will permit interest-only loans only where there is a clearly understood and credible strategy for repaying the capital (evidence of which the lender must obtain before making the loan and check at least once during the term of the loan) and the cost of the repayment strategy must be part of the affordability assessment.

European regulatory landscape

In March 2011, the European Commission published a proposal for a directive on credit agreements relating to residential immovable property for consumers. The proposal is to some extent modelled on the second directive on consumer credit and requires, among other things, standard pre-contractual information, calculation of the annual percentage rate of charge in accordance with a prescribed formula, and a right of the borrower to make early repayment. Until the final form of the proposed directive and UK implementing legislation are published, it is not certain what effect its adoption and implementation will have on the Bank's mortgage businesses.

2.11 **Insurance**

The Bank is also authorised for carrying out insurance mediation. The FCA's Insurance: Conduct of Business sourcebook sets out rules in respect of non-investment insurance.

2.12 **Financial Services Compensation Scheme**

FSMA established the FSCS, which pays compensation to eligible customers of authorised financial services firms which are unable, or are likely to be unable, to pay claims against them. The levels of compensation are, for example, for claims against firms declared in default on or after 1 January 2010 (31 December 2010 for deposits): (i) for deposits, 100 per cent. of the first £85,000; (ii) for mortgage advice and arranging, 100 per cent. of the first £50,000; and (iii) for insurance, 90 per cent. of the

claim with no upper limit (except compulsory insurance is protected in full). The FSCS only pays compensation for financial loss. Compensation limits are per person, per firm and per type of claim. Directive 2009/14/EC, amending the DGSD requires Member States to set the minimum level of compensation for deposits, for firms declared in default on or after 1 January 2011, at €100,000.

Amendments to the EU Deposit Guarantee Scheme Directive

The DGSD required each member state to introduce at least one deposit guarantee scheme, with implementation by 1 July 1995. The DGSD has been reviewed and a new legislative proposal was published by the European Commission in July 2010. The main changes proposed included a tighter definition of deposits, a requirement that the Deposit Guarantee Scheme repay customers within a week and that banks must be able to provide information (a single customer view) at any time. On 12 June 2013 the European Commission announced that the negotiations on revisions to the DGSD were on hold pending further developments on the RRD.

2.13 **Financial Ombudsman Service**

FSMA established the Financial Ombudsman Service (the **FOS**), which determines complaints by eligible complainants in relation to authorised financial services firms, consumer credit licensees and certain other businesses, in respect of activities and transactions under its jurisdiction. The FOS determines complaints on the basis of what, in its opinion, is fair and reasonable in all the circumstances of the case. The maximum level of money award by the FOS is £150,000 for complaints received by the FOS on or after 1 January 2012 (£100,000 for earlier complaints) plus interest and costs. The FOS may also make directions awards, which direct the business to take steps, as the FOS considers just and appropriate.

2.14 **Money Laundering Regulations**

The UK Money Laundering Regulations 2007 (the **MLRs**) place a requirement on the Bank to verify the identity and address of customers opening accounts with it, and to keep records to help prevent money laundering and fraud.

Guidance in respect of the MLRs is contained in the Guidance Notes of the Joint Money Laundering Steering Group, including in respect of the identification of new clients, record keeping and otherwise. Directive 2005/60/EC, which underpins the MLRs, was reviewed by the European Commission between 2010 and 2012 and it found that there were no fundamental shortcomings in the regime.

In response to the European Commission's review, broad support was expressed for the proposed alignment to the revised Financial Action Task Force standards and for greater clarification of certain issues, in particular in the area of data protection and cross-border transactions. In February 2013, the European Commission published proposals for a directive on the prevention of the use of the financial systems for the purpose of money laundering and terrorism financing and a regulation on information accompanying transfer of funds to secure due traceability of these transfers. These proposals are currently subject to the ordinary EU legislative procedure.

2.15 **Other**

The UK Data Protection Act 1998 regulates the processing of data relating to individual customers including the retention and use of such data. The Office of the Information Commissioner is responsible for overseeing the data protection regime in the UK. The UK Unfair Terms in Consumer Contracts Regulations 1999 (together with, insofar as applicable, the Unfair Terms in Consumer Contracts Regulations 1994) apply to consumer contracts entered into on or after 1 July 1995. The main effect of these Regulations is that a contract term which is "unfair" will not be enforceable against a consumer. This applies to, among other things, mortgages and related products and services. The FSA has issued statements of good practice in this regard in May 2005, January 2007 and January

2012, and since 1 April 2013 the FCA has worked with the Office of Fair Trading to, amongst other things, allocate responsibility for regulation of mortgage products.

The Bank participates in the unclaimed assets scheme established under the Dormant Bank and Building Society Accounts Act 2008. The purpose of this scheme is to enable money in dormant bank and building society accounts (i.e. balances in accounts that have been inactive or dormant for 15 years or more) to be distributed for the benefit of the community, while protecting the rights of customers to reclaim their money.

On 1 November 2009, the FSA introduced its Banking Conduct Regime for retail banking. The main constituents of this regime are: (i) extending certain of FSMA principles for businesses to apply to deposit-taking, from prudential matters only, to conduct of business matters; (ii) conduct of business requirements in the Payment Services Regulations 2009 (the **PSR**), which apply to certain payment services made in euro or sterling; and (iii) the FCA's Banking: Conduct of Business sourcebook, which applies to deposit-taking in respects not covered by the PSR.

On 1 November 2009, the British Bankers' Association, the Building Societies Association and The UK Cards Association launched The Lending Code, a voluntary code on unsecured lending to personal and small business customers, which is monitored and enforced by the Lending Standards Board. The voluntary Banking Code and the Business Banking Code then ceased to have effect.

18
INFORMATION INCORPORATED BY REFERENCE

This section contains a description of the information that is deemed to be incorporated by reference in this Prospectus.

INFORMATION INCORPORATED BY REFERENCE

The following documents, which have been published and filed with the Financial Conduct Authority, shall be incorporated in, and form part of, this Prospectus:

The auditor's report and audited consolidated and non-consolidated annual financial statements of the Bank for the financial years ended 31 December 2012, 31 December 2011 and 31 December 2010, respectively, including the following:

	Annual Report 2010	*Annual Report 2011*	*Annual Report 2012*
Business and Financial Review	Pages 5 to 8	Pages 5 to 7	Pages 6 to 9
Independent auditors' report	Page 29	Page 29	Page 32
Consolidated income statement	Page 30	Page 30	Page 33
Consolidated statement of comprehensive income	Page 31	Page 31	Page 34
Consolidated balance sheet	Page 32	Page 32	Page 35
Bank balance sheet	Page 33	Page 33	Page 36
Consolidated statement of cash flows	Page 34	Page 34	Page 37
Bank statement of cash flows	Page 35	Page 35	Page 38
Consolidated and bank statements of changes in equity	Page 36	Page 36	Page 39
Basis of preparation and significant accounting policies	Pages 37 to 44	Pages 37 to 45	Pages 40 to 50
Notes to the financial statements	Pages 82 to 123	Pages 75 to 122	Pages 83 to 132

Following the publication of this Prospectus a supplement may be prepared by the Bank and approved by the UK Listing Authority in accordance with Article 16 of the Prospectus Directive. Any statement contained in this Prospectus or in a document incorporated by reference herein shall be deemed to be modified or superseded to the extent that a statement contained in any such supplement modifies or supersedes such earlier statement (whether expressly, by implication or otherwise). Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Prospectus.

The documents referred to above are available free of charge from the Bank's registered office at 1 Balloon Street, Manchester M60 4EP and from http://www.morningstar.co.uk/uk/NSM.

Any documents themselves incorporated by reference in the documents incorporated by reference in this Prospectus shall not form part of this Prospectus.

Any non-incorporated parts of a document referred to herein are either deemed not relevant for Holders and other prospective investors or are otherwise covered elsewhere in this Prospectus.

Any website and its contents which is referred to in this Prospectus does not form part of this Prospectus.

19
TAXATION

The following section contains a general guide to certain UK tax considerations relevant to an investment in the Notes.

Further information with respect to the taxation consequences of participation in the Liability Management Exercise is set out in the Offer Memorandum attached as Appendix C (*Consent and Exchange Offer Memorandum*) to this Prospectus.

Holders should read these sections and discuss the taxation consequences with their tax adviser, financial adviser or other professional adviser before deciding whether or not to participate in the Liability Management Exercise.

TAXATION

UK TAXATION

The following statements are intended only as a general guide to certain UK tax considerations and do not purport to be a complete analysis of all potential UK tax consequences of acquiring, holding or disposing of the Notes. They are based on current UK tax law and what is understood to be the current published practice of HM Revenue and Customs (HMRC) as at the date of this Prospectus, both of which are subject to change, possibly with retrospective effect. They are intended to apply only to Noteholders who (unless the position of non-UK resident Noteholders is expressly referred to) are resident in the UK for UK tax purposes, who hold their Notes as investments (other than under an individual savings account) and who are the beneficial owners of their Notes and any interest paid on them. The statements may not apply to certain classes of Noteholders such as dealers in securities.

Prospective Noteholders are also directed to Section I (*Taxation Considerations*) of the Offer Memorandum which contains further information relevant to the potential UK tax consequences of acquiring the Notes pursuant to the LME.

Prospective Noteholders who are in any doubt as to their tax position regarding the acquisition of Notes pursuant to the LME, ownership and disposition of the Notes or who are subject to tax in a jurisdiction other than the UK should consult their own tax advisers.

A. Interest on the Notes

1. ***Payment of interest on the Notes***

Payments of interest on the Notes may be made without deduction of or withholding on account of United Kingdom income tax provided that the Notes continue to be listed on a "recognised stock exchange" within the meaning of section 1005 of the Income Tax Act 2007 (the **Act**). The London Stock Exchange is a recognised stock exchange. Securities will be treated as listed on the London Stock Exchange if they are included in the Official List (within the meaning of and in accordance with the provisions of Part 6 of FSMA) and admitted to trading on the London Stock Exchange. Provided, therefore, that the Notes remain so listed, interest on the Notes will be payable without withholding or deduction on account of United Kingdom tax.

Interest on the Notes may also be paid without withholding or deduction on account of United Kingdom tax where interest on the Notes is paid by a company and, at the time the payment is made, the Issuer reasonably believes (and any person by or through whom interest on the Notes is paid reasonably believes) that the beneficial owner is within the charge to United Kingdom corporation tax as regards the payment of interest, provided that HMRC has not given a direction (in circumstances where it has reasonable grounds to believe that it is likely that the above exemption is not available in respect of such payment of interest at the time the payment is made) that the interest should be paid under deduction of tax.

In other cases, an amount must generally be withheld from payments of interest on the Notes on account of United Kingdom income tax at the basic rate (currently 20 per cent.). However, where an applicable double tax treaty provides for a lower rate of withholding tax (or for no tax to be withheld) in relation to a Noteholder, HMRC can issue a notice to the Issuer to pay interest to the Noteholder without deduction of tax (or for interest to be paid with tax deducted at the rate provided for in the relevant double tax treaty).

2. ***Information Reporting***

HMRC has powers, in certain circumstances, to obtain information relating to securities.

The information HMRC can obtain includes: details of the beneficial owner of securities; details of the person for whom the securities are held, or the person to whom the payment is to be made (and, if more than one, their respective interests); information and documents relating to securities

transactions; and, in relation to interest paid or credited on money received or retained in the United Kingdom, the identity of the security under which interest is paid.

The persons from whom HMRC can obtain information include: a person who receives (or is entitled to receive) a payment derived from securities; a person who makes such a payment (received from, or paid on behalf of another person); a person by or through whom interest is paid or credited; a person who effects or is a party to securities transactions (which includes an issue of securities) on behalf of others; registrars or administrators in respect of securities transactions; and each registered or inscribed holder of securities.

In certain circumstances the information which HMRC has obtained using these powers may be exchanged with tax authorities in other jurisdictions.

3. ***EU Savings Directive***

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States are required to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State or to certain limited types of entities established in that other Member State. However, for a transitional period, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have adopted similar measures (a withholding system in the case of Switzerland). In April 2013, the Luxembourg Government announced its intention to abolish the withholding system with effect from 1 January 2015, in favour of automatic information exchange under the Directive.

The European Commission has proposed certain amendments to the Directive, which may, if implemented, amend or broaden the scope of the requirements described above.

4. ***Further United Kingdom Income Tax Issues***

Interest on the Notes constitutes United Kingdom source income for tax purposes and, as such, may be subject to income tax by direct assessment even where paid without withholding.

However, interest with a United Kingdom source received without deduction or withholding on account of United Kingdom tax will not be chargeable to United Kingdom tax in the hands of a Noteholder (other than certain trustees) who is not resident for tax purposes in the United Kingdom unless that Noteholder carries on a trade, profession or vocation in the United Kingdom through a United Kingdom branch or agency in connection with which the interest is received or to which the Notes are attributable (and where that Noteholder is a company, unless that Noteholder carries on a trade in the United Kingdom through a permanent establishment in connection with which the interest is received or to which the Notes are attributable). There are exemptions for interest received by certain categories of agent (such as some brokers and investment managers). The provisions of an applicable double taxation treaty may also be relevant for such Noteholders.

B. Further United Kingdom Tax Consequences of holding the Notes

1. ***United Kingdom Corporation Tax Payers***

In general, Noteholders which are within the charge to United Kingdom corporation tax will be charged to tax as income on all returns, profits or gains on, and fluctuations in value of, the Notes (whether attributable to currency fluctuations or otherwise) broadly in accordance with their statutory accounting treatment.

2. ***Individuals***

Interest

Noteholders who are either individuals or trustees and are resident for tax purposes in the United Kingdom or who carry on a trade, profession or vocation in the United Kingdom through a branch or agency to which the Notes are attributable will generally be liable to United Kingdom tax on the amount of any interest received in respect of the Notes.

Taxation of Chargeable Gains

The Notes are expected to constitute "qualifying corporate bonds" within the meaning of section 117 of the Taxation of Chargeable Gains Act 1992. Accordingly, a disposal by a Noteholder of a Note should not give rise to a chargeable gain or an allowable loss for the purposes of the UK taxation of chargeable gains.

Accrued Income Scheme

On a disposal of Notes by a Noteholder, any interest which has accrued since the last interest payment date may be chargeable to tax as income under the rules of the accrued income scheme as set out in Part 12 of the Act, if that Noteholder is resident or ordinarily resident in the United Kingdom or carries on a trade in the United Kingdom through a branch or agency to which the Notes are attributable.

Taxation of discount

The Notes may constitute "deeply discounted securities" for the purposes of Chapter 8 of Part 4 Income Tax (Trading and Other Income) Act 2005. Whether the Notes are deeply discounted securities will depend on the market value of the Dated Notes exchanged for the Notes at the time of the exchange compared to the amount payable on redemption. If the Notes are deeply discounted securities, any gain realised on redemption or transfer of the Notes by a Noteholder who is within the charge to United Kingdom income tax in respect of the Notes should generally be taxable as income but such Noteholder will not be able to claim relief from income tax in respect of costs incurred on the acquisition, transfer or redemption, or losses incurred on the transfer or redemption, of the Notes.

Noteholders should consult their own tax advisors to determine whether the Notes are deeply discounted securities.

C. Stamp Duty and Stamp Duty Reserve Tax (SDRT)

No UK stamp duty or SDRT should be payable on the issue or transfer of a Note or on its redemption.

THE ABOVE DESCRIPTION OF TAXATION IS GENERAL IN CHARACTER. IF YOU ARE IN ANY DOUBT AS TO YOUR TAX POSITION, YOU SHOULD CONSULT AN APPROPRIATE PROFESSIONAL ADVISER WITHOUT DELAY.

The Proposed Financial Transactions Tax (FTT)

The European Commission has published a proposal for a Directive for a common FTT in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the **participating Member States**).

The proposed FTT has very broad scope and could, if introduced in its current form, apply to certain dealings in the Notes (including secondary market transactions) in certain circumstances.

Under current proposals the FTT could apply in certain circumstances to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in the Notes where at least one party is a financial institution, and at least one party is established in a participating Member State. A financial institution may be, or be deemed to be, "established" in a participating Member State in a broad range of circumstances, including (i) by transacting with a person established in a participating Member

State or (ii) where the financial instrument which is subject to the dealings is issued in a participating Member State.

The FTT proposal remains subject to negotiation between the participating Member States and is the subject of legal challenge. It may therefore be altered prior to any implementation, the timing of which remains unclear. Additional EU Member States may decide to participate. Prospective holders of the Notes are advised to seek their own professional advice in relation to the FTT.

FOREIGN ACCOUNT TAX COMPLIANCE ACT

Sections 1471 through 1474 of the U.S. Internal Revenue Code of 1986 (**FATCA**) impose a new reporting regime and potentially a 30 per cent. withholding tax with respect to certain payments to any non-U.S. financial institution (a "foreign financial institution", or **FFI** (as defined by FATCA)) that does not become a **Participating FFI** by entering into an agreement with the U.S. Internal Revenue Service (**IRS**) to provide the IRS with certain information in respect of its account holders and investors or is not otherwise exempt from or in deemed compliance with FATCA. The Bank is classified as an FFI.

The new withholding regime will be phased in beginning 1 July 2014 for payments from sources within the United States and will apply to **foreign passthru payments** (a term not yet defined) no earlier than 1 January 2017. This withholding would potentially apply to payments in respect of (i) any Notes characterised as debt (or which are not otherwise characterized as equity and have a fixed term) for U.S. federal tax purposes that are issued on or after the **grandfathering date**, which is the later of (a) 1 July 2014 and (b) the date that is six months after the date on which final U.S. Treasury regulations defining the term foreign passthru payment are filed with the Federal Register, or which are materially modified on or after the grandfathering date and (ii) any Notes characterised as equity or which do not have a fixed term for U.S. federal tax purposes, whenever issued.

The United States and a number of other jurisdictions have announced their intention to negotiate intergovernmental agreements to facilitate the implementation of FATCA (each, an **IGA**). Pursuant to FATCA and the "Model 1" and "Model 2" IGAs released by the United States, an FFI in an IGA signatory country could be treated as a **Reporting FI** not subject to withholding under FATCA on any payments it receives. Further, an FFI in a Model 1 IGA jurisdiction generally would not be required to withhold under FATCA or an IGA (or any law implementing an IGA) (any such withholding being **FATCA Withholding**) from payments it makes. The Model 2 IGA leaves open the possibility that a Reporting FI might in the future be required to withhold as a Participating FFI on foreign passthru payments. Under each Model IGA, a Reporting FI would still be required to report certain information in respect of its account holders and investors to its home government or to the IRS. The United States and the United Kingdom have entered into an agreement (the **US-UK IGA**) based largely on the Model 1 IGA.

The Bank expects to be treated as a Reporting FI pursuant to the US-UK IGA and does not anticipate being obliged to deduct any FATCA Withholding on payments it makes. There can be no assurance, however, that the Bank will be treated as a Reporting FI, or that it would in the future not be required to deduct FATCA Withholding from payments it makes The Bank and financial institutions through which payments on the Notes are made may be required to withhold FATCA Withholding if any FFI through or to which payment on such Notes is made is not a Participating FFI, a Reporting FI, or otherwise exempt from or in deemed compliance with FATCA

In respect of any Notes which are held within the clearing systems, it is expected that FATCA will not affect the amount of any payments made under, or in respect of, the Notes by the Bank, any paying agent and the common depositary, given that each of the entities in the payment chain between the Bank and the participants in the clearing systems is a major financial institution whose business is dependent on compliance with FATCA and that any alternative approach introduced under an IGA will be unlikely to affect the Notes. The documentation expressly contemplates the possibility that the Notes may go into definitive form and therefore that they may be taken out of the clearing systems. If this were to happen, then a non-FATCA compliant holder could be subject to FATCA Withholding. However, definitive Notes will only be printed in remote circumstances.

FATCA is particularly complex and its application is uncertain at this time. The above description is based in part on regulations, official guidance and model IGAs, all of which are subject to change or may be implemented in a materially different form. Prospective investors should consult their tax advisers on how these rules may apply to the Bank and to payments they may receive in connection with the Notes.

TO ENSURE COMPLIANCE WITH IRS CIRCULAR 230, EACH TAXPAYER IS HEREBY NOTIFIED THAT: (A) ANY TAX DISCUSSION HEREIN IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED BY THE TAXPAYER FOR THE PURPOSE OF AVOIDING U.S. FEDERAL INCOME TAX PENALTIES THAT MAY BE IMPOSED ON THE TAXPAYER; (B) ANY SUCH TAX DISCUSSION WAS WRITTEN TO SUPPORT THE PROMOTION OR MARKETING OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) THE TAXPAYER SHOULD SEEK ADVICE BASED ON THE TAXPAYER'S PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.

20
ADDITIONAL INFORMATION

Holders should be aware of a number of other matters that may not have been addressed in detail elsewhere in this Prospectus.

These include the availability of certain relevant documents for inspection, confirmations from the Bank and details of the listing of the Notes.

ADDITIONAL INFORMATION

1. INCORPORATION AND REGISTERED OFFICE

1.1 The Bank was incorporated and registered in England and Wales under the name of Co-operative Bank Limited on 5 October 1970. On 21 May 1981 the Bank was re-registered as a public company and changed its name to Co-operative Bank Public Limited Company. On 10 January 1993 the Bank changed its name to The Co-operative Bank p.l.c.

1.2 The registered and head office of the Bank is at P.O. Box 101, 1 Balloon Street, Manchester M60 4EP (telephone number: + 44 (0) 161 832 3456, fax number: +44 (0) 161 829 4475).

1.3 The principal legislation under which the Bank operates, and under which the New Ordinary Shares will be created, is the Companies Act.

2. AUTHORISATION

The issue of the Notes was duly authorised by a resolution of the Board of Directors of the Issuer dated 1 November 2013.

3. LISTING

3.1 It is expected that the admission of the Notes to the Official List will be granted on or about the Issue Date. Application has been made to the UK Listing Authority for the Notes to be admitted to the Official List and to be admitted to trading on the London Stock Exchange's regulated market. Admission of the Notes to trading is also expected to occur on or about the Issue Date.

3.2 The amount of expenses related to the issue of the Notes will be specified when the final principal amount of Notes to be issued (if any) is announced by the Issuer.

4. CERTIFICATES

No temporary documents of title shall be issued by the Bank in respect of the Notes. The Registrar will, from the Issue Date, commence despatching the Certificates to all holders who hold their Notes in certificated form, at the risk of the persons entitled thereto, by post to the address on the register or if such holder has completed an Exchange Instruction with another address, to such address.

5. CLEARING SYSTEMS

5.1 The Notes in uncertificated form have been accepted for clearance in CREST and with Euroclear and Clearstream, Luxembourg through CREST. The ISIN for the Notes is GB00BFXW0853 and the SEDOL is BFXW085.

5.2 The current address of CREST is Euroclear UK & Ireland Limited, 33 Cannon Street, London EC4M 5SB.

5.3 The address of Euroclear is Euroclear Bank SA/NV, 1 Boulevard du Roi Albert II, B-1210 Brussels and the address of Clearstream, Luxembourg is Clearstream Banking, 42 Avenue JF Kennedy, L 1855 Luxembourg.

6. NO SIGNIFICANT CHANGE AND NO MATERIAL ADVERSE CHANGE

Save as set out in "*Current Trading*" of Section 12 (*Operating Financial Review*), there has been no significant change in the financial or trading position of the Bank or its subsidiaries since 30 June 2013, the date to which the last historical audited consolidated financial information of the Bank was prepared. Save as set out in "*Current Trading*" of Section 12 (*Operating Financial Review*), there has been no material adverse change in the prospects of the Bank or its subsidiaries since 30 June 2013.

7. AUDITORS

7.1 The financial statements for the financial years ended 31 December 2012, 2011 and 2010 which have been incorporated by reference into this Prospectus have been audited without qualification, by KPMG. The Interim Financial Information for the half-year ended 30 June 2013 has been audited for the purposes of this Prospectus and the audit opinion provided by KPMG is qualified by an "emphasis of matter".

7.2 KPMG Audit Plc's address is 15 Canada Square, London E14 5GL, United Kingdom.

7.3 KPMG Audit Plc is a member of the Institute of Chartered Accountants in England and Wales and has no material interest in the Bank.

7.4 KPMG Audit Plc has given and has not withdrawn its written consent to the inclusion in this Prospectus of its name, its accountants' reports in "*Part B*", "*Part D*" and "*Part E*" in Section 16 (*Financial Information*), and references to its name and those documents in the form and context in which they appear and has authorised the contents of those parts of this Prospectus which comprise its reports for the purposes of PR 5.5.4R(2)(f) of the Prospectus Rules.

8. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents are available for inspection during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted) for a period of 12 months from the date of this Prospectus at the Bank's registered office at P.O. Box 101, 1 Balloon Street, Manchester M60 4EP:

(a) the existing memorandum and articles of association of the Bank;

(b) the reports from KPMG set out in Section 16 (*Financial Information*);

(c) this Prospectus;

(d) the consent letters referred to in paragraph 7 "*Auditors*" above;

(e) the audited consolidated financial statements of the Issuer for the financial years ended 31 December 2012, 31 December 2011 and 31 December 2010, together with the audit reports thereon. The Issuer currently prepares audited consolidated financial statements only on an annual basis;

(f) the Interim Financial Information;

(g) the Trust Deed and the Registrar Agreement; and

(h) the Offer Memorandum.

9. YIELD

The yield of the Notes is 11 per cent. per annum calculated on the basis of the issue price of the Notes and as at the date of this Prospectus.

10. DEALER MANAGERS TRANSACTING WITH THE ISSUER

The Dealer Managers and their affiliates have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform services for the Issuer and its affiliates in the ordinary course of business.

11. MATERIAL CONFLICTS OF INTEREST IN THE OFFER

HSBC has been appointed as a dealer manager and adviser to the Bank and UBS has been appointed as a dealer manager, to facilitate the Liability Management Exercise. HSBC will be paid fees and expenses by the Bank in connection with the Liability Management Exercise. Please also see paragraph 10 above.

12. SUMMARY OF THE BANK'S ARTICLES OF ASSOCIATION

The articles of association of the Bank which will be proposed for approval at a general meeting of the Bank held on 15 November 2013, will include provisions with the effect as described below.

12.1 Objects

The objects of the Bank, in accordance with section 31(1) of the Companies Act, are unrestricted. The Bank shall promote and conduct its business to the extent practicable in a manner informed by the established values of the co-operative movement having regard to the highest standards of ethical principles and with the aim of being recognised as a good corporate citizen and contributing to building a stronger and sustainable society. The Bank shall promote and conduct its business in this manner in relation to:

(a) how it relates to, communicates with, balances the interests of, and otherwise deals with, its stakeholders; and

(b) how it applies the profits of the Bank, in accordance with the dividend policy.

Among the factors to which the directors must have regard in exercising their duties are (i) the promotion of co-operative values and ethical policies as approved and adopted by the Board from time to time after recommendation by the V&E Committee, (ii) the promotion of the desirability of customers of the Bank continuing to be able to participate in membership of Co-operative Group (for so long as Co-operative Group remains a bona fide co-operative society and directly or indirectly holds 20 per cent. or more of the Bank's ordinary shares), and (iii) the conduct of the Bank's business with respect to ethical standards and the interests of the customers, suppliers, employees and other stakeholders of the Bank in a manner consistent with the values and ethical policies approved and adopted by the Board.

12.2 Limited liability

The liability of the members is limited to the amount, if any, unpaid on the shares in the Bank respectively held by them.

12.3 Preference Shares

(a) Dividends – The Preference Shares carry the right to a fixed, non-cumulative preferential dividend on the capital for the time being paid up thereon at the rate of 9.25 per cent. per annum, exclusive of any associated tax credit. Such dividends shall be payable half-yearly on 31 May and 30 November in each year. Such dividends shall be payable out of the profits of the Bank available for distribution and resolved to be distributed. The holders of the Preference Shares shall be entitled to payment of such dividend in priority to any payment of dividend to the holders of any other class of shares in the capital of the Bank. If any instalment of the dividend cannot be paid because the distributable profits and reserves of the Bank are insufficient to enable payment in full or if in the judgement of the directors the payment of such instalment would breach or cause a breach of the Bank of England's capital adequacy requirements currently applicable to the Bank, each Preference Shareholder eligible for payment of such dividend shall (subject to the following sentence) be allotted, credited as fully paid, such additional nominal amount of further Preference Shares equal to the cash amount of such dividend multiplied by four-thirds. Such allotment will only be made if the amount standing to the credit of the profit and loss account, reserves, share premium account or capital redemption reserve fund of the Bank are sufficient to enable the allotments of additional preference stock in full.

(b) Capital – a return of capital on a winding-up or other return of capital (other than on redemption of any class of redeemable share capital), the assets of the Bank shall be applied in priority to any payments to the holders of any other class of shares in the capital of the Bank in repaying to the holders of the Preference Shares a sum equal to (A) the greater of (1) the

capital paid up or credited as paid up on the Preference Shares and (2) a sum equal to the average of the middle market quotations (as derived from the Daily Official List of The London Stock Exchange) during the three months immediately preceding the date of the notice convening the meeting to consider the resolution to approve the winding-up or other return of capital and (B) the amount that would have been properly payable by way of dividend at the annual rate thereof calculated on an annual pro rata basis by reference to the actual number of days elapsed on and from whichever of 1 June or 1 December shall have last occurred up to and including the date of the commencement of such winding-up or other return of capital.

(c) Voting and General Meetings – the holders of the Preference Shares shall have the right to speak and vote at a general meeting of the company only if and when, at the date of the notice convening such meeting, the fixed preferential dividend payable to them respectively has been in arrears for six months or more after any date fixed for payment thereof, or if a resolution is to be proposed at such meeting abrogating or varying any of the respective rights or privileges attaching to their shareholding or the winding up of the company or other return of capital and then on such resolution only.

(d) Modification of Rights – rights attaching to Preference Shares can only be varied by consent of the holders of three-fourths of the Preference Shares. This consent is required in accordance with the articles of association for:

(i) issue by the Bank of any share capital or the grant by the Bank of any rights to subscribe for or to convert shares or other securities into share capital ranking in priority to or pari passu with the Preference Shares as regards participation in the profits or assets of the Bank or being capable of being redeemed whilst any of the Preference Shares are in issue or the variation of the rights of any class of shares so as to fall within the foregoing;

(ii) the repayment or (otherwise than in accordance with these rights and conditions) the reduction of all or any part of the capital paid up on any shares in the capital of the Bank for the time being in issue (other than a repayment in the course of a winding-up of the Bank) including share premium account and capital redemption reserve fund or the acquisition by the Bank or any of its subsidiaries of any share capital of the Bank; and

(iii) the capitalisation for appropriation to the holders of the New Ordinary Shares of any part of the sums standing to the credit of the profit and loss account or to the credit of any reserve accounts of the Bank available for distribution if after such capitalisation the aggregate of the sums standing to the credit of the profit and loss account and to the credit of the Bank's reserves available for distribution would be a sum less than five times the aggregate amount of the annual preferential dividend (exclusive of any associated tax credit) payable on the new Preference Shares.

12.4 **Rights attaching to shares**

(a) Voting rights of members – subject to the articles of association and to any special rights or restrictions as to voting for the time being attached to any shares the provisions of the Companies Act shall apply in relation to voting rights. On a show of hands, every member or authorised corporate representative present has one vote and every proxy present has one vote except if the proxy has been duly appointed by more than one member and has been instructed by (or exercises his discretion given by) one or more of those members to vote for the resolution and has been instructed by (or exercises his discretion given by) one or more other of those members to vote against it, in which case a proxy has one vote for and one vote against the resolution. On a poll, every member present in person or by proxy has one vote for every share of which he is a holder. In the case of joint holders, the vote of the person whose name stands first in the register of members and who tenders a vote is accepted to the exclusion of any votes tendered by any other joint holders.

(b) Dividends – subject to the rights attached to any shares issued on any special terms and conditions, dividends shall be declared and paid according to the amounts paid up on the shares in respect of which the dividend is paid, but no amount paid up on a share in advance of calls should be treated for these purposes as paid up on the share.

(c) Return of capital – if the Bank is in liquidation, the liquidator may, with the sanction of extraordinary resolution of the Bank and any other authority required by any applicable statutory provision: (A) divide among the members in specie the whole or any part of the assets of the Bank; or (B) vest the whole or any part of the assets in trustees on such trusts for the benefit of members as the liquidator shall think fit, but no member shall be compelled to accept any assets upon which there is any liability.

(d) Capitalisation of reserves – the Board may, with the authority of an ordinary resolution of the Bank: (A) resolve to capitalise any sum standing to the credit of any reserve account of the Bank (including share premium account and capital redemption reserve) or any sum standing to the credit of profit and loss account not required for the payment of any preferential dividend (whether or not it is available for distribution); and (B) appropriate that sum as capital to the holders of shares in proportion to the nominal amount of the share capital held by them respectively and apply that sum on their behalf in paying up in full any shares or debentures of the Bank of a nominal amount equal to that sum and allot the shares or debentures credited as fully paid to those members, or as they may direct, in those proportions or in paying up the whole or part of any amounts which are unpaid in respect of any issued shares in the Bank held by them respectively, or otherwise deal with such sum as directed by the resolution provided that the share premium account and the capital redemption reserve, any redenomination reserve and any sum not available for distribution in accordance with the Companies Act may only be applied in paying up shares to be allotted credited as fully paid up.

12.5 **Transfer of shares**

A member may transfer all or any of his shares in any manner which is permitted by applicable statutory provisions and is from time to time approved by the Board. The Bank shall maintain a record of uncertificated shares in accordance with the relevant statutory provisions.

A member may transfer all or any of his certificated shares by an instrument of transfer in any usual form, or in such other form as the Board may approve. The instrument of transfer shall be signed by or on behalf of the transferor and, except in the case of a fully paid share, by or on behalf of the transferee. The Board may, in its absolute discretion, refuse to register any instrument of transfer of any certificated share which is not fully paid up (but not so as to prevent dealings in listed shares from taking place on an open and proper basis) or on which the Bank has a lien. The Board may also refuse to register any instrument of transfer of a certificated share unless it is left at the registered office, or such other place as the Board may decide, for registration, accompanied by the certificate for the shares to be transferred and such other evidence (if any) as the Board may reasonably require to prove title of the intending transferor or his right to transfer shares; and it is in respect of only one class of shares. If the Board refuses to register a transfer of a certificated share it shall, as soon as practicable and in any event within two months after the date on which the instrument of transfer was lodged, give to the transferee notice of the refusal together with its reasons for refusal. The Board must provide the transferee with such further information about the reasons for the refusal as the transferee may reasonably request. Unless otherwise agreed by the Board in any particular case, the maximum number of persons who may be entered on the register as joint holders of a share is four.

12.6 **Alteration of share capital**

The Bank may exercise the powers conferred by the applicable statutory provisions to:

(a) increase its share capital by allotting new shares;

(b) reduce its share capital, any capital redemption reserve and any share premium account in any way;

(c) subdivide or consolidate and divide all or any of its share capital;

(d) redenominate all or any of its shares and reduce its share capital in connection with such redenomination;

(e) issue redeemable shares; and

(f) purchase all or any of its own shares including any redeemable shares.

12.7 **Authority to allot shares and grant rights and disapplication of pre-emption rights**

The Bank may from time to time pass an ordinary resolution authorising, in accordance with section 551 of the Companies Act, the Board to exercise all the powers of the Bank to allot shares in the Bank or to grant rights to subscribe for or to convert any security into shares in the Bank up to the maximum nominal amount specified in the resolution. The authority shall expire on the day specified in the resolution (not being more than five years from the date on which the resolution is passed).

Subject (other than in relation to the sale of treasury shares) to the Board being generally authorised to allot shares and grant rights to subscribe for or to convert any security into shares in the Bank in accordance with section 551 of the Companies Act, the Bank may from time to time resolve, by special resolution, that the Board be given power to allot equity securities for cash as if section 561 of the Companies Act did not apply to the allotment but that power shall be limited: (A) to the allotment of equity securities in connection with a rights issue; and (B) to the allotment (other than in connection with a rights issue) of equity securities having a nominal amount not exceeding in aggregate the sum specified in the special resolution.

12.8 **Variation of rights**

Whenever the share capital of the Bank is divided into different classes of shares, the special rights for the time being attached to any class of shares in issue may be varied or abrogated either whilst the Bank is a going concern or during or in contemplation of a winding-up either with the consent in writing of the holders of three-fourths of the issued shares of that class or with the sanction of an extraordinary resolution passed at a separate class meeting of the holders of the shares of the class, but not otherwise. At any separate class meeting, the quorum is two members present in person or proxy holding at least one-third in nominal amount of the issued shares of the class in question (but at any adjourned meeting, the quorum is one member present in person or by proxy holding shares of the class) and the holders of shares of the class shall, on a poll, have one vote in respect of every share of the class held by them respectively.

12.9 **Creation or issue of further shares**

The special rights conferred upon the holders of any class of shares issued with preferred or other special rights shall be deemed to be varied by the reduction of the capital paid up on such shares but shall not (unless otherwise expressly provided by the articles of association of the Bank or by the conditions of issue of such shares) be deemed to be varied by the creation or issue of further shares ranking in some or all respects pari passu therewith or subsequent thereto.

12.10 **Disclosure of interests in shares**

If the holder of, or any person appearing to be interested in, any share has been given a notice requiring any of the information mentioned in section 793 of the Companies Act (section 793 notice) and, in respect of that share (a default share), has been in default for a period of 14 days after the section 793 notice has been given in supplying to the Bank the information required by the section 793 notice, the following restrictions shall apply: (A) if the default shares in which any one person is interested or appears to the Bank to be interested represent less than 0.25 per cent. of the issued shares

of the class, the holders of the default shares shall not be entitled, in respect of those shares, to attend or to vote, either personally or by proxy, at any general meeting of the Bank; or (B) if the default shares in which any one person is interested or appears to the Bank to be interested represent at least 0.25 per cent. of the issued shares of the class, the holders of the default shares shall not be entitled, in respect of those shares:

(a) to attend or to vote, either personally or by proxy, at any general meeting of the Bank; or

(b) to receive any dividend or other distribution; or

(c) to transfer or agree to transfer any of those shares or any rights in them.

12.11 **Uncertificated shares – general powers**

In relation to any uncertificated share, the Bank may utilise the relevant system in which it is held to the fullest extent available from time to time in the exercise of any of its powers or functions under any applicable statutory provision or the articles of association or otherwise in effecting any action. Any provision in the articles of association in relation to uncertificated shares which is inconsistent with any applicable statutory provision shall not apply. The Bank may, by notice to the holder of an uncertificated share, require the holder to change the form of that share to certificated form within such period as may be specified in the notice. For the purpose of effecting any action by the Bank, the Board may determine that shares held by a person in uncertificated form and in certificated form shall be treated as separate holdings but they shall not be treated as separate classes of shares.

12.12 **Directors**

(a) The directors (other than alternate directors) shall not, unless otherwise determined by an ordinary resolution of the Bank, be less than two.

(b) A director need not be a member of the Bank.

(c) The directors shall retire from office at each annual general meeting. A retiring director shall be eligible for re-election, and a director who is re-elected will be treated as continuing in office without a break. A retiring director who is not re-elected shall retain office until the close of the meeting at which he retires. If the Bank, at any meeting at which a director retires in accordance with the articles of association, does not fill the office vacated by such director, the retiring director, if willing to act, shall be deemed to be re-elected, unless at the meeting a resolution is passed not to fill the vacancy or to elect another person in his place or unless the resolution to re-elect him is put to the meeting and lost.

(d) The non-executive directors shall be paid such fees not exceeding in aggregate £1.5 million per annum (or such larger sum as the Bank may, by ordinary resolution, determine) as the directors may decide to be divided among them in such proportion and manner as they may agree, or failing agreement, equally.

(e) The Board may grant special remuneration to any director who performs any special or extra services to or at the request of the Bank. Such special remuneration may be paid by way of lump sum, salary, commission, participation in profits, provision for retirement or insurance benefit or otherwise as the Board may decide in addition to his ordinary remuneration (if any) as a director.

(f) The directors shall also be paid out of the funds of the Bank all expenses properly incurred by them in and about the discharge of their duties, including their expenses of travelling to and from the Board meetings, committee meetings and general meetings.

(g) The Board may exercise all the powers of the Bank to:

(i) pay, provide, arrange or procure the grant of pensions or other retirement benefits, and death, disability or sickness benefits, health, accident and other insurances or other such

benefits, allowances, gratuities or insurances, including in relation to the termination of employment, to or for the benefit of any person who is or has been at any time a director of the Bank or in the employment or service of the Bank or of any undertaking which is or was associated with the Bank or of the predecessors in business of the Bank or any such associated undertaking or the relatives or dependants of any such person. For that purpose the Board may procure the establishment and maintenance of, or participation in, or contribution to, any pension fund, scheme or arrangement or the payment of any insurance premiums;

(ii) establish, maintain, adopt and enable participation in any profit-sharing or incentive scheme including shares, share options or cash or any similar schemes for the benefit of any director or employee of the Bank or of any associated undertaking, and to lend money to any such director or employee or to trustees on their behalf to enable any such schemes to be established, maintained or adopted; and

(iii) support and subscribe to any institution or association which may be for the benefit of the Bank or of any associated undertaking or any directors or employees of the Bank or associated undertaking or their relatives or dependants or connected with any town or place where the Bank or an associated undertaking carries on business, and to support and subscribe to any charitable or public object whatsoever.

(h) If a situation (a **Relevant Situation**) arises in which a director has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the Bank but which does not arise in relation to a transaction or arrangement with the Bank, the director must declare the nature and extent of his interest to the other directors and the directors (other than the director, and any other director with a similar interest, who shall not be counted in the quorum at the meeting and shall not vote on the resolution) may (A) if the Relevant Situation arises from the appointment or proposed appointment of a person as a director of the Bank, resolve to authorise the appointment of the director and the Relevant Situation on such terms as they may determine and (B) if the Relevant Situation arises in other circumstances, resolve to authorise the Relevant Situation and the continuing performance by the director of his duties on such terms as they may determine. Any terms of such authorisation may be imposed at the time of the authorisation or may be imposed or varied subsequently and may include (without limitation):

(i) whether the interested directors may vote (or be counted in the quorum at a meeting) in relation to any resolution relating to the Relevant Situation;

(ii) the exclusion of the interested directors from all information and discussion by the Bank of the Relevant Situation; and

(iii) (without prejudice to the general obligations of confidentiality) the application to the interested directors of a strict duty of confidentiality to the Bank for any confidential information of the Bank in relation to the Relevant Situation.

(i) Any authorisation of a Relevant Situation may provide that, where the interested director obtains (other than through his position as a director of the Bank) information that is confidential to a third party, he will not be obliged to disclose it to the Bank or to use it in relation to the Bank's affairs in circumstances where to do so would amount to a breach of that confidence.

(j) If a director is in any way, directly or indirectly, interested in a proposed or an existing transaction or arrangement with the Bank, he must usually declare the nature and extent of that interest to the other directors.

(k) Subject to any applicable statutory provisions and to having declared his interest to the other directors, a director may:

(i) enter into or be interested in any transaction or arrangement with the Bank, either with regard to his tenure of any office or position in the management, administration or conduct of the business of the Bank, or as vendor, purchaser or otherwise;

(ii) hold and be remunerated in respect of any other office or place of profit with the Bank (except that of auditor) in conjunction with his office of director;

(iii) act by himself or his firm in a professional capacity for the Bank (except as auditor) and be entitled to remuneration for professional services as if he were not a director;

(iv) be or become a member or director of, or hold any other office or place of profit under, or otherwise be interested in, any parent undertaking or subsidiary undertaking of that parent undertaking or any undertaking in which the Bank may be interested; and

(v) be or become a director of any other undertaking in which the Bank does not have an interest if that cannot reasonably be regarded as likely to give rise to a conflict of interest at the time of his appointment as a director of that other undertaking.

(l) A director shall not vote (or be counted in the quorum at a meeting) in respect of any resolution concerning his own appointment (including fixing and varying its terms), or the termination of his own appointment, as the holder of any office or place of profit with the Bank or any other undertaking in which the Bank is interested but, where proposals are under consideration concerning the appointment (including fixing or varying its terms), or the termination of the appointment, of two or more directors to offices or places of profit with the Bank or any other undertaking in which the Bank is interested, those proposals may be divided and considered in relation to each director separately; and in such case each of the directors concerned (if not otherwise debarred from voting under the articles of association) shall be entitled to vote (and be counted in the quorum) in respect of each resolution except that concerning his own appointment or the termination of his own appointment.

(m) A director shall not vote (or be counted in the quorum at a meeting) in respect of any resolution relating to any transaction or arrangement with the Bank in which he has an interest which may reasonably be regarded as likely to give rise to a conflict of interest. Notwithstanding the above, a director may vote (and be counted in the quorum) on: (A) any transaction or arrangement in which he is interested by virtue of an interest in shares, debentures or other securities of the Bank or otherwise in or through the Bank; (B) the giving of any guarantee, security or indemnity in respect of money lent or obligations incurred by him or by any other person at the request of, or for the benefit of, the Bank or any of its subsidiary undertakings; or a debt or obligation of the Bank or any of its subsidiary undertakings for which he himself has assumed responsibility in whole or in part (either alone or jointly with others) under a guarantee or indemnity or by the giving of security; (C) indemnification (including loans made in connection with it) by the Bank in relation to the performance of his duties on behalf of the Bank or of any of its subsidiary undertakings; (D) any issue or offer of shares, debentures or other securities of the Bank or any of its subsidiary undertakings in respect of which he is or may be entitled to participate in his capacity as holder of any such securities or as an underwriter or sub-underwriter; (E) any transaction or arrangement concerning any other company in which he does not hold, directly or indirectly as shareholder, or through his direct or indirect holdings of financial instruments (within the meaning of Chapter 5 of the Disclosure and Transparency Rules) voting rights representing 1 per cent. or more of any class of shares in the capital of such company; (F) any arrangement for the benefit of employees of the Bank or any of its subsidiary undertakings which does not accord to him any privilege or benefit not generally accorded to the employees to whom the arrangement relates; and (G) the purchase or maintenance of insurance for the benefit of directors or for the benefit of persons including directors.

12.13 **General meetings**

An annual general meeting shall be held in accordance with the applicable statutory provisions at such place as may be determined by the Board. Other general meetings shall be held whenever the Board thinks fit or on the requisition of shareholders in accordance with the Companies Act.

Subject to the applicable statutory provisions, an annual general meeting shall be called by at least 21 clear days' notice and all other general meetings shall be called by not less than 14 clear days' notice or by not less than such minimum notice period as is permitted by the applicable statutory provisions.

The requisite quorum for general meetings of the Bank shall be two qualifying persons, representing different members and entitled to vote on the business to be transacted at the meeting. A qualifying person is an individual who is a member of the Bank; a corporate representative; or a proxy.

12.14 **Borrowing powers**

There is no requirement on the directors to restrict the borrowing of the Bank or any of its subsidiary undertakings.

12.15 **Change of name**

The Board may change the name of the Bank.

12.16 **Values and Ethics Committee**

(a) The values and ethics committee (the **V&E Committee**) shall be a committee of the Board and shall recommend to the Board for its approval and adoption the co-operative values and ethical policies of the Bank and shall represent, monitor, and advise the Board on matters concerning the interests of all stakeholders in their dealings with the Bank in line with the objects of the Bank, whilst having regard to: (i) to the legal and regulatory requirements applicable to the Bank and the directors; (ii) the need for the Bank's operations to be commercially sustainable and profitable; and (iii) the desirability of maintaining and enhancing the public reputation and image of the Bank. The V&E Committee shall have the right to engage with any of the directors or senior management of the Bank upon matters of relevance to its purpose and authority.

(b) The V&E Committee shall at least annually prepare and present to the Board for its approval a report on its activities and on its assessment as to the Bank's performance having regard to its values and ethical policies, and the report (in a form approved by the Board) shall be included in the Bank's annual report and accounts in a form approved by the Board. The Bank's shareholders shall be entitled to raise questions on the work of the V&E Committee and the report at the annual general meeting.

(c) The V&E Committee shall be comprised of a minimum of five and a maximum of seven members, of whom: (A) the majority shall be independent directors of the Bank; and (B) at least five shall be directors. The V&E Committee may contain up to two members who are not directors of the Bank, one or both of whom must be senior executives of the Bank and one of whom may be an individual who is not a senior executive of the Bank provided that the individual has credentials appropriate for the role. The chairman of the V&E Committee shall be an independent director of the Bank specifically appointed to act as chairman.

(d) For so long as Co-operative Group directly or indirectly holds 20 per cent. or more of the Bank's ordinary shares, it shall have the right to appoint one of the directors as a member of the V&E Committee, and may at any time remove such director as a member of the V&E Committee by appointing another director in his or her place.

(e) For so long as Co-operative Group directly or indirectly holds 20 per cent. or more of the Bank's ordinary shares, all provisions contained in the articles of association relating to the V&E Committee, the provisions relating to co-operative values and ethical principles, the Co-operative Group's nominee directors and the dividend policy may be amended or repealed only

with the prior written consent of Co-operative Group in addition to the passing of a special resolution approving such changes. This provision shall cease to apply upon the earlier to occur of: (i) Co-operative Group ceasing to hold directly or indirectly 20 per cent. or more of the Bank's ordinary shares; and (ii) Co-operative Group ceasing to be a bona fide co-operative society.

12.17 **Co-operative Group Limited Nominee Directors**

For so long as Co-operative Group remains a bona fide co-operative society and directly or indirectly controls:

(a) 25 per cent. or more of the voting rights exercisable at general meetings of the Bank, it shall be entitled to appoint, remove and replace up to two natural persons as directors; or

(b) 20 per cent. or more (but less than 25 per cent.) of the voting rights exercisable at general meetings of the Bank, it shall be entitled to appoint, remove and replace one natural person as a director.

The articles of association also contain details as to the mechanism for such appointments, removals and replacements.

12.18 **Dividends**

(a) Declaration of dividends – the Bank may, by ordinary resolution, declare a dividend to be paid to the members, according to their respective rights and interests in the profits, and may fix the time for payment of such dividend, but no dividend shall exceed the amount recommended by the Board.

When considering any dividend, the board shall take into account the Bank's capital and financial position, cash requirements and liquidity and profits available as well as the Bank's regulatory outlook, capital position, investment needs and principal relevant risk factors subsisting at the time. In addition, the board shall consider the need to balance the division of profits between:

(i) distributions to its shareholders;

(ii) investment in products and services;

(iii) retaining earnings for future development; and

(iv) support for social and/or environmental objectives.

(b) Fixed and interim dividends – the Board may pay such interim dividends as appear to the Board to be justified by the financial position of the Bank and may also pay any dividend payable at a fixed rate at intervals settled by the Board whenever the financial position of the Bank, in the opinion of the Board, justifies its payment. If the Board acts in good faith, none of the directors shall incur any liability to the holders of shares conferring preferred rights for any loss such holders may suffer in consequence of the payment of an interim dividend on any shares having non-preferred or deferred rights.

(c) Calculation and currency of dividends – except insofar as the rights attaching to, or the terms of issue of, any share otherwise provide: (A) all dividends shall be declared and paid according to the amounts paid up on the shares in respect of which the dividend is paid, but no amount paid up on a share in advance of calls shall be treated as paid up on the share; (B) all dividends shall be apportioned and paid pro rata according to the amounts paid up on the shares during any portion or portions of the period in respect of which the dividend is paid; and (C) dividends may be declared or paid in any currency and the Board may agree with any member that dividends which may at any time or from time to time be declared or become due on his shares in one currency shall be paid or satisfied in another, and may agree the basis of conversion to be applied and how and when the amount to be paid in the other currency shall be calculated and paid and for the Bank or any other person to bear any costs involved.

(d) Dividends not to bear interest – no dividend or other moneys payable by the Bank on or in respect of any share shall bear interest as against the Bank unless otherwise provided by the rights attached to the share.

(e) Calls or debts may be deducted from dividends – the Board may deduct from any dividend or other moneys payable to any person (either alone or jointly with another) on or in respect of a share all such sums as may be due from him (either alone or jointly with another) to the Bank on account of calls or otherwise in relation to shares of the Bank.

(f) Dividends *in specie* – with the authority of an ordinary resolution of the Bank and on the recommendation of the Board, payment of any dividend may be satisfied wholly or in part by the distribution of specific assets and in particular of paid up shares or debentures of any other company.

(g) Scrip dividends – the Board may, with the authority of an ordinary resolution of the Bank, offer any holders of shares the right to elect to receive further shares by way of scrip dividend instead of cash in respect of all (or some part) of any dividend specified by the ordinary resolution.

(h) Unclaimed dividends – any dividend unclaimed for a period of 12 years after having been declared shall be forfeited and cease to remain owing by the Bank.

12.19 **Forfeiture of shares**

If the whole or any part of any call or instalment remains unpaid on any share after the due date for payment, the Board may give a notice to the holder requiring him to pay so much of the call or instalment as remains unpaid, together with any accrued interest.

If the requirements of a notice are not complied with, any share in respect of which it was given may (before the payment required by the notice is made) be forfeited by a resolution of the Board. The forfeiture shall include all dividends declared and other moneys payable in respect of the forfeited share and not actually paid before the forfeiture.

Every share which is forfeited or surrendered shall become the property of the Bank and (subject to the applicable statutory provisions) may be sold, re-allotted or otherwise disposed of, upon such terms and in such manner as the Board shall decide either to the person who was before the forfeiture the holder of the share or to any other person and whether with or without all or any part of the amount previously paid up on the share being credited as so paid up.

12.20 **Communications by the Bank**

Subject to the applicable statutory provisions, a document or information may be sent or supplied by the Bank to any member in electronic form to such address as may from time to time be authorised by the member concerned or by making it available on a website and notifying the member concerned (in accordance with the applicable statutory provisions) of the presence of a document or information on the website. A member shall be deemed to have agreed that the Bank may send or supply a document or information by means of a website if the applicable statutory provisions have been satisfied.

12.21 **Directors' indemnity, insurance and defence**

As far as the applicable statutory provisions allow, the Bank may:

(a) indemnify any director of the Bank (or of an associated body corporate) against any liability;

(b) indemnify a director of a company that is a trustee of an occupational pension scheme for employees (or former employees) of the Bank (or of an associated body corporate) against liability incurred in connection with the company's activities as trustee of the scheme;

(c) purchase and maintain insurance against any liability for any director referred to in paragraph (a) or paragraph (b) above; and

(d) provide any director referred to in paragraph (a) or paragraph (b) above with funds (whether by loan or otherwise) to meet expenditure incurred or to be incurred by him in defending any criminal, regulatory or civil proceedings or in connection with an application for relief (or to enable any such director to avoid incurring such expenditure).

12.22 **Corporate Governance**

For so long as the Ordinary Shares are not admitted to the premium listing segment of the Official List (and there can be no guarantee that the Bank will be able to satisfy the necessary eligibility criteria in order to do so), the Bank shall: (i) use all reasonable endeavours to comply with the UK Corporate Governance Code; and (ii) comply with the provisions of LR 9.8.6R(5) and LR 9.8.6R(6) of the Listing Rules as if they applied to the Bank, in each case, as if the Bank were in the FTSE 350.

12.23 **Significant Transactions, Related Party Transactions, Circulars etc.**

Following, and for the duration of, any admission of the Ordinary Shares to the standard segment of the Official List, the Bank shall adopt and follow policies requiring the Bank to comply with the rules in Chapter 10 (significant transactions), Chapter 11 (related party transactions), Chapter 12 (dealing in own securities and treasury shares) and Chapter 13 (contents of circulars) of the Listing Rules (the **10-13 LRs**), on a voluntary basis, as if the Bank were listed on the premium segment of the Official List.

For so long as the Ordinary Shares are not admitted to either the standard segment or premium segment of the Official List (and there can be no guarantee that the Bank will be able to satisfy the necessary eligibility criteria in order to do so), the Bank shall adopt and follow policies to comply with 10-13 LRs to the extent reasonably practicable and in accordance with the spirit of the 10-13 LRs.

13. DIRECTORS AND SENIOR MANAGEMENT

13.1 The biographies of the Directors and Senior Management are set out in Section 9 (*Directors, Senior Management, Employees and Corporate Governance*).

13.2 The business address of each of the Directors and each of the Senior Managers is CIS Tower, Miller Street, Manchester M60 4EP, United Kingdom.

13.3 In addition to their directorships of the Bank and its subsidiaries, the Directors and members of Senior Management hold, or have held, the following directorships and are or were members of the following partnerships, within the past five years:

Name	*Position*	*Company/Society/Partnership*	*Status (Current/ Previous)*
DIRECTORS			
Niall Booker	Director	Banking Group	Previous
	Deputy Chief Executive	Co-operative Group	Previous
	Chief Executive Officer	HSBC North America Holdings Inc.	Previous
	Chief Executive Officer	HSBC Finance Corporation International	Previous
	Member of Group Management Board	HSBC Holdings plc	Previous
	Chair	Committee of Council of Glenalmond College	Current
Rodney Jensen Bulmer	Director	The Co-operative Academy of Manchester	Current
	Director	CFS Services Limited	Previous

Name	*Position*	*Company/Society/Partnership*	*Status (Current/ Previous)*
	Director	Co-operative Legal Services Limited	Previous
	Director	Banking Group	Previous
	Director	RLUM (CIS) Limited	Previous
	Director	RL Marketing (CIS) Limited	Previous
	Director	Royal London Asset Management (CIS) Limited	Previous
	Chairman	The Co-operative Academy of Manchester	Previous
	Director	CIS General Insurance	Previous
	Director	Royal London (CIS) Limited	Previous
Richard Pym	Chairman	Nordax Finans AB (publ)	Current
	Chairman	UK Asset Resolution Limited	Current
	Chairman	Bradford & Bingley plc	Current
	Chairman	Northern Rock (Asset Management) plc	Current
	Chairman	BrightHouse Group plc	Current
	Chairman	Banking Group	Previous
	Non-Executive Director	The British Land Company plc	Previous
	Chairman	Halfords Group plc	Previous
	Group Chief Executive	Mortgage Express	Previous
	Director	Old Mutual plc	Previous
John Richard Coates	Non-Executive Director	Police Mutual Assurance Society	Current
	Director	Banking Group	Previous
	Managing Director	Baseline Capital Limited	Previous
	Non-Executive Director	Northern Rock PLC	Previous
Anne Margaret Gunther	Venture Partner	Octopus Investment Managers	Current
	Non-Executive Director	MBNA Limited	Current
	Non-Executive Director	North East and West Devon NHS Clinical Commissioning Group	Current
	Chair	Warwick Business School	Current
	Director	Banking Group	Previous
	Director	CIS General Insurance	Previous
	Director	Royal London (CIS) Limited	Previous
	Chief Executive	Standard Life Healthcare	Previous
	Chief Executive	Standard Life Bank plc	Previous
	Director	Standard Life Assurance Limited	Previous
	Director	Standard Life Client Management Limited	Previous
	Director	Standard Life Wealth Limited	Previous
	Director	Norwich & Peterborough Building Society	Previous
	Director	Lynch Wood Insurance Services Limited	Previous
	Director	Lynch Wood Services Limited	Previous
	Director	Norwich & Peterborough General Insurance Services Limited	Previous
	Director	Norwich & Peterborough Sharedealing Services Limited	Previous
	Director	Water Lunniss Nominees Limited	Previous

Name	*Position*	*Company/Society/Partnership*	*Status (Current/ Previous)*
	Trustee and Chair of Audit/Finance Committee	Arts & Business	Previous
	Council Member	Council of Mortgage Lenders	Previous
Merlyn Vivienne Lowther	Trustee	Winston Churchill Memorial Trust	Current
	Trustee and Vice Chairman	The Henry Smith Charity	Current
	Director	Banking Group	Previous
	Director	Royal London Asset Management (CIS) Limited	Previous
	Director	CIS General Insurance	Previous
	Director	Royal London (CIS) Limited	Previous
	Non-Executive Director	Schroders plc	Previous
Euan Angus Sutherland	Non-Executive Director	Super Group plc	Current
	Chief Executive	Co-operative Group	Current
	Director	Banking Group	Current
	Chief Executive Officer	Kingfisher UK & Ireland	Previous
	Chief Operating Officer	Kingfisher plc	Previous
	Chairman	B&Q plc	Previous
Richard Graeme Barclay Hardie	Member	Shelter Scotland	Current
	Director	Northpoint Consultancy Services Limited	Current
	Non-Executive Director	FNZ (UK) Limited	Current
	Director	Banking Group	Previous
	Non-Executive Director	Metro Bank UK Limited	Previous
	Non-Executive Director	Dunfermline Building Society	Previous
	Director	Abbey National Bank plc	Previous
	Senior Adviser	Hartford Life (Europe) Limited	Previous
Bennett Lyle Edward Reid	Member of the Board of Governors	University of Wolverhampton	Current
	Director	Co-operative Group Holdings (2011) Limited	Current
	Director	Co-operative Group	Current
	Chair	Walsall Healthcare NHS Trust	Current
	Chief Executive	The Midcounties Co-operative	Current
	Non-Executive Director	Banking Group	Previous
	Director	CIS General Insurance	Previous
	Director	Royal London (CIS) Limited	Previous
	Chief Executive Officer	Walsall Regeneration Company Limited	Previous
William Gennydd Thomas	LLP Member	The Invicta Film Partnership, LLP	Current
	Non-Executive Independent Director	XChanging plc	Current
	Independent Director	Balfour Beatty plc	Current
	Non-Executive Independent Director	GFI SA	Current
	Chair of Advisory Board	Cranfield University School of Management	Current
	Member of Advisory Board	Leeds University Business School	Current

Name	*Position*	*Company/Society/Partnership*	*Status (Current/ Previous)*
	Corporate President	EDS Finance Limited	Previous
	Corporate President	HP Enterprise Services Defence & Security UK Ltd	Previous
	Corporate President	HP Enterprise Services UK Ltd	Previous
	Corporate President	E.D.S. International Limited	Previous
	Corporate President	EDS Nominees Limited	Previous
SENIOR MANAGERS			
John Baines	Director	John Baines Consulting Limited	Current
	Chief Financial Officer	Aldermore Bank plc	Previous
	Director	Aldermore Bank plc	Previous
	Chief Executive Officer, Wealth Management Division	Royal Bank of Scotland Group plc	Previous
	Director	AC Acquisitions Limited	Previous
	Director	Coutts & Company	Previous
	Director	RBS Coutts Bank Limited	Previous
Grahame McGirr	Director	Naissance UK Limited	Current
	Director	Naissance Capital Limited	Current
	Representative of the Members on the LLP Management Committee	The Covered Bond LLP	Current
	Representative of the Members on the LLP Management Committee	Moorlands Covered Bonds Limited Liability Partnership	Current
	Chief Risk Officer	Banking Group	Previous
Liam Coleman	Non-Executive Director	The Great Western Hospitals NHS Foundation Trust	Current
	Deputy Group Treasurer	Royal Bank of Scotland plc	Previous
	Group Director, Treasury	Nationwide Building Society	Previous
Julie Harding	HR Director	Banking Group	Previous
	Global Head HR Transformation	HSBC Holdings plc	Previous
	Head of HR UK Bank	HSBC Bank plc	Previous
Robert Rickert	Chief Operating Officer and Finance Director and Board Member	DTZ Holdings PLC	Previous
	Managing Director	UBS	Previous
	Chief Information Officer, Global Retail	Barclays Global Retail and Commercial Bank	Previous

13.4 Save as disclosed below, as at the date of this Prospectus none of the Directors or members of the Senior Management has at any time within at least the past five years:

(a) save as disclosed in this paragraph 13, been a director or partner of any companies or partnerships; or

(b) had any convictions in relation to fraudulent offences (whether spent or unspent); or

(c) been adjudged bankrupt or entered into an individual voluntary arrangement; or

(d) been a director of any company at the time of, or within 12 months preceding, any receivership, compulsory liquidation, creditors' voluntary liquidation, administration, company voluntary arrangement or any composition or arrangement with that company's creditors generally or with any class of its creditors; or

(e) been a partner in a partnership at the time of, or within 12 months preceding, any compulsory liquidation, administration or partnership voluntary arrangement of such partnership; or

(f) had his assets form the subject of any receivership or been a partner of a partnership at the time of, or within 12 months preceding, any assets thereof being the subject of a receivership; or

(g) been subject to any official public incrimination and/or sanctions by any statutory or regulatory authority (including any designated professional body); or

(h) ever been disqualified by a court from acting as a director of a company or from acting in the management or conduct of the affairs of any company.

13.5 Richard Graeme Barclay Hardie was a non-executive director of Dunfermline Building Society from September 2008 to March 2009. A sale process was conducted by the Bank of England in March 2009 under the Special Resolution Regime provisions of the Banking Act. Richard was brought in by Dunfermline Building Society to assist with the challenges it was facing at the time.

Richard Pym has been Chairman of Northern Rock (Asset Management) plc since January 2010. Northern Rock plc was nationalised and taken into Government ownership in February 2008 and was then restructured into two legal entities on 31 December 2009 – Northern Rock plc and Northern Rock (Asset Management) plc. Richard was appointed Chief Executive of Bradford & Bingley in August 2008 and was appointed Chairman in November 2008. On 29 September 2008, all of Bradford & Bingley's retail branches and its savings accounts were transferred to Abbey, and subsequently rebranded Santander. The remainder of the business, including the mortgage books of Bradford & Bingley and specialist lending arm Mortgage Express were nationalised and taken into public ownership by the Government. Since July 2010 Richard has been Chairman of UK Asset Resolution Limited which was established to facilitate the orderly management of the closed mortgage books of both Bradford & Bingley plc and Northern Rock (Asset Management) plc to maximise value for taxpayers.

14. DIRECTORS' AND SENIOR MANAGERS' INTERESTS IN THE BANK

14.1 As at the date of this Prospectus and as is expected to be the position immediately following completion of the Liability Management Exercise, neither the Directors nor the Senior Managers, and none of their respective immediate families, have any interests in the share capital of the Bank which:

(a) are required to be notified to the Bank pursuant to Chapter 3 of the Disclosure and Transparency Rules; or

(b) are interests of a connected person (within the meaning of Schedule 11B of FSMA) which would be required to be disclosed under paragraph (a) above and the existence of which is known to or could with reasonable diligence be ascertained by that Director or Senior Manager.

14.2 No Director or Senior Manager will have any interest in the share capital or loan capital of the Bank on completion of the Liability Management Exercise and there is no person to whom any capital of any member of the Bank or any of its subsidiaries is under award or option or agreed unconditionally to be put under award or option.

14.3 Euan Angus Sutherland is the Chief Executive of Co-operative Group and a director of Banking Group. Bennett Lyle Edward Reid is a director of Co-operative Group Holdings (2011) Limited and Co-operative Group. Euan and Bennett are nominee directors of Co-operative Group and are intended to constitute nominee directors for the purposes of the Articles of Association of the Bank which will

be proposed for approval at a general meeting of the Bank to be held on 15 November 2013, and as referred to in the Relationship Agreement. Under the terms of the Relationship Agreement, Co-operative Group acknowledges that its nominee director(s) shall not be able to vote at Board meetings of the Bank on any matter where there is a conflict of interests or potential conflict of interests between the Bank or any of its subsidiaries (on the one hand) and Co-operative Group or any of its subsidiaries (excluding the Bank and its subsidiaries) (on the other hand).

Save as disclosed in this paragraph, none of the Directors or Senior Managers has any potential conflict of interest between their duties to the Bank and their private interests and/or their duties to third parties.

14.4 None of the Directors or Senior Managers has or has had any interest in any transaction which is or was unusual in its nature or conditions or significant to the business which was effected by the Bank or any of its subsidiaries during the current or immediately preceding financial year, or which was effected during an earlier financial year and remains in any respect outstanding or unperformed.

14.5 None of the Directors or Senior Managers has or had a beneficial interest in any contract to which the Bank or any of its subsidiaries was a party during the current or immediately preceding financial year.

14.6 Except as disclosed below, no Director or Senior Manager was selected to act in such capacity pursuant to any arrangement or understanding with any shareholder, customer, supplier or any other person having a business connection with the Bank or any of its subsidiaries.

Pursuant to the Articles of Association of the Bank, which will be proposed for approval at a general meeting of the Bank to be held on 15 November 2013, and as referred to in the Relationship Agreement, Co-operative Group will have the right to nominate up to two persons to be members of the Board for so long as certain circumstances continue to exist. As at the date of this Prospectus, Co-operative Group's nominated directors are Euan Angus Sutherland and Bennett Lyle Edward Reid and they are intended to constitute as such under the Articles of Association of the Bank. Please refer to paragraph 20.3 titled "*Relationship Agreement*" in this Section 20 (*Additional Information*) for further details of the Relationship Agreement.

14.7 There are no family relationships between any of the Directors or Senior Managers.

15. MATERIAL SHAREHOLDINGS

Apart from the Liability Management Exercise, the result of which, if successful, will reduce Banking Group's shareholding of the issued Ordinary Shares in the Bank to 30 per cent., the Bank and the Directors are not aware of any arrangement the operation of which may at a subsequent date result in a change in control of the Bank.

16. SHARE INCENTIVE PLANS

The Directors intend to consider after completion of the Liability Management Exercise the long-term incentive arrangements over the Ordinary Shares of the Bank and will seek shareholder approval in respect of such arrangements, as required.

17. PENSION SCHEMES

(a) Summary of UK pension benefits

17.1 The Co-operative Pension Scheme (Pace) (**Pace**)

The Bank participates in Pace. Pace is a non-segregated hybrid scheme providing defined contribution benefits and defined benefits based on a member's average career salary and length of contributory membership of the scheme. The defined contribution benefits are provided under two defined contribution sections, Pace Essential (**Pace Essential**) and Pace Extra (**Pace Extra**). Although any employee may join the Pace Essential and the Pace Extra sections, employees can choose to join the defined benefit section, Pace Complete (**Pace Complete**), once they have completed two or more consecutive years' service. In addition,

benefits accrued on a defined benefits basis prior to 6 April 2006 continue to be linked to final salary. The introduction of the automatic enrolment legislation requires qualifying employees to be automatically enrolled into a pension scheme and Pace Essential was designed with this legislation in mind.

As at June 2013, Pace had 133,826 members (54,984 active members (of whom 15,193 belong to Pace Complete), 41,591 deferred pensioners (of whom 40,226 belong to Pace Complete) and 37,251 pensioners (all of whom belong to Pace Complete)). Members of Pace Essential make contributions of 1 per cent. with Co-operative Group and those of its subsidiaries participating in Pace contributing 2 per cent. and members of Pace Extra make contributions of 4 per cent. with Co-operative Group and those of its subsidiaries participating in Pace contributing 8 per cent. The member contribution rate to Pace Complete is currently 8 per cent. In the financial year ended 31 December 2012 the Bank made contributions of £29.1 million to Pace (of which £8.3 million related to the past service deficit in Pace Complete).

Pace is currently undergoing an actuarial valuation as at 5 April 2013. The most recent actuarial valuation of Pace was carried out as at 5 April 2010. This valuation reported assets at a value of £5,827 million and liabilities of £6,075 million and a funding deficit of £248 million. The most recent update to this valuation as at 5 April 2013 indicated that the funding deficit had increased to £715 million. Under the schedule of contributions agreed following the 2010 actuarial valuation, the participating employers in Pace agreed to pay deficit reduction contributions of £20 million a year, from 1 April 2011 until 31 March 2019 inclusive. In the financial year ended 31 December 2012, the Bank contributed £8.3 million out of the £20 million.

17.2 Britannia Pension Scheme (the **Britannia Scheme**)

The Bank has granted two guarantees in respect of the Britannia Scheme: one in respect of CFSMS' scheme funding and employer debt obligations in relation to the Britannia Scheme and one in respect of the participating employers' liabilities in relation to the Britannia Scheme up to 105 per cent. funding on the section 179 Pensions Act 2004 valuation basis, which is used for the purposes of calculating the scheme-based element of the Pension Protection Fund levy payable by a defined benefit pension scheme. The Britannia Scheme is a hybrid scheme providing defined benefit and defined contribution benefits. The Britannia Scheme closed to future accrual from 6 October 2012. Defined benefits built up to this date continue to be linked to final pensionable salary at a member's date of leaving or retirement, whichever is earlier. As at 5 April 2013, the Britannia Scheme had 5,138 members (734 active/closure members, 3,290 deferred pensioners and 1,114 pensioners). Members of the Britannia Scheme were invited to join Pace in October 2012.

The most recent actuarial valuation of the Britannia Scheme was carried out as at 5 April 2011. This valuation reported that there was a deficit on the funding basis of £3.7 million. A lump sum was paid to the Britannia Scheme of £3.7 million by 30 April 2012 to eliminate this deficit. The most recent update to this valuation as at 5 April 2013 indicated that the funding deficit had increased to £61 million. During the financial year ended 31 December 2012, the Bank paid £7.9 million to the Britannia Scheme to cover contributions to the defined benefit and defined contribution sections and contributions under salary sacrifice. A fixed allowance of £1 million per annum for running expenses was also paid. As the Britannia Scheme is now closed to future accrual, there will be no further contributions in respect of future service accrual.

17.3 Other pension schemes

The Bank is connected and/or associated with employers in Co-operative Group that participate in other Co-operative Group defined benefit pension schemes, all of which are closed to new entrants and future accrual (other than a final salary link for past service). The Bank does not however participate in or guarantee the liabilities of these schemes.

17.4 Unfunded arrangements

The Bank operates several unfunded unregistered retirement benefit arrangements relating to a discretionary early retirement facility and pension arrangements for current and former Bank executives. The most recent actuarial valuations of these arrangements indicated that the Bank's unfunded pension liabilities amounted to £4 million as at 31 December 2012.

(b) Co-operative Group has engaged in discussions with the trustees of the funded pension schemes and the Pensions Regulator. These discussions have centred on the effect on the pension schemes of the turnaround plan, in particular on the future funding of the pension schemes and the position of the trustees as creditors compared with that of other creditors. These discussions have not yet concluded and Co-operative Group continues to seek to satisfy the trustees and the Pensions Regulator on the matters they have raised.

(c) There are currently no provisions made or amounts set aside or accrued by the Bank for the pensions of the Directors and Senior Managers for the year ended 31 December 2012.

(d) Summary of overseas pension benefits

Britannia International Limited, a wholly owned subsidiary of the Bank, contributes to a group personal pension plan, called the Britannia International Group Personal Pension Plan. This is a defined contribution arrangement in the Isle of Man.

18. SIGNIFICANT SUBSIDIARY AND ASSOCIATED UNDERTAKINGS

18.1 The following table shows details of the Bank's significant subsidiary companies:

Name	*Owner*	*Percentage Ownership*	*Country of incorporation/ residence*	*Principal activity*
Unity Trust Bank plc *(held through subsidiary undertaking)*[1]	Bank	27	England	Banking
Co-operative Commercial Limited	Bank	100	England	Investment company
First Roodhill Leasing Limited	Bank	100	England	Leasing
Second Roodhill Leasing Limited	Bank	100	England	Leasing
Third Roodhill Leasing Limited	Bank	100	England	Leasing
Fourth Roodhill Leasing Limited	Bank	100	England	Leasing
Britannia Treasury Services Limited	Bank	100	England	Holding company
Britannia Asset Management Limited	Bank	100	England	Holding company
Britannia Development and Management Company Limited	Bank	100	England	Property investment
Illius Properties Limited	Bank	100	England	Property investment
Moorland Covered Bonds LLP	Bank	100	England	Mortgage acquisition and guarantor of covered bonds
Britannia International Limited	Bank	100	Isle of Man	Deposit taking
Britannia Life Direct Limited	Britannia LAS Direct Limited[2]	100	Scotland	Direct sales of financial services
Mortgage Agency Services Number One Limited	Britannia Treasury Services Limited	100	England	Mortgage and syndicated lending

Name	*Owner*	*Percentage Ownership*	*Country of incorporation/ residence*	*Principal activity*
Mortgage Agency Services Number Two Limited	Britannia Treasury Services Limited	100	England	Mortgage lending
Mortgage Agency Services Number Four Limited	Britannia Treasury Services Limited	100	England	Mortgage lending
Mortgage Agency Services Number Five Limited	Britannia Treasury Services Limited	100	England	Mortgage lending
Mortgage Agency Services Number Six Limited	Britannia Treasury Services Limited	100	England	Mortgage lending
Western Mortgage Services Limited	Britannia Treasury Services Limited	100	England	Mortgage book administration
Platform Group Holdings Limited	Britannia Treasury Services Limited	100	England	Holding Company
Platform Consumer Services Limited	Platform Group Holdings Limited	100	England	Mortgage lending
Platform Funding Limited	Platform Consumer Services Limited	100	England	Mortgage origination
Platform Home Loans Limited	Platform Consumer Services Limited	100	England	Mortgage origination and servicing

Notes:

(1) Unity Trust Bank plc is considered to be a subsidiary undertaking of the Bank as the Bank elects a majority of the directors and appoints the chair and managing director. This provides the power to control.

(2) Britannia LAS Direct Limited was incorporated in Scotland and is a dormant wholly-owned subsidiary of the Bank.

18.2 The results of the principal securitisation vehicles listed below are consolidated into the results of the Bank under SIC 12 (Consolidation: Special Purpose Entities). All securitisation vehicles are registered in England and operate in the UK.

Name	*Principal activity*
Leek Finance Number Seventeen plc	Securitisation company
Leek Finance Number Eighteen plc	Securitisation company
Leek Finance Number Nineteen plc	Securitisation company
Leek Finance Number Twenty plc	Securitisation company
Leek Finance Number Twenty One plc	Securitisation company
Leek Finance Number Twenty Two plc	Securitisation company
Meerbrook Finance Number One Limited	Securitisation company
Meerbrook Finance Number Two Limited	Securitisation company
Meerbrook Finance Number Three Limited	Securitisation company
Meerbrook Finance Number Four Limited	Securitisation company
Meerbrook Finance Number Six Limited	Securitisation company
Silk Road Finance Number One plc	Securitisation company
Silk Road Finance Number Two plc	Securitisation company
Silk Road Finance Number Three plc	Securitisation company
Cambric Finance Number One plc	Securitisation company

19. PROPERTY, PLANT AND EQUIPMENT

19.1 The following are the principal establishments and assets of the Bank and its subsidiaries:

Name and Location	*Notes*	*Type of facility/asset*	*Tenure*
9th Floor Arndale Tower Manchester M3 3AQ	1	Office	Leasehold
CIS Building Miller Street Manchester M60 0AL	2	Office	Leasehold
The Money Centre Drake Circus Plymouth PL1 1QH		Office	Leasehold
Britannia House Cheadle Road Leek Staffordshire ST13 5RG	3	Office	Freehold
Newton House Leek ST13 5RG	4	Office	Freehold
Prescot Street 9 Prescot Street London E1 8AZ		Office	Leasehold
1 Balloon Street Manchester M60 4EP		Office / Branch	Leasehold

Name and Location	*Notes*	*Type of facility/asset*	*Tenure*
Olympic House 6 Olympic Court Montford Street Salford Greater Manchester M5 2QP		Data Centre	Freehold
Montford House Unit 540 Montford Court Montford Street Salford Greater Manchester M5 2SN		File Store	Leasehold
Delf House Southway Skelmersdale Lancashire WN8 6NY	5	Office	Leasehold
Pennylands CNT Building Pennylands Skelmersdale Lancashire WN8 8AZ		Office	Freehold
The Pyramid Kings Valley Office Park Yew Street Stockport Cheshire SK4 2JN	6	Office	Freehold
Sandalwood Court Springwood Way Tytherington Business Park Macclesfield SK10 2XR		Data Centre	Leasehold
St Pauls House 8-12 Warwick Lane London EC4M 7BP	7	Office	Sublease

Notes:

(1) CFSMS has a lease over this property which is guaranteed by the Bank. It is expected that the Bank will have the right to occupy the property pursuant to an underlease which will be entered into on arm's length commercial terms and in the ordinary course of business.

(2) Co-operative Group owns the freehold to this property. The Bank will shortly be acquiring a lease over the property from Co-operative Group which will be entered into on arm's length commercial terms and in the ordinary course of business.

(3) The freehold for this property is owned by a wholly-owned subsidiary of the Bank and the Bank has a lease over the property with the subsidiary.

(4) The freehold for this property is owned by a wholly-owned subsidiary of the Bank and the Bank has a lease over the property with the subsidiary.

(5) The Bank had a 25-year lease over this property which ended on 28 September 2013. The Bank is currently in negotiation with the landlord over the terms of renewal.

(6) The freehold for this property is owned by a wholly-owned subsidiary of the Bank and the Bank has a lease over the property with the subsidiary.

(7) Co-operative Group owns the interest in the head-lease to this property. The Bank will shortly be acquiring a sublease over four floors of the property with Co-operative Group which will be entered into on arm's length commercial terms and in the ordinary course of business.

19.2 No single tangible fixed asset (including property, plant and equipment) accounts for more than 10 per cent. of the Bank's net turnover or production.

20. MATERIAL CONTRACTS

The following is a summary of each contract (not being a contract entered into in the ordinary course of business) that has been entered into by the Bank or any of its subsidiaries either (a) within two years preceding the date of this document which are material to the Bank or any of its subsidiaries; or (b) at any time and contains any provision under which the Bank or any of its subsidiaries has an obligation or entitlement that is material to the Bank or any of its subsidiaries and is outstanding at the date of this Prospectus:

20.1 Project Unity

In connection with Project Unity, the Bank and CFSMS entered into intra-group agreements between 2011 and 2013 to govern the provision of certain services by Co-operative Group (as service provider) to Banking Group (as service recipient). The Bank expects to enter into amended versions of these agreements on or prior to completion of the Liability Management Exercise. Details of the current agreements and the revised agreements in the form in which they were contemplated for the purposes of the 17 June Plan, are summarised below. As mentioned in paragraph 8 titled "*Separation*" in Section 8 ("*Description of the Bank*"), the Bank and Co-operative Group are considering whether any additional amendments (including to the scope of services and key terms) are required to the Project Unity agreements to reflect that Co-operative Group will be a minority shareholder in the Bank following completion of the Liability Management Exercise.

(a) IT Services Agreement

The Bank currently receives IT services under an agreement dated 5 July 2012 (as amended and restated from time to time and including most recently on 22 May 2013) with Co-operative Group and CFSMS, pursuant to which Co-operative Group provides members of Banking Group and Co-operative Insurance Society Limited with a wide range of IT services (the **Existing IT Services Agreement**). It is intended that the Existing IT Services Agreement will be amended prior to or on completion of the Liability Management Exercise.

The Bank originally appointed CFSMS as its agent in order to perform all of its obligations and exercise all of its rights under the Existing IT Services Agreement. However, in light of the importance of these services to the Bank, it was proposed under the New IT Services Agreement, that Bank terminate the appointment of CFSMS as its agent so that it could enforce its rights directly against Co-operative Group.

Under the New IT Services Agreement contemplated for the 17 June Plan, it was proposed that Co-operative Group provide the Bank with the following services:

- colleague technology services (the technologies that individuals rely upon to do their daily work), including:
  - Bank branch maintenance – support and the maintenance of the agreed equipment of the agreed branch estate;
  - managed print services – technical support, repair and provision of multifunctional devices and printers for all sites as agreed,
  - e-mail and collaboration – maintain and make available the email and collaboration services (e.g. intranet); and
  - managed desktop and mobile devices – provide software and hardware support for the desktops and mobile devices;

- network services (provision of the communications infrastructure), including:
    - data network services – maintain and make available the data network infrastructure to support the services;
    - voice network services – maintain and make available voice network and telephony infrastructure to support the services; and
    - remote access services – provision and maintain the remote access services to allow remote workers to connect securely to the data network;
- core services (provision of the main computing infrastructure), comprising:
    - enterprise computing: (i) mainframe services; (ii) mid-range services; (iii) database services; (iv) storage management; (v) capacity planning; and (vi) intel services. This service maintains current and future availability of the mainframe and mid-range computing environments to host the business's applications, supported with appropriate database and storage technologies, to meet the business's current and forecasted requirements;
    - output management – develop and maintain bulk print management solutions to support customer correspondence according to the needs of the business;
    - middleware services – maintain and make available the (middleware) services to ensure that all data and messages are successfully delivered between key systems and internal and external services;
    - systems management – maintain and make available the systems management environments to ensure that all key platforms, systems and services are proactively managed in line with agreed service levels;
    - data centre management – provide and manage data centre facilities required to host the computer hardware and infrastructure required to deliver the services; and
    - computer operations and production support – running the online services and continuous batch processing of mainframe and mid-range computer systems that deliver the services;
- service management services (support for the day-to-day operational service and future service planning);
    - problem management – to minimise the adverse impact of problems resulting from one or more incidents;
    - change management – provide standardised methods and procedures for the handling of IT/project change and mandatory IT/project change in order to minimise disruption to the services;
    - service desk and incident management – provide a single point of contact for incident notification and escalation and to attempt 'first level' incident resolution, and to manage incidents that have not been classed as major incidents from detection to restoration so as to endeavour to minimise the adverse impact of incidents;
    - major incident management – manage incidents that have been classed as 'major incidents' from detection to the point of service restoration;
    - request fulfilment – provide capability for the logging of service requests to order IT supplied goods and services, and the subsequent management of such service requests through to completion;

    - service level management (management information and reporting) – manage the quality, quantity and performance of the services provided; and
    - capacity management – provide infrastructure capacity management service based upon customer projection and current usage;
- change management services (support the introduction of new/amended systems and infrastructure);
    - environment management – ongoing support, management (including rationalization), monitoring and reporting of the non-production environments;
    - non-function testing service – operational acceptance testing, performance testing;
    - data provision services – provide compliant data provisioning and control services in compliance with data governance policy, data protection policy and security policies and standards;
    - infrastructure build – build required infrastructure components as defined in the infrastructure design document that complies with agreed IT policies and standards;
    - service authority – to ensure that new systems can be accepted into IT operations without disruption, or to prepare IT operations for the transition of new systems; and
    - technical design – the creation, documentation and agreement of the design of IT programmes which would be built to meet the requirements of a new project;
    - IT programme management office – provide a centralised IT Programme Management Office (**PMO**). The PMO would define and maintain all IT frameworks and standards for the 'delivery community'. The PMO would also be the source of guidance and metrics whilst assuring quality and management information on all supported projects; and

It was proposed that the IT service continuity and disaster recovery function, which is currently provided to the Bank by Co-operative Group under the Existing IT Services Agreement, would return to the Bank under the New IT Services Agreement and that Bank would manage the Bank's receipt of Co-operative Group's provision of these services.

Under the New IT Services Agreement it was further proposed that Bank would manage the receipt of the Co-operative Group's provision of the services provided. The Bank's head of 'IT Service Management' (who reports into the Bank's Chief Information Officer) will manage the receipt of the services provided by Co-operative Group under the New IT Services Agreement.

Key Terms of the New IT Service Agreement

The day-to-day operational management of the services supplied under the New IT Services Agreement would be monitored by a Co-operative Group contract manager (as the supplier of the services), a Bank contract manager (as a customer), functional leads for Co-operative Group and the Bank and risk, audit and compliance for the Bank.

Under the New IT Services Agreement, unless service levels are expressly agreed between the parties in respect of a service to be provided under the agreement, Co-operative Group would be required to provide the services to the same standards as those provided to Banking Group before the service commencement date. The Bank would be required to ensure that its systems are in good working order and suitable for purpose, and assets are maintained to a reasonable level of currency. Co-operative Group would be relieved from its responsibility to provide the

services where caused by failure of any Bank system, or any legacy Bank systems used by Co-operative Group, which would have a material adverse effect on the ability of Co-operative Group to provide the services.

Under the New IT Services Agreement, services would be provided by Co-operative Group in accordance with Co-operative Group policies, unless Co-operative Group and the Bank agreed, or agreed in the future, that a Bank policy should apply in substitution for the relevant Co-operative Group policy. The Bank could require that Co-operative Group provides the services in accordance with Bank policies where required by law or a regulator.

Charges would be paid quarterly and in arrears unless a "Special Resolution Event" occurred, in which case charges would be payable three months in advance.

The New IT Services Agreement would continue in force until terminated by any party.

The Bank would have step-in rights to perform or manage the services, or appoint a third party to do so, upon notice to Co-operative Group following the occurrence of certain defined trigger events (e.g. a material breach by Co-operative Group). An exit plan would be prepared and kept updated. During the exit period, Co-operative Group would be required to provide any reasonable assistance required by the Bank to allow relevant services to continue.

The Bank and CFSMS would each be entitled to nominate persons to which all or part of the business of a service recipient had been transferred as a result of a special resolution event, excluding affiliates of service recipients (**Special Resolution Recipients**) who would be entitled to the benefit of the New IT Services Agreement for an interim period. Any Special Resolution Recipient could enforce certain provisions in the agreement even though the relevant provision may only refer to the Bank or other service recipients. Co-operative Group, upon request by the service recipient, would offer to enter into a direct agreement with the Special Resolution Recipient to which all or part of the business of the service recipient has been transferred for the supply of services on the same terms as the New IT Services Agreement. The Bank and CFSMS would each be entitled to nominate divested entities (which include normal course of business disposals as well as disposals on a special resolution event) to receive services under the New IT Services Agreement and exit services for up to 12 months, but with the addition of a mark-up of 20 per cent. on the charges. During the interim period prior to the Special Resolution Recipient entering into a direct agreement with Co-operative Group, the Bank would remain responsible for payment of any charges in relation to services provided to Special Resolution Recipients nominated by the Bank, as well as for any liability arising from any act or omission of the Special Resolution Recipient that would have given rise to liability on the part of the Bank if it was an act or omission of the Bank.

(b) MSA

The Bank entered into a professional services master services agreement with Co-operative Group and CFSMS dated 14 February 2013 (as amended from time to time) pursuant to which Co-operative Group provides the Bank with certain services (the **Existing MSA**). It is intended that the Existing MSA will be amended prior to or on completion of the Liability Management Exercise. The Bank initially appointed CFSMS as its agent in order to perform all of its obligations and exercise all of its rights under the Existing MSA. However, in light of the importance of these services to the Bank, it was proposed under the New MSA that Bank terminate the appointment of CFSMS as its agent so that it could enforce its rights directly against Co-operative Group.

The New MSA is a framework agreement, intended to establish a flexible contractual arrangement to enable the Bank and CFSMS to obtain certain professional services from Co-operative Group as agreed from time to time in service contracts.

Service contracts that would be entered into pursuant to the New MSA would be in substantially the same form as one another as they are to be based on a template contained in

the New MSA and serve to give effect to and implement the purposes of the New MSA. Each service contract would detail the services to be provided under that service contract and include details of certain key provisions relating to the term, charges, service levels, governance and business continuity. Each service contract would also contain an exit plan based on a template contained in the New MSA and any other additional requirements specific to the services being provided pursuant to that service contract.

As contemplated for the 17 June Plan, it was proposed that services contracts would be entered into (on or before completion of the Liability Management Exercise) in relation to the following:

(i) Secretariat (Governance)

Under the Existing MSA the Bank's secretariat governance function is provided by Co-operative Group. Pursuant to the New MSA, the company secretary for the Bank and the Bank chair would be appointed by the Bank's Board, reporting to the CEO of the Bank and the Bank chair, and would lead a team of specialist company secretaries. The Bank company secretary's duties will include:

- setting governance schedules and agendas in line with the Bank's requirements and obligations; and
- directing the preparation of company records, accounts and regulatory returns and, at his discretion, utilising administrative support from Co-operative Group.

Co-operative Group would provide the following logistical and administrative support to the Bank, as directed by the Bank:

- organising meetings (including annual general meetings, board meetings, and board committee meetings);
- collating briefing materials (as per the agenda) on segregated file storage to maintain confidentiality;
- distributing briefing materials via segregated infrastructure; and
- signing and sealing of documents as required.

Minutes of meetings would be kept by the company secretary of the Bank and be distributed via Co-operative Group's logistical and administrative support function.

The operation of the FCA Approved Persons Regime would, under the New MSA, continue to be undertaken within the Bank.

Monthly service reviews would monitor the effectiveness of Co-operative Group's logistical and administrative support to the Bank, with operational issues being escalated by the Bank's company secretary to Co-operative Group's company secretary.

(ii) Legal

Under the Existing MSA, Co-operative Group provides the Bank with a variety of legal services. Under the New MSA, Co-operative Group would no longer provide these services to the Bank. Instead, the Bank would, on or prior to completion of the Liability Management Exercise, appoint a General Counsel (as 'Head of Legal') to report to the CEO of the Bank. The Bank's Head of Legal would be supported by the following specialist legal roles:

- 'Senior Manager Treasury (Legal)' with a supporting team of appropriate expertise providing core bank corporate banking and treasury markets capability; and

- 'Head of Regulatory (Legal)' with a supporting team of appropriate expertise providing regulatory support product documentation and compliance capability.

(iii) Corporate Affairs

Under the Existing MSA, Co-operative Group provides the Bank with corporate affairs services (which comprises (a) internal communications; (b) public relations; (c) public affairs; and (d) social goals and sustainability and ethics).

Under the New MSA, these functions would be controlled and managed by the Bank. The Bank would provide Co-operative Group with instructions in the form of briefing memos, setting out the communication action to be carried out by Co-operative Group, who would execute the instructions. Furthermore, pursuant to the New MSA, the parties to the New MSA would establish a service management framework under which the Bank would conduct a monthly review of the corporate affairs services to be provided by Co-operative Group.

Internal Communications

The 'Internal Communications' function:

- promotes employee engagement;
- deals with the communication of day-to-day business information and updates to employees;
- provides advice and practical support to senior managers delivering major change programmes;
- protects, promotes and enhances business interests and corporate reputation through internal communications; and
- designs, develops and implements employee-influencing strategies to shape regulation and legislation for the benefit of the Bank.

Investor Relations

Under the New MSA, the Bank's 'Investor Relations' function would be led from within the Bank by a 'Head of Investor Relations', who would be responsible for the Bank's Investor Relations activities and would provide direction to Co-operative Group's public relations team, who would carry out the Head of Investor Relations' directions.

Public Relations

The Bank's 'Public Relations' function consists of: (i) reputational risk management; (ii) PR campaign management; (iii) PR monitoring and evaluation; and (iv) media relations.

Public Affairs:

The 'Public Affairs' function:

- protects, promotes and enhances business interests and corporate reputation;
- designs, develops and implements influencing strategies to shape regulation and legislation for the benefit of the Bank;
- provides timely monitoring and intelligence to the Bank executive on legislative developments and advises on their potential significance, monitoring the external political and regulatory landscape with a view to managing challenges and opportunities in terms of reputational impact;

- supports development and promotion of public policy positions;
- advises and provides guidance to senior managers to support their engagement with public affairs stakeholders; and
- identifies and optimises business development opportunities created and controlled by government.

Social Goals & Sustainability and Ethics

Direction of this service would be set by the Bank's ethical policy and plan which is approved by the Bank's board of directors. Oversight would be provided throughout at the Bank's executive meetings.

The 'Social Goals and Sustainability and Ethics' function provides the following services:

- New SME customer 'ethical checking' for the Bank;
- protecting, promoting and enhancing corporate reputation;
- direction on sustainability matters, in particular via Co-operative Group ethical plan;
- day-to-day management of environmental, ethical, community and sustainability programmes;
- support for the management of relations with democratic structures/active democrats;
- oversight of the distribution of Co-operative Group community dividend and operational management of connected community and campaigns programmes;
- sustainability accounting and reporting;
- management of the implementation of the Bank's ethical policy, home and motor insurance products;
- management of ISO140001 environmental management certification;
- advice and practical support;
- securing external recognition for the service recipients, e.g., FT Sustainable Bank of the Year; and
- stakeholder engagement and investment and campaigns management services with the common objective of ensuring that Co-operative Group would be viewed as the UK's most socially responsible business.

(iv) Marketing

The direction of the Bank's marketing strategy is currently determined by the Bank's Distribution Director via the Bank's governance forums (being the Bank's customer committee, the data governance forum and quality assurance committee). The Bank's distribution director (for the Core Business) from within the Bank is responsible for the 'Marketing' function of the Bank and directs Co-operative Group on the marketing services it requires. Under the New MSA, Co-operative Group would be required to provide those services in accordance with the Bank's instructions. In addition, Co-operative Group would provide the Bank with the following support services:

- *Insight* – Customer level analytics, input into customer contact strategies, provision of agency partner options and marketing campaign and research projects management and delivery;
- *Brand* – (i) support, guidance and governance over the use of the Co-operative brand including any relationships with businesses which subscribe to the brand and its services, including sponsorship relationships; (ii) digital marketing best practice guidance; (iii) management and appointment of marketing rostered agencies; (iv) brand governance and sponsorship; and
- *Membership* – provides members who join Co-operative Group membership scheme through the Bank with an identical membership service to the membership they provide to any other member.

(v) Finance

Under the New MSA, the Bank would produce all of its financial accounts information in respect of the Bank and its subsidiaries. However, the Bank would utilise Co-operative Group's 'Finance Shared Service Centre', an accounting administration function established within Co-operative Group, to undertake the bulk of general transactional finance processes and Co-operative Group would provide general transactional finance process services required to operate the Bank's business.

In particular, Co-operative Group's Finance Shared Service Centre would provide the Bank with the following services:

- accounting support for financial control including general ledger and Bank reconciliations, accruals and prepayments, journal processing and system integrity balancing, cash allocation and cash management, cost centre management inquiries and support, IS invoice matching and processing, corporate invoicing, insurance premium tax returns preparation, AP – master-file maintenance and Leek CHAPS processing;
- accounts payable – includes processing and payment of supplier invoices/staff expenses and management of supplier relations in respect of processing and payment of services;
- accounts receivable – credit management services, activities include processing and despatch of customer sales ledger, credit risk assessments, credit control activities through to litigation, processing and reconciliation of sales ledger payments, debtor reporting and review meetings with business partners, reconciliation, accounting and reporting of redeemed coupons;
- processing and resolution of claims relating to direct deliveries invoicing;
- processing of GI cheque stops and the POSPAY process (a system for validating cheques in the clearing cycle);
- current account servicing in branches reconciliation and settlement;
- maintenance of the delegated financial authorities database and ensuring adherence to the delegated financial authorities policy; and
- supplier and process compliance, reporting and development.

Procurement

Under the New MSA, Co-operative Group would provide the Bank with procurement services at the direction of the procurement director of the Bank, facilitating the purchase of all of the Bank's goods and services, to the extent that they fall within the

scope of Co-operative Group procurement policy. This would include (i) running supplier tenders and sourcing; (ii) developing business insight across categories and business areas to support informed sourcing activity; (iii) forming sourcing teams to effectively source goods and services; (iv) consolidating service requirements into standard tender documents; (v) directing tendering approach and evaluation criteria; (vi) providing expert industry knowledge and market intelligence to the sourcing process; (vii) planning and providing skilled negotiation support; (viii) commercially evaluating supplier proposals; (ix) making recommendations regarding supplier award; (x) undertaking supplier financial due diligence and facilitating reasonable other forms of due diligence with customer functional experts (i.e. data security, IT security etc.) highlighting to the business potential risks to inform award decisions; (xi) providing support during significant contractual changes and disputes; (xii) engaging with the Co-operative Group's legal team to implement a robust supplier contract; (xiii) co-ordinating the signing of contracts; (xiv) supporting the Bank in the smooth transition and implementation of these services; (xv) recommending annual savings targets to the Bank; (xvi) highlighting, where possible, areas of missed savings opportunity; ensuring all contract and supplier commitments are signed off through the appropriate channel in line with the customer's delegations of authority and governance hierarchy as advised to Co-operative Group by the customer. The Bank would instruct Co-operative Group on the services it required Co-operative Group to provide.

Tax

Under the New MSA Co-operative Group would provide the Bank with tax assistance. Co-operative Group would report to the Bank's chief financial officer on tax matters and would provide the following tax-related services:

- fulfilling the Bank's statutory and regulatory obligations for corporation tax, value added tax, insurance premium tax, operational taxes and PAYE;
- preparation of current and deferred tax provisions and disclosure notes for inclusion in statutory accounts; and
- managing the relationship with external and internal auditors, and external advisers in respect of tax affairs.

Acquisitions & Disposals

Pursuant to the New MSA, Co-operative Group would provide the Bank with assistance on acquisitions and disposal, when instructed to do so by the Bank. The services which may be provided by Co-operative Group to the Bank in this regard include: (i) overall acquisitions & disposal strategy; (ii) pre-transaction analysis, including methodologies for evaluation of potential acquisition targets including financial and strategic fit metrics, potential synergies and transaction implications; and (iii) structuring transactions; and (iv) undertaking M&A transactions; and appointing and managing external advisers.

(vi) Corporate HR

The Bank's HR function is currently led from within the Bank by the Bank's HR director and is responsible for all of the Bank's HR activities. Existing HR teams within the Bank provide regulatory training, managers advice (the 'Ask HR' service) and resourcing and will be extended to exert appropriate control over services provided by third parties and Co-operative Group and oversee the correct governance and control processes including the appropriate Bank risk framework, and the following services:

- business partnering – providing a service to the retained Bank including the Core Business and the Non-core Business as well as the relevant support services; and

- service management for HR contracts, people risk and Bank policy.

Under the Existing MSA Co-operative Group's 'Corporate HR' function provides the Bank with the following services:

- employee relations: employee relations strategy and policy;
- reward: reward strategy, benefits administration, policy framework, benefits management and organisation design;
- talent and organisational capability: talent sourcing for leadership roles, senior talent assessment, graduate programme and apprenticeships;
- employee engagement & diversity – annual employment measurement survey, diversity policy and the employee assistance programme;
- pensions: provision of pension scheme for Bank employees, advice, governance and risk management; and
- HR policy development, advice and communications.

Co-operative Group seeks to provide these services in a way that enables the Bank to comply with applicable law and regulation.

(vii) People Services

Under the New MSA, the Bank would continue to utilise Co-operative Group's HR shared service centre and people services established within Co-operative Group, to undertake the bulk of general transactional HR processes required to operate the Bank's business.

In particular, Co-operative Group's HR shared service centre would provide the Bank with the following services:

- service delivery advice line: advice and support from trained advisers on payroll related queries and advice, new starter administration, general HR administration and routing of appropriate tier two calls to the Bank 'Ask HR' team;
- payroll: payments to the Bank's employees including salary, bonus and deductions. The payroll and administration service would continue to be provided by Co-operative Group under the New MSA as an arm's length agreement. The service has been provided in this way for nearly 12 months. The service operates through a series of control meetings including weekly operational service meetings, periodic service review meetings and quarterly executive review meetings. The HR Director for the Bank oversees control of the service and the service manager reports directly to the HR Manager;
- HR self service: Oracle HRMS Self Service;
- HR administration: for exit and family friendly policies;
- new starters: on-boarding activities and pre-screening activities in line with Bank defined screening policy;
- HR governance, portfolio & management information: provision of management information to the Bank HR Director's requirements;
- HR systems and support: for HR technology

The Bank HR service management function would manage the services provided by the 'Corporate HR' and 'People Services'. It would be managed and controlled according

to the governance framework within the Existing MSA, with formal monthly service review meetings and a quarterly executive meeting. As part of the service review meetings the risks would be reviewed and any mitigating actions agreed. The Bank's risk, control and self-assessment processes would be used as well as the agreed governance framework. The service would also be reviewed by the third line Bank audit function.

(viii) Estates

This service was established pre-Unity, and would continue to be provided by Co-operative Group. Direction would be provided by the Bank, either directly in the form of Bank strategy, or as acceptance/rejection of recommendations from Co-operative Group in response to the Bank strategy or requirements. Conflicts of interest would be avoided by allocating separate individual representation for Co-operative Group and the Bank in any situation where a conflict could arise. Dedicated service management would be established within the Bank to ensure:

- focused and relevant management information is delivered;
- service is provided as agreed;
- costs are managed; and
- governance and control via five separate (monthly and quarterly) forums.

Services to be provided by Co-operative Group under the New MSA would include:

- facilities management shared services: manage the maintenance and repair of property assets and property services that are delivered through a number of third parties;
- project management and construction;
- trading property:
- property management service to maximise long-term value of the Bank's trading premises (branches etc.) whilst minimising costs and ensuring that the Bank can maintain and fulfil its contractual obligations as a tenant or owner of those trading properties;
- analysis, locating and acquiring and disposing of the Bank branches;
- capital investment service, for expert planning and effective delivery of planned investments into the Bank branch estate;
- commercial and investment property;
- ensures the Bank meets its contractual obligations as a landlord or tenant, and realises value from its non-trading properties (eg vacant branches, adjunct premises, onerous leasehold properties and other property investments);
- acquisition and disposal of major occupancies;
- energy, environment and engineering tenders for and purchases utilities using Co-operative Group's buying power and professional expertise in buying and negotiating for utilities, and in line with the Bank's energy risk management policy and procedures; and
- premises strategy and business change strategic direction and workplace strategy for the major occupancies, in line with business requirements. Plans and delivers

moves, capital works and business programmes across the major occupancy estate.

(ix) Illius (Property Management)

Co-operative Group would ensure the long-term value of the residential properties that were transferred into Illius Properties Limited is maximised. This would be done by seeking to hold the portfolio until a point in time when each disposal can be achieved in suitable market conditions, and meanwhile seeking to rent the property.

(x) Risk

Co-operative Group would return the following services to the Bank, specifically:

- specific crime or act of reputational damage (fraud investigations team) – investigation and prevention of certain specific crimes or acts of reputational damage; namely employee fraud; external fraud in excess of £25,000; linked funds; external frauds; vulnerable victims of fraud; repeated allegation frauds; incidents with serious reputational impact etc.
- business continuity, health & safety and environmental compliance oversight; and
- insurance: expertise to provide direction and to set strategy in respect of risk appetite and pricing.

Co-operative Group would continue to provide the following services:

- health and safety and environmental compliance – expertise would be required in the Bank to provide oversight;
- health and safety – ensuring the Bank meets its health and safety obligations in respect of employees, subcontractors, visitors, customers and the general public, including health and safety assessments, training and incident management;
- fire – ensuring the Bank meets its obligations to comply with current fire safety legislation, ensuring it protects its employees, subcontractors, visitors, customers and the general public from the dangers of fire, including fire prevention, assessment, training, drills and incident management;
- environmental compliance – ensuring the Bank maintains its compliance with all applicable environmental laws and regulations, as well as helping to identify and correct unregulated environmental hazards, including by managing environmental risks and incidents;
- business continuity – ensuring the Bank has tactical capacity to plan for and respond to incidents and business disruptions in order to continue business operations at an acceptable pre-defined level, including business continuity planning, support and compliance monitoring;
- crime – investigation and prevention of general crimes, such as: robbery, burglary, minor physical assault, arson, suicide, riot and terrorism;
- physical security – specify requirements, prepare policy and provide support to ensure all Bank's premises are safe and secure at all times so as to protect and preserve people, assets and premises. Including through specification of physical security requirements; recommendations post-incident and ATM installation risk assessments;

(xi) Internal Audit

The 'Internal Audit' capability has already returned to the Bank to execute audits within the Bank on the Bank's behalf only.

Separately, the Bank would commission Co-operative Group's Internal Audit function to audit the services provided by Co-operative Group.

Key Terms of the New MSA

Under the New MSA, the Bank, and CFSMS would manage and supervise the services through three key governance forums: (1) the 'Unity Outsourcing Steering Group', which would be responsible for (i) overall strategic direction of the provision of services under the Unity Agreements; (ii) the review of the overall operating model; (iii) the review of the governance model; and (iv) the resolution of escalated issues, and would be attended by the appropriate Co-operative Group director responsible for the management of the Unity Agreements and director of financial control for Co-operative Group, the appropriate Bank Director responsible for the management of the Unity Agreements and the director of financial control, risk director and contract manager for the Bank and persons performing equivalent roles for CFSMS; (2) the 'Service Review', which would meet quarterly and be responsible for overall performance and cost, upcoming developments, staffing, overall review of change programme and significant changes, review of the risks register, review of compliance and audit programme findings and resolution of escalated issues; and (3) the 'Functional Service Review' for each functional area, which would meet monthly and be responsible for functional performance and costs, functional issues, achievement of function-specific objectives, compliance and risk issues and review of service specific change and change costs.

The day-to-day operational management of the services supplied under the New MSA would be monitored by a Co-operative Group contract manager (as the supplier of the services), a Bank contract manager (as a customer), functional leads for Co-operative Group and the Bank and risk, audit and compliance for the Bank. The Existing MSA service contract service levels were documented on the basis that, unless service levels are expressly agreed between the parties in respect of a service to be provided under a service contract, Co-operative Group is required to provide the services to the same standards as those received by the Bank immediately before the commencement of the relevant service contract. There is a principle of no betterment of service levels compared to those provided to Banking Group before the service commencement date under the relevant service contract. The Bank is required to ensure that its systems are in good working order and suitable for purpose, and assets are maintained to a reasonable level of currency. Co-operative Group is relieved from its responsibility to provide the services where caused by failure of any Bank system, or any legacy Bank system used by Co-operative Group, which has a material adverse effect on the ability of Co-operative Group to provide the services.

Under the New MSA, services would be provided by Co-operative Group in accordance with Co-operative Group policies, unless Co-operative Group and the Bank agreed, or agreed in the future, that a Bank policy should apply in substitution for the relevant Co-operative Group policy. The Bank could require that Co-operative Group provides the services in accordance with Bank policies where required by law or a regulator.

Charges would be paid quarterly and in arrears unless a "Special Resolution Event" has occurred, in which case charges would be payable three months in advance.

The New MSA would continue in force until terminated by a party.

The Bank would have step-in rights to perform or manage the services, or appoint a third party to do so, upon notice to Co-operative Group following the occurrence of certain

defined trigger events (eg a material breach by Co-operative Group). An exit plan for each service contract would be prepared and kept updated. Charges will be agreed in the New MSA in respect of all service contracts, and are to be payable quarterly in arrears unless a "Special Resolution Event" occurred, in which case charges would be payable three months in advance.

The Bank and CFSMS would each be entitled to nominate persons to which all or part of the business of a service recipient had been transferred as a result of a special resolution event, excluding affiliates of service recipients (**MSA Special Resolution Recipients**) who would be entitled to the benefit of the New MSA and any relevant service contract(s) for an interim period. Any MSA Special Resolution Recipient could enforce certain provisions in the agreement and the relevant services contract(s) even though the relevant provision may only refer to the Bank or other service recipients. The Co-operative Group, upon request by the service recipient, would offer to enter into a direct agreement with the MSA Special Resolution Recipient to which all or part of the business of the service recipient has been transferred for the supply of services on the same terms as the New MSA and the relevant service contract(s). Under the New MSA, the Bank and CFSMS would each be entitled to nominate divested entities (which include normal course of business disposals as well as disposals on a special resolution event) to receive services under the New MSA and the relevant service contract(s) and exit services for up to 12 months, but with the addition of a mark-up of 20 per cent. on the charges. During the interim period prior to the MSA Special Resolution Recipient entering into a direct agreement with Co-operative Group, the Bank would remain responsible for payment of any charges in relation to services provided to MSA Special Resolution Recipients nominated by the Bank, as well as for any liability arising from any act or omission of the MSA Special Resolution Recipient that would have given rise to liability on the part of the Bank if it was an act or omission of the Bank.

20.2 CFSMS-Bank Framework Agreement

On 16 February 2006, the Bank and CFSMS entered into the CFSMS-Bank 2006 Agreement pursuant to which CFSMS provides assets such as office equipment, materials and office space, and other facilities and services, and consultants who act as secondees to the Bank, in each case strictly in accordance with the Bank's instructions and directions from time to time. This is a cost-based agreement terminable by CFSMS on six months' notice with a 12 months run–off period. The Bank has no right to terminate unless CFSMS is subject to a change of control. The Bank provides CFSMS with an indemnity for all liabilities, losses, damages, costs and expenses of any nature as a result of CFSMS entering into and performing the agreement in respect of the assets, services and personnel provided to the Bank.

By the date of completion of the Liability Management Exercise, the Bank and CFSMS intend to have replaced the CFSMS-Bank 2006 Agreement with appropriate revised arrangements under the CFSMS-Bank Framework Agreement pursuant to which it is proposed that CFSMS supply services, secondees, and procure the supply of certain third party services and assets, to the Bank and its subsidiaries. Details of certain terms of the CFSMS-Bank Framework Agreement, as contemplated for the 17 June Plan are summarised below. The Bank and Co-operative Group are considering whether any additional amendments are required to the CFSMS-Bank Framework Agreement to reflect that Co-operative Group will be a minority shareholder in the Bank following completion of the Liability Management Exercise.

Once agreed by the Bank and Co-operative Group as part of the separation process, the CFSMS-Bank Framework Agreement will establish a flexible contractual framework that shall enable the Bank and its subsidiaries to obtain from CFSMS those existing services and secondees, and procure the supply of third party procured services and assets, that CFSMS currently provides to the Bank (under the CFSMS-Bank 2006 Agreement or otherwise), and will also cover any new services and CFSMS secondees, and third party supplied services and assets that the Bank procures through CFSMS.

Under the terms of the CFSMS-Bank Framework Agreement, CFSMS would be entitled separately to provide some of the services and secondees and third party procured services and assets, on a shared basis, to other current and former members of Banking Group from time to time.

CFSMS would be required to provide the services to the same standards as those received by the Bank immediately before commencement. There is a principle of no betterment of service levels compared to those provided to the Bank before the service commencement date under the CFSMS-Bank Framework Agreement.

Charges would be paid daily in advance based on an estimate of costs to be incurred by CFSMS for that day unless a "Special Resolution Event" has occurred, in which case charges would be payable three months in advance.

The CFSMS-Bank Framework Agreement would continue in force until terminated by either party.

The Bank would have step-in rights to perform or manage CFSMS services and to perform or manage CFSMS' obligations in relation to the provisions of assets, the then current secondees or third party procured services, or appoint a third party to do so, upon notice to CFSMS following the occurrence of certain defined trigger events (eg a material breach by CFSMS).

An exit plan would be prepared and kept updated. During the exit period, CFSMS would be required to provide any reasonable assistance required by the Bank to allow the relevant secondees, assets or third party procured services to continue to be enjoyed without interruption or adverse effect.

The Bank would be entitled to nominate persons to which all or part of the business of a service recipient had been transferred as a result of a special resolution event, (excluding affiliates of service recipients) (**CFSMS Special Resolution Recipients**) who would be entitled to the benefit of the CFSMS-Bank Framework Agreement for an interim period. Any CFSMS Special Resolution Recipient could enforce certain provisions in the agreement even though the relevant provision may only refer to the Bank or other service recipients. CFSMS, upon request by the service recipient, would offer to enter into a direct agreement with the CFSMS Special Resolution Recipient to which all or part of the business of the service recipient had been transferred for the supply of services, secondees, assets or third party procured services on the same terms as the CFSMS-Bank Framework Agreement. The Bank would be entitled to nominate divested entities (which include normal course of business disposals as well as disposals on a special resolution event) to receive services under the CFSMS-Bank Framework Agreement and exit services for up to twelve months, but with the addition of a mark-up of 20 per cent. on the charges. During the interim period prior to the CFSMS Special Resolution Recipient entering into a direct agreement with CFSMS, the Bank would remain responsible for payment of any charges in relation to services provided to CFSMS Special Resolution Recipients nominated by the Bank, as well as for any liability arising from any act or omission of the CFSMS Special Resolution Recipient that would have given rise to liability on the part of the Bank if it was an act or omission of the Bank.

20.3 Relationship Agreement

The Bank has entered into the Relationship Agreement with Co-operative Group and Banking Group on 4 November 2013, which will regulate the basis of their on-going relationship and includes appropriate measures regarding the degree of control that Co-operative Group, Banking Group and their associates may exercise over the management of the Bank.

The principal terms of the Relationship Agreement will take effect on the Liability Management Exercise becoming unconditional and will continue for so long as the Co-operative Group (or any member of its group) remains a significant shareholder of the Bank. However, if Co-operative Group ceases to be a significant shareholder because Banking Group fails to satisfy the Undertaking to Pay (defined below) and is consequently forced to transfer its Ordinary Shares, the rights of Co-operative Group and Banking Group under the Relationship Agreement shall be waived, and the Relationship Agreement shall continue until the fifth anniversary of the Liability Management Exercise becoming unconditional. For these purposes a "significant shareholder" is any person (or persons acting jointly

by agreement whether formal or otherwise) who is entitled to exercise, or to control the exercise of, 20 per cent. of the rights to vote at a general meeting of the Bank.

Under the Relationship Agreement, Co-operative Group undertakes that it will conduct transactions with the Bank on arm's length terms and not seek to influence the day-to-day running of the Bank. Amendments to existing contracts and arrangements in place between Co-operative Group and the Bank will require the approval of a majority of independent directors. The Relationship Agreement contains provisions on conflicts and related party transactions.

Co-operative Group also undertakes that neither it, nor any member of its group, shall without the prior written consent of the Bank (i) operate, establish or acquire any undertaking which constitutes a competing business for a period of the later of the third anniversary of the Liability Management Exercise becoming unconditional and three years from the date of termination of the Relationship Agreement (although Co-operative Group is permitted to carry on business activities carried on at the date when the Liability Management Exercise becomes unconditional), or (ii) solicit for employment any of the directors (or their respective direct reports) or senior managers of the Bank for the same time period as applies in (i) above. For a period of two years after termination of the Relationship Agreement or seven years after the Liability Management Exercise becomes unconditional, whichever is the later, Co-operative Group has agreed to: (i) use the Bank as exclusive financial services provider in respect of clearing and certain other services (excluding lending) that are currently provided by the Bank to the Co-operative Group on an exclusive basis; (ii) use the Bank as principal financial services provider in respect of certain services (excluding lending) that have been provided by Bank to Co-operative Group at any time during the 12 month period prior to the date of the Relationship Agreement to the extent the Bank has the capacity to provide such services; (iii) promote the Bank's banking business and facilitate and encourage Co-operative Group's customers and members to hold bank accounts with, and otherwise use the services of, the Bank; and (iv) support (which, for the avoidance of doubt, shall not include any obligation on the Co-operative Group to make any financial contribution to the Bank in this regard) the enhancement and rejuvenation of the Co-op brand and franchise.

The Bank will have a Values and Ethics Committee which shall recommend to the Board for approval and adoption the co-operative and ethical policies of the Bank and shall represent, monitor and advise the Board concerning the interests of customers, suppliers, employees and other stakeholders in their dealings with the Bank. The terms of reference of the Values and Ethics Committee are set out in the agreement. The Values and Ethics Committee shall prepare an annual report on its activities which, subject to approval by the Board, shall be included in the annual report and accounts of the Bank and shareholders will be able to question the Values and Ethics Committee at the annual general meetings of the Bank. Further details on the Values and Ethics Committee are in paragraph 2 titled "*Corporate Governance*" in Section 9 (*Directors, Senior Management, Employees and Corporate Governance*).

In recognition of the mutual benefits derived by the Co-operative Group and the Bank from ensuring an appropriate alignment of their respective business strategies, the Bank has agreed to include in its Articles of Association a requirement to promote and conduct its business to the extent practicable in a manner informed by the established values of the co-operative movement having regard to:

(a) how it relates to, communicates with, balances the interests of, and otherwise deals with its stakeholders; and

(b) how it applies the profits of the Company, in accordance with the dividend policy set out in its Articles of Association.

Subject to certain conditions, the Relationship Agreement also provides a mechanism for the appointment of up to two persons (in each case, after having been identified for such purpose by the Purchasers): (i) nominated by the holders of the Dated Notes at or around the time of the Scheme Meeting; or (ii) to the extent the holders of the Dated Notes have not so nominated, approved by the shareholders other than Co-operative Group or Banking Group (and for these purposes, a person is

'approved' if less than 25 per cent. of relevant votes disapprove of the relevant person within a specified timeframe).

For as long as the Ordinary Shares are not admitted to the premium listing segment of the Official List, the Bank has agreed to use its reasonable endeavours to procure, and the Banking Group and Co-operative Group have agreed to exercise all of their respective powers of control to procure, that the Bank shall comply with the UK Corporate Governance Code as if it were in the FTSE 350 (as well as comply with the related provisions of LR 9.8.6R(5) and LR 9.8.6R(6) of the FCA's Listing Rules, as if they applied to the Bank). In addition, for as long as the Ordinary Shares are not admitted to the premium listing segment of the Official List, the Company has agreed to comply with certain of the continuing obligations for a premium listed company under the FCA's Listing Rules (and to the extent the Bank does not have a standard listing, only to the extent reasonably practicable, and in accordance with the spirit of those obligations). Analogous provisions are also contained in the Articles of Association, further details of which are set out in the sub-paragraphs 12.22 and 12.23 entitled "*Corporate Governance*" and "*Significant Transactions, Related Party Transactions, Circulars etc.*" respectively in Section 20 (*Additional Information*).

Co-operative Group has agreed to provide Bank with reasonable assistance to obtain a listing on the premium segment of the Official List within 12 months following the Liability Management Exercise becoming unconditional (although there can be no guarantee that the Bank will be able to satisfy the necessary eligibility criteria in to do so) and has agreed not to transfer the shares held directly or indirectly by Co-operative Group outside its group (subject to certain limited exceptions) for a period of five years from the date the Liability Management Exercise becomes unconditional unless the agreement has been terminated prior to such sale.

Provisions are included in the Relationship Agreement concerning the fact that Co-operative Group and Bank share many of the same customers and it is therefore necessary to mitigate risks and deal with practical issues concerning the processing of data.

The Bank has agreed to restrict non-pre-emptive share issuances (other than in certain specified exceptions) without the consent of the Co-operative Group for up to a maximum period of 36 months after the Liability Management Exercise becomes unconditional. Additionally, it will limit rights issues and other pre-emptive offers to an aggregate of £200 million for 12 months after the Liability Management Exercise becomes unconditional or until admission to listing, whichever is the earlier.

The Board believes that the terms of the Relationship Agreement will ensure that (subject to other existing contractual arrangements with Co-operative Group as at the date the Liability Management Exercise becomes unconditional) all transactions and relationships between the Bank and Co-operative Group and its affiliates are, and will be, at arm's length and on a normal commercial basis and that the Bank will be able to carry on with its business with only limited and appropriate levels of control or influence from Co-operative Group.

20.4 2014 Commitment Agreement

On 4 November 2013, Banking Group entered into a legally binding and irrevocable commitment with the Bank (the **2014 Commitment Agreement**), conditional upon the Scheme having been implemented in accordance with its terms (including the completion of the subscription of the Additional New Ordinary Shares Offer to Holders of Dated Notes in accordance with the Scheme) and each of the Exchange Offers having become unconditional in accordance with their respective terms (the **Condition**), to subscribe for 54,058,442 New Ordinary Shares (the **Group Shares**) in consideration for an irrevocable undertaking to pay the sum of £333 million (the **Undertaking to Pay**), such amount being the amount of the 2014 Commitment. The other parties to the 2014 Commitment Agreement are the Co-operative Group and the Bank.

The Group Shares will be issued by Bank to Banking Group immediately following the satisfaction of the Condition. In the 2014 Commitment Agreement, the parties have agreed that the New Ordinary Shares issued in consideration for the Undertaking to Pay will be fully paid up for the purposes of the

Companies Act and will be freely transferable (subject to the certain lock-up restrictions, which shall be superseded by the lock-up restrictions contained in the Relationship Agreement once this comes into force and as described in paragraph 20.3 above) and fungible with all other Ordinary Shares. The New Ordinary Shares issued against the Undertaking to Pay will be issued at the effective subscription price of £6.16 per New Ordinary Share, as calculated in the manner set out in the Offering Memorandum. The New Ordinary Shares issued to Banking Group under the 2014 Commitment Agreement will represent 21.6 per cent. of the Ordinary Shares in issue on completion of the Liability Management Exercise.

The Undertaking to Pay does not generate Common Equity Tier 1 Capital of the Bank until such time as the cash proceeds of the undertaking are received by the Bank. The PRA has stipulated that the 2014 Commitment must be satisfied in two tranches, with £170 million payable by 30 June 2014 and £163 million payable after 30 June 2014 but not later than 31 December 2014. In the 2014 Commitment Agreement, Banking Group has agreed to contribute the 2014 Commitment and satisfy the Undertaking to Pay in a number of tranches, with (i) £20 million payable by no later than 31 December 2013; (ii) £50 million by no later than 31 January 2014; (iii) £100 million by no later than 30 June 2014; and (iv) £163 million by no later than 31 December 2014. In addition, following receipt by Banking Group of the Co-operative Life Insurance and Asset Management Deferred Consideration or the net proceeds of the disposal of CIS General Insurance, Banking Group is required to apply such proceeds as soon as reasonably practicable following receipt of such proceeds in satisfaction of the Undertaking to Pay (in part or in full as the case may be).

To support Banking Group's obligations under the 2014 Commitment, Banking Group has entered into an intra-group loan facility (the **Intra-group Loan**) with Co-operative Group, which entitles Banking Group to draw down under the Intra-group Loan in the event that the Insurance Proceeds are not available at the point in time required to satisfy the 2014 Commitment. The 2014 Commitment Agreement stipulates that any monies drawn down under the Intra-group Loan shall only be repaid by Banking Group after the Undertaking to Pay has been fully discharged. The Intra-group Loan is described in further detail in paragraph 20.6 below.

Co-operative Group has informed the Bank that it has appropriate arrangements in place to satisfy the discharge of its obligations under the Intra-group Loan in the event that the Insurance Proceeds are not sufficient to satisfy the 2014 Commitment or otherwise not received in time to satisfy the PRA's required timing for the satisfaction of the 2014 Commitment. See the risk factor entitled "*The commitment by Banking Group to contribute £333 million during 2014, in addition to being solely conditional upon the successful completion of the Liability Management Exercise, is subject to the ability of Banking Group and/or Co-operative Group to fund the commitment, which is dependent on certain actions, some of which are partially outside the control of Co-operative Group*" in Section 2 (*Risk Factors*).

In the event that Banking Group breaches its obligations under the Undertaking to Pay:

(a) Banking Group has agreed to a default interest at a rate of 9 per cent. per annum on the outstanding amount under the Undertaking to Pay accruing on a daily basis, from and including the due date for payment (provided that, for the avoidance of doubt, the amount of the Undertaking to Pay will not increase by such default interest);

(b) Banking Group has agreed to waive all rights that it has in respect of the Group Shares, including rights to dividend, capital and voting;

(c) Banking Group and Co-operative Group have agreed to waive all their respective rights that they may have under the Relationship Agreement;

(d) Banking Group has agreed to procure the immediate resignation of nominee directors appointed by it or by Co-operative Group from the Board, failing which, the Bank may remove such Nominee Directors;

(e) the Bank may exercise or direct the security trustee to exercise any of its rights, remedies, powers or discretions under the Intra-group Loan and the associated security agreement in connection with the Intra-group Loan; and

(f) the Banking Group shall, at the request of the Bank, transfer all, or some of its Group Shares (i) to a third party as directed by Bank (a **Third Party Transfer**) or (ii) to the Bank for nil consideration.

In respect of any transfer pursuant to sub-paragraph (f) above the Bank shall:

(a) use reasonable endeavours (acting in good faith) to ensure that any Third Party Transfer is on terms as close to arms' length as possible, and use any amount received from the relevant third party to reduce any amount outstanding to the Bank from Banking Group;

(b) where the Bank determines to require the transfer of Group Shares to it pursuant to clause 8.2(f)(ii), the Bank may require the transfer of:

(i) such proportion of the Group Shares as is equal to the outstanding amount of the Undertaking to Pay plus any amount in respect of default interest (at the time of the relevant breach of the obligation under the Undertaking to Pay) as a proportion of the subscription amount (being £333 million) and the Undertaking to Pay plus any amount in respect of default interest shall, following such transfer, be discharged in its entirety; or

(ii) such other number of Group Shares as the Bank shall specify (the Specified Shares), provided that the Specified Shares and shall have a value no greater than the aggregate amount outstanding under the Undertaking to Pay and any Default Interest, and shall reduce such amount by the lower of:

(A) the fair market value of the Group Shares so transferred to the Bank; and

(B) where the Group Shares are retained or cancelled by the Bank, the aggregate amount that a third party (or third parties, as the case may be) pay to the Bank in consideration (including any deferred consideration) for the issuance by the Bank of such number of ordinary shares in the Bank as is equal to the number of Group Shares transferred pursuant to sub-paragraph (f)(ii) above, whether or not such shares are issued at a discount to their fair market value and provided that such ordinary shares are issued on or before the six month anniversary of the transfer of such Group Shares to the Bank pursuant to sub-paragraph (f)(ii),

provided further that if such lower amount exceeds the Undertaking to Pay, the Bank shall account to Banking Group for the difference.

With effect from the Subscription Date and to the fullest extent permitted by law, Bank (for itself and for each subsidiary and subsidiary undertaking of Bank together with all directors and employees of each such subsidiary and subsidiary undertaking of Bank) and Co-operative Group (for itself and each other member of the Co-operative Group together with its subsidiary undertaking and all directors and employees of each member of the Co-operative Group and its subsidiary undertakings), have agreed to waive each and every claim which they may have against the other in relation to or in connection with or in any way arising out of the preparation, negotiation or implementation of the Liability Management Exercise or the recapitalisation of the Bank and/or the circumstances which gave rise to the requirement for a recapitalisation of the Bank (provided that this does not preclude any such persons from enforcing any rights under any of the transaction documentation entered into in connection with the Recapitalisation Plan).

In connection with a notice of extraordinary general meeting sent to the shareholders of the Bank on or around 4 November 2013 (the **Notice**) convening an extraordinary general meeting of the Bank, to

be held on or around 15 November 2013 (the **EGM**), each of Co-operative Group and Banking Group have irrevocably undertaken and agreed:

(a) to vote in favour of each and every resolution to be proposed at the EGM in respect of all the ordinary shares in Bank they each hold as at the date of the EGM, including resolution (1) contained in the Notice, adopting the new Articles of Association of the Bank in the agreed form; and

(b) to do to everything reasonably practicable to procure the adoption of the new Articles of Association of the Bank in the agreed form.

In addition, the 2014 Commitment Agreement also contains certain customary warranties. Banking Group has also agreed to pass all shareholder and other resolutions, and to do all such things and take all actions as may be reasonably required in order to give effect to the Recapitalisation Plan, including the Scheme and the Liability Management Exercise.

20.5 The Agreed Co-existence Principles

The Bank and Co-operative Group have agreed co-existence principles (the **Agreed Co-existence Principles**), to be expressed in a Co-existence Agreement on terms later agreed between the parties (the **Co-existence Agreement**). The Agreed Co-existence Principles govern the use of trade marks containing "Co-operative" or "Co-op" and other associated trademarks owned by both parties

The Agreed Co-existence Principles are as follows:

- Until a trigger event occurs, namely if the Bank removes or alters any of the provisions in its articles of association that entrench co-operative values and ethics without Co-operative Group consent, Co-operative Group cannot conduct any business under a brand that combines the words "Co-operative" or "Co-op" and "Bank".
- After the Relationship Agreement ends (with a minimum lock up of five years) but before a trigger event, the Bank is free to continue using the terms "Co-operative" and "Co-op" provided it does so in a way that does not confuse the public into believing that the Bank is still a part of Co-operative Group. Where trade marks are required by the Bank for this, Co-operative Group will grant a non-exclusive royalty free licence until a trigger event occurs.
- After the expiry of the Non-Compete period (the minimum lock up of five years for the Relationship Agreement plus a further three years) Co-operative Group is free to conduct any financial services business under any of its brands, subject to the restriction placed on its use of "Co-operative" or "Co-op" with "Bank" as provided for above.
- Until the thirteenth anniversary of the 'Effective Date' (five years after the end of the Non-Compete period defined in the Relationship Agreement) Co-operative Group will not conduct any such business which competes with the Bank under a main business brand including the words "Co-operative" or "Co-op" but may include such words in supporting marketing and advertising materials to make it clear that the business is part of the Co-operative Group.
- The Bank and Co-operative Group each own various trade marks, some of which are predominantly used by the other party. There will be an exchange of trade mark registrations to ensure that at the outset of the Co-existence Agreement the trade marks are owned by the correctly entitled and utilising entity.
- The defined "banking" field of use for the purposes of the Agreed Co-existence Principles and the Co-existence Agreement must ensure that it is fair to both the Bank and Co-operative Group given each of their current and anticipated activities.

20.6 Intra-group Loan

The Bank, Banking Group and Co-operative Group have entered into an intra-group loan facility agreement dated 4 November 2013 (the **Intra-group Loan**) pursuant to which Co-operative Group will make available during 2014 to Banking Group a term loan facility to be utilised by way of advances. The term loan facility will mature no earlier than 27 July 2019 and, subject to Co-operative Group's existing syndicated facilities being repaid in full, all amounts outstanding under the Intra-group Loan will be automatically crystallised at maturity.

The Intra-group Loan has been entered into to support Banking Group's obligations under the 2014 Commitment. Banking Group is expecting to satisfy the 2014 Commitment from the net proceeds of the sale by Banking Group of Co-operative Life Insurance and Asset Management and the proposed sale of CIS General Insurance (the **Insurance Proceeds**). In the event that the Insurance Proceeds are not available at the point in time required to satisfy the 2014 Commitment, or are insufficient to do so, Banking Group is entitled to draw down under the Intra-group Loan. The 2014 Commitment is further described in paragraph 20.4 "*2014 Commitment Agreement*" in this Section 20 ("*Additional Information*").

The maximum amount which Banking Group can draw down is £313 million, which is £333 million less £20 million sourced from a proportion of net initial consideration already paid to Banking Group as a result of the disposal of Co-operative Life Insurance and Asset Management (such initial consideration which is scheduled to be paid to the Bank under the terms of the 2014 Commitment Agreement by 31 December 2013). This amount of £313 million is automatically reduced by the proceeds received by Banking Group from the sale of Co-operative Life Insurance and Asset Management and the sale of CIS General Insurance and applied in satisfaction of Banking Group's obligations under the 2014 Commitment. Any excess Insurance Proceeds which are not required to satisfy Banking Group's 2014 Commitment will be applied in mandatory prepayment of the loans.

The Bank may deliver draw down requests on behalf of Banking Group. Any draw down made by Banking Group pursuant to the Intra-group Loan is to be paid directly to the Bank in satisfaction of Banking Group's obligations under the 2014 Commitment. If any loan proceeds are provided to Banking Group under the Intra-group Loan, they must be held on trust for the Bank and Banking Group must promptly pay them to the Bank. Banking Group also holds on trust for the Bank its right to submit a drawdown request under the Intra-group Loan.

Banking Group has assigned to the Bank its rights in respect of any claims Banking Group may have against Co-operative Group in the event that Co-operative Group fails to provide Banking Group with a loan it is required to make pursuant to the terms of the Intra-group Loan.

A security assignment in respect of the Insurance Proceeds has been entered into between Banking Group and Co-operative Group as security trustee for itself and the Bank to secure Banking Group's obligations to the Bank in respect of the 2014 Commitment and Banking Group's obligations as borrower to Co-operative Group as lender under the Intra-group Loan.

Co-operative Group has informed the Bank that it has appropriate arrangements in place to satisfy the discharge of its obligations under the Intra-group Loan in the event that the Insurance Proceeds are not sufficient or otherwise not received in time for Banking Group to satisfy the 2014 Commitment. Based on the information provided by Co-operative Group and on investigations made by and on behalf of the Bank, the Bank believes these arrangements are appropriate.

20.7 Dealer Manager Agreement

The Bank, Co-operative Group, UBS and HSBC (UBS and HSBC taken together, for the purposes of this paragraph 20.7, the **Joint Dealer Managers**) have entered into a dealer manager agreement on 4 November 2013 (the **DMA**) whereby the Bank has appointed the Joint Dealer Managers as the exclusive dealer managers (and HSBC as adviser) in connection with the Liability Management Exercise.

The Joint Dealer Managers are appointed on a several and not joint basis. Each Joint Dealer Manager will perform certain services including:

(a) identifying and contacting holders of the Existing Securities and presenting the Liability Management Exercise to them on behalf of the Bank;

(b) making available employees to answer queries from, and provide additional information to, holders of the Existing Securities in connection with the Liability Management Exercise;

(c) providing assistance as and when requested by the Bank in relation to any decision to re-open, amend, terminate, shorten or extend the Liability Management Exercise;

(d) making or arranging for the making of such announcements as are agreed between the parties on behalf of the Bank in connection with the Liability Management Exercise; and

(e) providing such other assistance and undertaking such other duties as are agreed in writing between the parties to the Dealer Manager Agreement from time to time.

UBS's fee is payable by Co-operative Group while the Bank is to pay HSBC's fee.

The Bank and Co-operative Group have each given certain representations, warranties and undertakings to the Joint Dealer Managers.

The DMA also contains certain indemnities given by the Bank, failing which Co-operative Group, in favour of the Joint Dealer Managers in respect of, inter alia, claims made against or losses suffered or incurred by the Joint Dealer Managers in connection with the services rendered under the DMA.

Under the DMA each Joint Dealer Manager may terminate its obligations under the DMA in certain specified circumstances, including circumstances where any warranties are found to be untrue or inaccurate.

20.8 Lock-up Agreement

On or around the date of this Prospectus, Bank expects to enter into lock-up agreements with a number of Holders of Dated Notes.

Each lock-up agreement will provide that the relevant Holder will agree, amongst other things and subject to certain conditions, to cast all of its votes in respect of its Dated Notes that are subject to its lock-up agreement in favour of the Scheme.

The lock-up agreement includes various undertakings by the Bank in connection with the Scheme and, in certain circumstances, will terminate either automatically, or (depending on the circumstance) at the election of either the relevant Holder or the Bank. The lock-up agreement will terminate automatically (i) at a scheme meeting at which a vote takes place, if the Scheme is not approved by the requisite majorities, (ii) on the earlier of the Scheme Settlement Date and the 31 December 2013, (iii) if the Bank gives any Holder of Dated Notes written notice of an intention either not to proceed with the Scheme, or to proceed with a scheme of arrangement on terms that are different to the Scheme in any material respect, (iv) if the Holder of Dated Notes transfers all its Dated Notes that are subject to the lock-up agreement, or (v) if the Holders of the 5.5555% Bonds vote against the relevant proposals at the 5.5555% Meeting or the Holders of the 13% Bonds vote against the relevant proposals at the 13% Meeting or the Preference Shareholders vote against the relevant proposals at the Preference Shareholder meeting. The Bank may enter into lock-up agreements or similar arrangements in connection with the Scheme with other Holders of Dated Notes after the date of this Prospectus.

20.9 Purchase Agreement

The Bank has entered into a purchase agreement with certain Holders of the Dated Notes as listed in the purchase agreement (the **Purchasers**) on 4 November 2013 (the **Purchase Agreement**).

Pursuant to the Scheme, 62,500,000 Additional New Ordinary Shares will be made available to Holders of the Dated Notes for subscription.

To the extent that the amount received by 13 December 2013 from the Holders of Dated Notes who elect to participate in the Additional New Ordinary Shares Offer is less than £125 million, the Purchasers have severally agreed to subscribe for the remaining Additional New Ordinary Shares in accordance with the proportions set out in the Purchase Agreement (the **Subscription**).

However, if, as a result of the Subscription, a Purchaser was obliged to subscribe for an amount of Additional New Ordinary Shares that would result in it holding more than 9.99 per cent. of the total issued share capital of the Bank (the **Threshold Amount**) (the **Excess Shares**), it is in relation to the shares which are in excess of the Threshold Amount (the **Excess Shares**), may satisfy its undertaking to subscribe for the Excess Shares by paying the amount in respect of such shares and directing that they be issued to a non-affiliated third party (who cannot be an associate of the relevant Purchaser). If no such third-party is nominated, the Purchaser will subscribe for the Excess Shares so long as either (1) the subscription for such Excess Shares would not cause it to hold more than the Threshold Amount; or (2) it receives approval from the PRA to hold such Excess Shares.

Subject to the satisfaction of the conditions of the Purchase Agreement, the Purchasers under the Purchase Agreement will be entitled to receive a commission for agreeing to subscribe for Additional New Ordinary Shares in accordance with the Purchase Agreement. The maximum aggregate amount of such commissions that may be paid to the Purchasers is equal to four per cent. of £125 million (the **Purchaser Premium**). The Bank will also pay certain costs and fees incurred in connection with the Purchase Agreement (whether or not the Purchaser's obligations under the Purchase Agreement became unconditional or are terminated).

All Holders of Dated Notes will be entitled to participate in a sub-purchase of the Purchase Agreement (the **Sub-Purchase Offer** and the sub-purchase of the Purchase Agreement, the **Sub-Purchase**). The Sub-Purchase Offer will be available to all Holders of Dated Notes, including the Purchasers. To participate in the sub-purchase a Holder of Dated Notes (the **Sub-Purchaser**) will be entitled to nominate the commitment that Holder is prepared to sub-purchase, subject to a maximum commitment of £125 million and a minimum commitment of £100,000. The allocation of sub-purchase commitment to a Holder of Dated Notes that wishes to participate in the Sub-Purchase Offer will, in the case of aggregate nominations being less than £125million, be the amount of Sub-Purchasers' nominations and, in the case of nominations in aggregate exceeding £125million, be pro rata based on the proportion of its Scheme Claim (as at the Scheme Record Date) to the aggregate Scheme Claims of all Holders (as at the Record Date) who have elected to participate in the Sub-Purchase Offer, subject to (i) a minimum commitment of £100,000 and (ii) a maximum commitment equal to the amount of the sub-purchase commitment elected for by that Holder (the **Sub-Purchase Commitment**), provided always that the aggregate amount of all Sub-Purchase Commitments allocated to all Holders of Dated Notes that participate in the Sub-Purchase is no greater than £125 million.

The Sub-Purchasers will be required to enter into an agreement with Bank on or around the date of the Scheme Meeting (the **Sub-Purchase Agreement**). The Bank will pay each Sub-Purchase a fee equal to 2 per cent. of their Sub-Purchase Commitment, provided that they comply with their obligations under the Sub-Purchase Agreement (the **Sub-Purchase Fee**). The aggregate Purchaser Premium payable to the Purchasers will be reduced in an amount equal to the aggregate Sub-Purchase Fees paid to the Sub-Purchasers, such reduction to be allocated among the Purchasers based on their subscription commitment as set out in the Purchase Agreement.

To the extent that the aggregate allocation of Additional New Ordinary Shares to all Holders of Dated Notes who elect to participate in the Additional New Ordinary Shares Offer is less than 62,500,000 Additional New Ordinary Shares, the Sub-Purchasers pursuant to the Sub-Purchase Agreement will be required to subscribe for such number of remaining Additional New Ordinary Shares up to their Sub-Purchase Commitments. If there are still Additional New Ordinary Shares to be issued, the Purchasers under the Purchase Agreement will be required to subscribe for the remaining Additional New Ordinary Shares. Furthermore, if a Holder of Dated Notes elects to participate in the Additional

New Ordinary Shares Offer, or participates in the Sub-Purchase Offer, but, in either case, fails to fund the purchase of its allocation of Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer, or the Sub-Purchase Commitment, as applicable, the Purchasers, under the Purchase Agreement, will also be required to subscribe for those Additional New Ordinary Shares.

The obligation of each Purchaser Purchase under the Purchase Agreement in respect of the Subscription are subject to certain conditions being satisfied or waived, including:

(a) the Bank having complied in all material respects with all its obligations under the Purchase Agreement, the Scheme and the Exchange Offers and the warranties given by the Bank being true and accurate;

(b) an office copy of the sanction order of the Scheme must have been delivered to the Registrar of Companies at Companies House;

(c) there shall have been no change in the condition (financial or otherwise) or prospects of the Bank and no litigation or regulatory proceedings will have commenced which is likely to have a material adverse effect upon the Bank's compliance with the minimum regulatory capital requirements or solvency, or which is likely to trigger the regulators' resolution powers under the Banking Act; and

(d) all shareholder, and other, resolutions have been adopted to redesignate and buy-back the existing ordinary shares of the Bank as contemplated by the Recapitalisation Plan.

If the conditions are not satisfied by 31 December 2013 the Purchase Agreement will automatically cease to have effect.

The Bank has given certain representations, warranties and undertakings to the Purchasers under the Purchase Agreement.

20.10 Pensions Undertaking

On 4 November 2013 Co-operative Group and the Bank entered into an undertaking pursuant to which Co-operative Group agreed with the Bank, subject to certain exceptions, not to require the Bank to cease to participate in Pace in connection with the Liability Management Exercise or any subsequent reduction in Co-operative Group's shareholding in the Bank (including to nil). Should either Co-operative Group or the Bank so request, the parties will enter into good faith discussions to agree on the separation of Pace, so that the scheme liability properly attributable to the Bank and an equivalent proportion of the scheme's assets would be transferred to a separate tax registered pension arrangement or a segregated section of the scheme. Neither the Co-operative Group nor the Bank is under an obligation to agree to any separation of the scheme that would result in a requirement to make material payments to or in respect of the scheme.

The undertaking also provides that Co-operative Group will agree with the Bank the proportion of the future service accrual contribution and the proportion of all other contributions due to Pace that the Bank will make. If Co-operative Group and the Bank are unable to agree the proportions payable by the Bank then the matter shall be referred to an independent third party chosen by both parties.

Co-operative Group also agrees to procure that, for so long as the principal employer of the Britannia Scheme is an entity outside of the Bank's group, such employer will not take any action in relation to the scheme without the Bank's prior agreement where such action would or might be expected to increase the liabilities of the Bank or contributions payable by the Bank in connection with the Britannia Scheme.

21. LITIGATION AND ARBITRATION

Save as disclosed in paragraph 21 of this Section 20 (*Additional Information*), there are no governmental, legal or arbitration proceedings which may have or have had in the 12 months prior to the date of this

Prospectus a significant effect on the financial position or profitability of the Bank and/or the Bank and its subsidiaries, nor, so far as the Bank is aware, are any such proceedings pending or threatened.

21.1 PPI

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

The FSA (as it was then known) issued a policy statement in August 2010 which amended the 'Disputes Resolution: Complaints' section of the Financial Services Handbook, setting out new rules for handling complaints, including complaints of PPI mis-selling. The Bank must comply with the policy statement which requires complainants to receive adequate redress and the Bank to complete a proactive review of all past business to identify mis-sold policies where no complaint has been made.

On 4 January 2013, the FSA fined the Bank £113,300 for failing to handle PPI complaints fairly during the period 21 January 2011 and 9 May 2011. During this period, the British Bankers Association unsuccessfully challenged the FSA measures (published in August 2010) designed to ensure all PPI complaints are treated fairly. The FSA found that during this period it was likely the Bank unfairly put on hold a significant proportion of 1,629 complaints, incorrectly deciding that they could not be determined because the outcome of the judicial review would have a bearing on the final decision.

In line with the rest of the banking industry, the Bank saw a continued increase in the volume of PPI complaints in 2012. As a result, an additional provision of £149.7 million (2011: £90.0 million) was recognised in 2012, in respect of the total expected cost to the Bank of carrying out this work and paying compensation, making total provisions raised of £244.0 million as at 31 December 2012 (2011: £94.3 million).

An additional provision of £53.0 million for redress relating to PPI has been recognised in the period 1 January 2013 to 30 June 2013 primarily to cover increased operating and ombudsman costs. This increases the total estimated cost to £297.0 million as at 30 June 2013 (31 December 2012: £244.0 million). As at 30 June 2013, £166.9 million of this PPI provision had been spent, with £130.1 million remaining. The number of inbound complaints has shown a significant decline in the six months to 30 June 2013, with the average weekly inbound volume being 25.2 per cent. lower than the levels seen in 2012.

This provision represents management's best estimate of the anticipated costs of related customer contact and redress, including administration expenses. The provision is based on the FSA's (as it was then known) policy statement and industry claims experience. Its calculation requires significant judgement by management in determining appropriate assumptions, which include the level of complaints, uphold rates, proactive contact and response rates, and Financial Ombudsman Service referral and uphold rates.

21.2 Interest rate hedging products (**IRHPs**) mis-selling claims

The Bank sold IRHPs to certain SME (non-sophisticated) customers.

On 29 June 2012 the FSA (as it was then known) announced the results of its thematic review of IRHP sales. The review found serious failings in the sale of such products by Barclays, HSBC, Lloyds and RBS to non-sophisticated customers. The FSA agreed a past business review (**PBR**) and redress exercise with these banks.

The FCA has not examined the Bank's sales of IRHPs and so has not made any finding of mis-selling. However, along with six other banks, in July 2012 the Bank volunteered to participate in the past business review (the **Bank's PBR**) and redress exercise, on the same basis as the PBR.

The Bank's PBR is on-going and involves an assessment of historic IRHP sales against eight sales standards (as agreed in collaboration with the FCA). The Bank's PBR population, as agreed with Grant Thornton (the Bank's skilled person as required by the FCA) and the FCA, includes approximately 64 business customers (a substantially smaller number than some banks), of which seven customers were part of an initial pilot scheme (that has now been finalised); redress is payable in two of the assessed pilot cases. Of the customers initially flagged for inclusion within the Bank's PBR, as at 23 October 2013 40 have opted to take part, 15 have opted out and two have yet to revert to the Bank.

The Bank's PBR will assess whether each sale complied with the sale standards. The potential outcomes of the Bank's review of each sale in the PBR are: (1) that the sale was fully compliant; (2) that the sale was not fully complaint but that no redress is payable; or (3) that the sale was not compliant and redress is due. Redress may involve inter alia switching the customer to an alternative product, or ripping up the existing IRHP and refunding payments made for the product. A provision of £10.0 million (2012: £nil) has been recognised for the six months ended 30 June 2013 in respect of the total expected cost to the Bank and the matter remains under review.

21.3 Third Party card protection

Between 1999 and 2012, the Bank introduced and/or sold third party card and identity protection products to its customers through a number of different third parties. In July 2013, the FCA contacted the Bank directly, confirming that it considered one of the third party's product offering to be defective (as customers could receive certain elements of the protection provided for free from their bank) and suggested that the Bank may be expected, moving forward, to offer redress to customers as a consequence of such failings.

A number of financial institutions (not including the Bank) have recently agreed, following discussions with the FCA, to repay substantial sums of redress to customers who took out card protection insurance products with Card Protection Plan Limited (**CPP**). Whilst the same approach would not necessarily be used by the FCA in relation to the third party, it is proposed (subject to creditor and court approval) that the CPP redress would be paid via a scheme of arrangement.

The Bank met with the FCA in September 2013 to discuss the FCA's concerns with the third party product. Further to this meeting, the Bank received a circular letter from the FCA on 15 October 2013 giving reasons why the FCA considers that the Bank is liable, together with the third party provider, to pay redress for sales of card protection products made between 14 January 2005 and 1 October 2012, and/or sold prior to 14 January 2005 and renewed before 1 October 2012. The Bank stopped actively advocating the third party product in February 2012. The FCA asked that the Bank cooperate with the FCA in the implementation of a customer redress process and the Bank is currently considering its position.

As at the date of this prospectus, it is difficult to estimate the cost, (if any), of the redress process to the Bank for the reasons stated above, and because the Bank has minimal data on sales and renewals of the third party product. Whilst the exact nature and extent of any redress is not fully clear at this stage, a precautionary provision of £26.0 million (2012: £nil) has been recognised for the six months ended 30 June 2013 in respect of the total expected cost to the Bank for potential customer redress relating to the above alleged failings.

21.4 ATM business rates

The Bank operates ATMs from a number of Co-operative food stores and other Co-operative society stores across the UK. The relationship between the Bank and the other Co-operative entities in relation to the service/functioning of such ATMs is governed by specific contractual provisions between the parties.

In mid-2013, correspondence was received from HMRC's Valuation Office, in relation to the rating assessments of the aforementioned ATMs. In this correspondence HMRC's Valuation Office has

asserted that business rates will be payable in relation to the ATMs. The Bank has estimated that this will amount to approximately £12 million to £15 million.

This assertion continues to be disputed by the Bank. The future rating liability for the above ATMs is potentially in the region of £4 million per annum.

As the legal position is not clear, discussions are on-going with HMRC's Valuation Office as to whether business rates can be applied by the HMRC Valuation Office in the manner which has led them to seek this additional amount.

This is an issue which is common across the retail banking industry. A one-off provision of £13.9 million for the six months ended 30 June 2013 has been made in respect of this.

21.5 Platform and Mortgage Agency Services First Payment

The Bank is currently investigating an issue related to the first payment made by a significant number of current and former mortgage customers in relation to their capital and interest (repayment) mortgages. The Bank's practice had been to collect only the interest element of the first monthly mortgage payment; this with the intention of helping customers avoid falling into arrears immediately after their first monthly mortgage payment fell due. Whilst the 'welcome letter' sent to customers correctly identified that only interest was to be collected in the first payment, some of the further payment information in that letter did not fully correspond to information in the Offer Key Facts Illustration document. The Bank's investigations and consideration of the issue are evolving. It is believed that the issue affects all Platform advances, intermediary mortgage sales and all Mortgage Agency Services (**MAS**) further advances completed between 2002 and 17 March 2013. A number of Platform advances and MAS further advances completed prior to 2002 are also affected.

The Bank has raised this issue and is continuing to liaise with the FCA. As a matter of prudence, having regard to information that is known at the date of the Prospectus, a provision of £34 million was made.

22. RELATED PARTY TRANSACTIONS

Other than:

(i) as disclosed in note 37 of the Bank's consolidated audited financial statements for the financial years ended 31 December 2012, 2011, and 2010, such notes being incorporated by reference into this Prospectus;

(ii) Note 32 of the Interim Financial Information;

(iii) (a) the Existing IT Services Agreement and the proposed New IT Services Agreement (see paragraph 20.1(a) titled "*IT Services Agreement*" in this Section 20 (*Additional Information*")); (b) the Existing MSA and the proposed New MSA (both as defined in paragraph 20.1(b) titled "*MSA*" in this Section 20 (*Additional Information*)); (c) the CFSMS-Bank Framework Agreement (see paragraph 20.2 titled "*CFSMS-Bank Framework Agreement*" in this Section 20 (*Additional Information*)); (d) the Relationship Agreement (see paragraph 20.3 titled "*Relationship Agreement*" in this Section 20 (*Additional Information*)); (e) the 2014 Commitment Agreement (see paragraph 20.4 titled "*2014 Commitment Agreement*" in this Section 20 (*Additional Information*)); (f) the Agreed Co-existence Principles (see paragraph 20.5 titled "*The Agreed Co-existence Principles*" in this Section 20 (*Additional Information*)); (g) the Intra-group Loan (see paragraph 20.6 titled "*Intra-group Loan*" in this Section 20 (*Additional Information*)); and (h) the Dealer Manager Agreement (see paragraph 20.7 titled "*Dealer Manager Agreement*" in this Section 20 (*Additional Information*)); and

(iv) as disclosed in paragraphs 22.1 to 22.6 inclusive below,

neither the Bank nor any of its subsidiaries has entered into any related party transactions (which for these purposes are those set out in the standards adopted according to the Regulation (EC) No 1606/2002) with any related party during the financial years ended 31 December 2012, 2011 and

2010, during the six months ended 30 June 2013, and up to the latest practicable date prior to publication of this Prospectus.

22.1 The Bank entered into a services agreement with Co-operative Legal Services Limited (**CLS**) on 15 October 2013. This agreement replaces the pre-existing arrangements relating to the introduction of customers to CLS by the Bank. This is an arm's length agreement entered into in the ordinary course of business.

Under this agreement, the Bank will (a) promote the products and services of CLS through the Bank branch network by displaying materials produced by CLS which describe or promote the services they offer; (b) identify customers who have a need for the legal services of CLS and refer them to CLS; and (c) provide space in its premises for CLS staff to undertake pre-arranged appointments with customers who have been referred by the Bank. CLS retains an absolute and unfettered discretion to accept or decline any application to use its services in accordance with its normal practices and internal policies.

In return, CLS agrees to pay the Bank a quarterly marketing services charge. This payment is calculated on the basis of elements such as: (i) amount of time the Bank's colleagues spend discussing the products offered by CLS; and (ii) the amount of window space and leaflet dispensers in a premises of the Bank used to promote CLS' services. Banking Group is to provide this information to CLS and CLS will calculate the service charge payable. The first payment to be made under the agreement is not due until January 2014. It is not expected that this payment will exceed £45,000. CLS will also provide the Bank with the materials necessary for the promotional activity to take place, such as the leaflets. For the purposes of promotion, the parties agree to grant each other a royalty free non-exclusive licence to use, in the case of the CLS, the Bank logo and the following names: The Co-operative Bank and Co-operative Banking Group Limited, and, in the case of the Bank, the CLS logo and the following names: Co-operative Legal Services, The Co-operative Legal Services and Co-operative Legal Services Limited.

The services agreement has an initial term of three years from the date of the agreement and will continue thereafter unless terminated by either party on at least 12 months' notice. Either party may terminate the agreement if there is a change of control of the other party except where such change of control is for the purposes of solvent re-organisation or corporate arrangements, refinancing or mergers. If either party wishes to make an amendment to the marketing services charge they must propose it to the other at the joint management committee (**JMC**) which consists of senior management from both parties. If the parties fail to agree to the proposed change and the JMC cannot resolve the dispute, it shall be escalated to the managing director of CLS and the current Managing Director, Retail Bank, of the Bank. If the parties still fail to agree, either party may terminate on 30 days' written notice.

Each party's liability to the other party under the agreement is limited to £200,000 in the aggregate.

22.2 The Bank is proposing to enter into a services agreement with Funeral Services Limited (**FSL**) prior to the end of 2013. It will be an arm's length agreement entered into in the ordinary course of business.

Under this agreement, it is proposed that the Bank will (a) promote the products and services of FSL through the Bank branch network and (b) offer FSL funeral care planning products to its customers and potential customers. FSL retains an absolute and unfettered discretion to accept or decline any application to use its services in accordance with its normal practices and internal policies.

It is expected that this agreement will be entered into on terms similar to the agreement summarised in paragraph 22.1 above.

22.3 The Bank entered into a cash in transit services agreement dated 10 May 2012 with Sunwin Services Group (2010) Limited (**Sunwin**) (the **CITSA**). The CITSA is an arm's length agreement entered into in the ordinary course of business.

Under the CITSA, Sunwin agrees to provide the following services to the Bank: collection of cash, coin and cheques from the Bank's offices, branches, ATMs or corporate customers for the delivery of

cash, coins and cheques, as applicable, to the Bank's chosen cheque-processing centre, the Bank's offices, branches, ATMs or corporate customers. Sunwin also agrees to perform collection and cash processing services (a) from Co-operative Group stores upon Jersey and Guernsey, and (b) to and from Banking Group's Guernsey branch.

In return, the Bank will pay Sunwin for the provision of the services. The amount to be paid varies depending upon how much the Bank utilises the services. The Bank paid approximately £1.2 million, inclusive of VAT, under the CITSA for the previous year.

The term of the CITSA began on 13 June 2011 and will end on termination of the CITSA. The Bank may terminate the CITSA immediately if continued association with Sunwin would, in the Bank's sole reasonable opinion, contravene the Bank's sustainable procurement and supplier policy. It may also terminate the CITSA if (i) Sunwin is subject to a change of control to which the Bank has not provided its consent or (ii) the Bank gives 12 months' written notice to Sunwin, such notice not to take effect prior to the fourth anniversary of the date of the agreement.

22.4 The Bank entered into an ATM cash replenishment agreement dated 24 October 2012 with Sunwin Services Group (2010) Limited (**Sunwin**) (the **CRA**). The CRA is an arm's length agreement entered into in the ordinary course of business.

Under the CRA, Sunwin agrees to provide to the Bank the following services: collection and return of ATM cash, cash replenishments, housekeeping of the ATMs and account management.

In return, the Bank will pay Sunwin for the provision of the services. The amount to be paid varies depending upon the how much the Bank utilises the services. It is expected that the Bank will pay between approximately £13 million and £15 million, inclusive of VAT, per annum for the services provided under the CRA. The CRA may be terminated, inter alia, by either party on 12 months' notice, provided that the notice period shall not expire earlier than five years from the date of the CRA. The Bank may terminate the CRA immediately if continued association with Sunwin would, in the Bank's sole reasonable opinion, contravene the Bank's sustainable procurement and supplier policy. The Bank may also terminate the CRA if Sunwin is subject to a change of control to which the Bank has not provided its consent.

22.5 The Bank entered into an agreement with Co-operative Group (CWS) Limited (now called Co-operative Group) (**CWS**) concerning the installation and operation of ATMs dated 1 January 2008 (the **ATMA**). The ATMA is an arm's length agreement entered into in the ordinary course of business.

Under the ATMA, CWS has granted a licence to the Bank to install and operate ATMs in CWS premises. The ATMs are to be installed in prominent locations in CWS premises by mutual agreement and the Bank has the right of first refusal to site ATMs at CWS premises. If the Bank declines a location offered, CWS has the right to install a third party's ATM at that location.

The ATMA is for an initial term of five years from the date of agreement, with automatic renewal on the same terms for 12 months' at a time unless either party gives two months' written notice to the other. Given the five year initial term has expired, the ATMA is continuing in force on the basis of the rolling 12 month notice period. On termination of the ATMA, all removal costs of the ATMs shall be shared equally by both parties.

The terms of the existing agreement are currently under review by the parties. As at the date of this Prospectus it is currently anticipated that a new agreement will be entered into prior to 2014. The new agreement is expected to provide greater detail on the operational arrangements required as well as clarifying aspects concerning the ownership of property, including the perfection of rights required to install and operate the ATM's, their ancillary plant and equipment and obligations and privileges for each ATM to operate without prejudice to the safety and operation of the building in which it is located and vice versa.

22.6 The Bank and CIS General Insurance have, for approximately three years, had a course of dealings which is undocumented by which the Bank (a) promotes the products and services of CIS General

Insurance through the Bank branch network by displaying materials produced by CIS General Insurance which describe or promote the services they offer; and (b) offers CIS General Insurance home insurance policies through the Bank's mortgage advisors. In return, CIS General Insurance pays the Bank a commission of £40 for every insurance policy sold. During the financial year to 31 December 2012, CIS General Insurance paid the Bank £849,180 in commissions.

As part of the sale of proposed CIS General Insurance it is proposed that a new agreement be entered into to document this arrangement.

23. DEPENDENCE UPON OTHER ENTITIES IN CO-OPERATIVE GROUP

The Bank is dependent on Co-operative Group for the provision of certain administrative services (such as finance, marketing, human resources, some risk functions and, in particular, IT) although the extent of this reliance is expected to be reduced following completion of the Liability Management Exercise as services are likely to be repatriated to the Bank. These arrangements may need to be renegotiated as a result of the successful implementation of the Liability Management Exercise. In addition the Bank is dependent on the strength of the wider Co-operative brand and its reputation with customers and potential customers of the Bank.

21
IMPORTANT LEGAL INFORMATION

This section contains some important legal information regarding the basis on which this Prospectus may be used and other matters.

IMPORTANT LEGAL INFORMATION

The Prospectus has been prepared on a basis that permits a public offer of the Notes that is not within an exemption from the requirement to publish a prospectus under Article 5.4 of Directive 2003/71/EC as amended (which includes the amendments made by Directive 2010/73/EU to the extent that such amendments have been implemented in a relevant Member State of the European Economic Area) in the United Kingdom.

Persons authorised to use this Prospectus

The Notes are being offered by the Issuer only. In addition, the offer is being made only to investors who hold the Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (the **2016 Notes**), the 5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942) (the **2019 Notes**), the 9.25% Subordinated Notes due 28 April 2021 (ISIN: XS0620315902) (the **April 2021 Notes**), the Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984) (the **November 2021 Notes**), the 7.875% Subordinated Notes due 19 December 2022 (ISIN: XS0864253868) (the **2022 Notes**), the 5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183) (the **2024 Notes**), the 5.875% Subordinated Notes due 2033 (ISIN: XS0145065602) (the **2033 Notes**) (together the **Dated Notes**), the 5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) (the **5.5555% Bonds**) and other capital securities issued by the Bank of the Issuer which are currently outstanding, as part of the Liability Management Exercise being conducted by the Issuer and the Co-operative Group. Accordingly, the Issuer has not authorised any subsequent resale of the Notes through financial intermediaries.

The Dealer Managers and the Trustee

None of the Dealer Managers or the Trustee has independently verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Dealer Managers or the Trustee as to the accuracy or completeness of the information contained or incorporated in this Prospectus or any other information provided by the Issuer in connection with the offering of the Notes. Neither the Dealer Managers nor the Trustee accept any liability in relation to the information contained or incorporated by reference in this Prospectus or any other information provided by the Issuer in connection with the offering of the Notes or their distribution. Each Dealer Manager and the Trustee accordingly disclaims all and any liability whether arising in tort or in contract or otherwise which it might otherwise have in respect of this Prospectus.

No person is or has been authorised by the Issuer, the Dealer Managers or the Trustee to give any information, or to make any representation, not contained in, or not consistent with, this Prospectus or any other information supplied in connection with the offering of the Notes and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer, the Dealer Managers or the Trustee.

Neither this Prospectus nor any other information supplied in connection with the offering of the Notes (i) is intended to provide the basis of any credit or other evaluation or (ii) should be considered as a recommendation by the Dealer Managers or the Trustee that any recipient of this Prospectus or any other information supplied in connection with the offering of the Notes should participate in the Liability Management Exercise or invest in the Notes. Each investor contemplating participating in the Liability Management Exercise or investing in the Notes should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer. Neither this Prospectus nor any other information supplied in connection with the offering of the Notes constitutes an offer or invitation by or on behalf of the Issuer, the Dealer Managers or the Trustee to any person to subscribe for or to purchase any Notes.

Neither the delivery of this Prospectus nor the offering, sale or delivery of the Notes shall in any circumstances imply that the information contained herein concerning the Issuer is correct at any time subsequent to the date hereof or that any other information supplied in connection with the offering of the Notes is correct as of any time subsequent to the date indicated in the document containing the same. The Dealer Managers and the Trustee expressly do not undertake to review the financial condition or affairs of

the Issuer during the life of the Notes or to advise any investor in the Notes of any information coming to their attention.

Each of HSBC Bank plc and UBS Limited are authorised by the PRA and regulated by the PRA and the FCA. To the fullest extent permitted by applicable law and regulation, no person will become a client of either Dealer Manager (within the meaning of the FCA's rules) by virtue of receipt of this Prospectus or participation in the Liability Management Exercise or any component part thereof. The Dealer Managers are acting on their own account in relation to the Liability Management Exercise and, to the fullest extent permitted by applicable law and regulation, will not be responsible to any other person for providing the protections which would be afforded to clients of either Dealer Manager or for providing advice in relation to the Liability Management Exercise or any component part thereof.

Offer and distribution restrictions

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended (the **Securities Act**). Holders who wish to participate in the Exchange Offers will be required to represent that they will not resell or otherwise transfer the Notes during the 40 day period commencing on the Settlement Date except outside of the United States in a transaction complying with Rule 903 or 904 of Regulation S.

This Prospectus does not constitute an offer to sell or the solicitation of an offer to buy the Notes in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Prospectus and the offer or sale of Notes may be restricted by law in certain jurisdictions. The Issuer, the Dealer Managers and the Trustee do not represent that this Prospectus may be lawfully distributed, or that the Notes may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular, except as indicated in Section F "*Offer Restrictions*" in the Offer Memorandum set out in Appendix C to this Prospectus, no action has been taken by the Issuer, the Dealer Managers or the Trustee which is intended to permit a public offering of the Notes or the distribution of this Prospectus in any jurisdiction where action for that purpose is required. Accordingly, no Notes may be offered or sold, directly or indirectly, and neither this Prospectus nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Prospectus or any Notes may come must inform themselves about, and observe, any such restrictions on the distribution of this Prospectus and the offering and sale of Notes. In particular, there are restrictions on the distribution of this Prospectus and the offer or sale of Notes in the United States and the United Kingdom, see Section F "*Offer Restrictions*" in the Offer Memorandum set out in Appendix C to this Prospectus.

PRESENTATION OF FINANCIAL INFORMATION

The financial information contained in this Prospectus has been prepared for the Bank. Prospective investors should consult their own professional advisers to gain an understanding of the financial information contained in the Prospectus. An overview of the basis for presentation of financial information in this Prospectus is set out below.

Save as set out below, financial information presented or incorporated by reference in this Prospectus: (i) comprises information for the Bank for the financial years ended 31 December 2012, 2011 and 2010 and the six months ended 30 June 2013 and 2012; and (ii) has been extracted without material adjustment from the audited consolidated financial statements of the Bank for the years ended 31 December 2012, 2011 and 2010 and the interim financial information of the Bank for the six months ended 30 June 2013 (**Interim Financial Information**).

The consolidated financial statements of the Bank for the years ended 31 December 2012, 2011 and 2010 and the Interim Financial Information have been audited by KPMG Audit Plc, independent auditors, in accordance with applicable law and the International Standards on Auditing (UK & Ireland) issued by the Auditing Practices Board in the UK. They have been prepared in accordance with the requirements of the

Prospectus Directive and the UK Listing Rules and in accordance with IFRS, as adopted by the EU. The consolidated financial statements of the Bank for the years ended 31 December 2012, 2011 and 2010 have been incorporated by reference, as detailed in Section 18 (*Information Incorporated by Reference*). The Interim Financial Information is set out at Part B of Section 16 (*Financial Information*). In the financial year ended 31 December 2011 the Bank reported its operating segments as 'Retail', 'Corporate and Business Banking' and 'Other' and in the financial year December 2010 the Bank reported its operating segments as 'Retail', 'Corporate and Markets' and 'Other', based on differences in products and services. In 2012 the Bank refined the 'Corporate and Business Banking' into core and non-core and moved the Platform portfolio from 'Corporate and Business Banking' to the 'Retail' business. The Bank reported on this refined basis in the financial year ended 31 December 2012 and the Interim Financial Information. The comparatives for the six months ended 30 June 2012 are also reported on this basis.

In 2013, as the strategy of the Bank developed and as part of the Bank's plan to simplify and reshape itself as announced on 17 June 2013, the core and non-core business activities constituted in 2012 were redefined as:

(i) Retail and SME Banking (the **Core Business**); and

(ii) Co-operative Asset Management (the **Non-core Business**).

The Core Business represents lines of business that are consistent with the Bank's strategy and risk appetite. The Non-core Business includes those businesses and assets which are not consistent with the Bank's business strategy, are managed to achieve the most appropriate asset value on an individual portfolio basis or are targeted for run down or exit, and contain the majority of the Bank's impairment risk. These include the Optimum portfolio (a closed book of predominantly interest only, intermediary and acquired mortgage book assets), the Illius portfolio of investment properties and non-core corporate banking assets, in particular the commercial real estate portfolio.

Save as set out below, the historical financial information of the Bank for the financial years ended 2012, 2011 and 2010 and the six months ended 30 June 2013 and 2012 incorporated by reference into or included in this Prospectus, notably Section 10 (*Capitalisation and Indebtedness*), Section 11 (*Selected Financial Information*), Section 12 (*Operating and Financial Review*) and Section 16 (*Financial Information*), reflects the segments of the business in place during the relevant reporting periods including, for the financial statements for the year ended 31 December 2012 and the six months ended 30 June 2013, the core and non-core business segments as constituted in 2012.

The historical financial information of the Bank for the six months ended 30 June 2013 as set out in Section 8 (*Description of the Bank*) and Section 15 (*Segmented Financial and Other Information*) reflects the divisions of the Bank as now managed, i.e. the Core Business and Non-core Business. This financial information is unaudited and has been extracted from the Bank's internal management systems for the six months ended 30 June 2013.

The Accountant's Report on the Bank's Interim Financial Information for the six months ended 30 June 2013 also includes an emphasis of matter paragraph relating to note 2 to the Interim Financial Information.

IFRS and generally accepted accounting procedures in the United Kingdom (**UK GAAP**) differ from each other in certain significant respects. The Bank's financial statements and interim reports have not been reconciled to UK GAAP. The Bank has not prepared any financial information in accordance with UK GAAP nor a reconciliation or quantification of differences between IFRS and UK GAAP.

CURRENCIES

Unless otherwise indicated, in this Prospectus, all references to:

(i) **US dollars, dollars, USD, US$** or **cents** are to the lawful currency of the United States;

(ii) **euro** or **€** are to the lawful currency of the European Union (as adopted by certain member states); and

(iii) **British pounds sterling, Sterling, pounds sterling** or **£** are to the lawful currency of the UK.

Unless otherwise indicated, the financial information contained in this Prospectus has been expressed in pounds sterling. The Bank's functional currency is pounds sterling and the Bank prepares its financial statements in pounds sterling.

FORWARD-LOOKING STATEMENTS

Certain information contained or incorporated by reference in this Prospectus including any information as to the Bank's strategy, plans or future financial or operating performance constitute "forward-looking statements". These forward-looking statements can be identified by the use of forward-looking terminology, including the terms "believes", "estimates", "anticipates", "projects", "expects", "intends", "aims", "plans", "predicts", "may", "will", "seeks" or "should" or, in each case, their negative or other variations or comparable terminology, or by discussions of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this Prospectus and include statements regarding the intentions, beliefs or current expectations of the Directors concerning, amongst other things, the Bank's results of operations, financial condition, prospects, growth, strategies and the industry in which the Bank operates.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. Forward-looking statements are not guarantees of future performance. The Bank's actual results of operations, financial condition, and the development of the financial services industry in which the Bank operates, may differ materially from those suggested by the forward-looking statements contained in this Prospectus. In addition, even if the Bank's results of operations, financial condition, and the development of the financial services industry are consistent with the forward-looking statements contained in this Prospectus, those results or developments may not be indicative of results or developments in subsequent periods.

Prospective investors are advised to read, in particular, Section 2 (*Risk Factors*) and Section 8 (*Description of the Bank*) for a more complete discussion of the factors that could affect the Bank's future performance and the financial services industry. In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements in this Prospectus may not occur.

The forward-looking statements contained in this Prospectus speak only as of the date of this Prospectus. The Bank, the Dealer Managers and the Trustee expressly disclaim any obligation or undertaking to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise, unless required to do so by applicable law, the Prospectus Rules, the Listing Rules, or the Disclosure and Transparency Rules of the FCA. All subsequent written and oral forward-looking statements attributable to the Bank or individuals acting on behalf of the Bank are expressly qualified in their entirety by this paragraph.

MARKET, ECONOMIC AND INDUSTRY DATA

The Prospectus contains information regarding Bank's business and the industry in which it operates and competes, which the Bank has obtained from third-party sources.

Bank and other institutions operating in the financial services industry make available a wide range of financial and operational information to regulatory and market bodies, including the Bank of England and the CML. These bodies use certain of the data supplied to publish market share statistics relating to retail mortgage lending and savings, among other matters. However, no assurance can be made that the information reported to these bodies by different market participants is, in all cases, directly comparable.

In some cases, independently determined industry data is not available. In these cases, any Bank market share included in this Prospectus is referred to as having been estimated. All such estimates have been made by the Bank using its own information and other market information which is publicly available. All such estimations have been made in good faith based on the information available and Bank's knowledge of the market within which it operates.

Where third-party information has been used in this Prospectus, the source of such information has been identified. In the case of the presented economic and statistical information, similar information may be obtainable from other sources, although the underlying assumptions and methodology, and consequently the resulting data, may vary from source to source.

The Bank confirms that all information extracted from third party sources has been accurately reproduced and, as far as the Bank is aware and has been able to ascertain from information published by those sources, no facts have been omitted which would render the reproduced information inaccurate or misleading. Where third party information has been used in this Prospectus, the source of such information has been identified.

Where information has not been independently sourced, it is the Bank's own information.

DEFINITIONS

Certain capitalised and other terms used in this Prospectus are defined in Appendix A (*Defined Terms*).

ROUNDING

Certain data in this Prospectus has been rounded. As a result of such rounding, the totals of data presented in tables or narrative descriptions in this Prospectus may vary slightly from the arithmetic totals of such data.

CREDIT RATING AGENCIES

This prospectus contains references to Moody's, Fitch and S&P.

Each of Moody's, Fitch and S&P are established in the European Union and are registered under the CRA Regulation. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

NO INCORPORATION OF WEBSITE INFORMATION

The Bank's website is www.co-operativebank.co.uk. The information on this website or any website mentioned in this Prospectus or any website directly or indirectly linked to these websites has not been verified and is not incorporated by reference into this Prospectus and investors should not rely on it.

All references in this document to times are to UK time unless otherwise stated.

A
APPENDIX A
DEFINED TERMS

This Appendix sets out the meaning of certain defined terms used in this Prospectus or indicates the location in this Prospectus where such meaning can be found.

The following definitions apply throughout this Prospectus unless the context requires otherwise:

Terms and expressions defined in Appendix C (*Consent and Exchange Offer Memorandum*) shall have the same meanings in this Prospectus, except where the context otherwise requires or unless otherwise stated.

13% Bonds	13% Perpetual Subordinated Bonds (ISIN: GB00B3VH4201)
5.5555% Bonds	5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45)
2014 Commitment	the commitment by Banking Group made pursuant to a legally binding and irrevocable commitment with the Bank on 4 November 2013 (conditional upon the Scheme having been implemented in accordance with its terms (including the subscription of Additional New Ordinary Shares Offer to Holders of Dated Notes in accordance with the Scheme)), to contribute £333 million Common Equity Tier 1 Capital to the Bank during 2014, as agreed with the PRA
2014 Commitment Agreement	the agreement between the Banks and Banking Group which is further described in paragraph 20.4, titled "*2014 Commitment Agreement*" in Section 20 (*Additional Information*)
2016 Notes	Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998)
2019 Notes	5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942)
2022 Notes	7.875% Subordinated Notes due 19 December 2022 (ISIN: XS0864253868)
2024 Notes	5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183)
2033 Notes	5.875% Subordinated Notes due 2033 (ISIN: XS0145065602)
Accrual Date	As defined in Appendix B (*Conditions of the Notes*)
Additional New Ordinary Shares	means 62,500,000 ordinary shares to be issued by the Bank for an aggregate consideration equal to £125 million pursuant to the Additional New Ordinary Shares Offer
Additional New Ordinary Shares Offer	the offer to subscribe for Additional New Ordinary Shares in accordance with the terms of the Scheme
Additional Preference Shares	as defined in Section 6 (*Details of the Liability Management Exercise*)
Additional Tier 1 or **ATI**	at any time has the meaning ascribed thereto in Basel III
ALCO	Bank Asset and Liability Committee
Approved Persons	persons approved by either or both of the FCA or the PRA under section 59 of FSMA
April 2021 Notes	9.25% Subordinated Notes due 28 April 2021 (ISIN: XS0620315902)
Authorities	HM Treasury, the Bank of England, the FCA and/or the PRA

B2.5	refers to amendments made to the Basel II framework under the following three papers published by the Basel Committee in July 2009: (a) Enhancements to the Basel II framework (BCBS157); (b) Revisions to the Basel II market risk framework (BCBS158); and (c) Guidelines for computing capital for incremental risk in the trading book (BCBS159)
BACB	the Bank's core business and commercial banking business as further described in paragraph 5 "*Business Overview"* in Section 8 (*Description of the Bank*)
Bank	The Co-operative Bank p.l.c. and its subsidiaries, depending on the context
Bank T2 Notes	new 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853; SEDOL: BFXW085), which may be issued by the Bank pursuant to the Liability Management Exercise
Banking Act	the Banking Act 2009
Banking Group	Co-operative Banking Group Limited, or Co-operative Banking Group Limited and its subsidiaries, depending on the context
Banking Reform Bill	Financial Services (Banking Reform) Bill
Barclays	Barclays Bank PLC, a public limited company organised under the laws of England and Wales, registered with Companies House under number 01026167
Basel II or **B2**	the international capital requirements framework as set out in the Basel Committee's document: *International Convergence of Capital Measurements and Capital Standards: a Revised Framework* (revised in November 2005)
Basel III or **B3**	the reforms to enter new international capital and liquidity requirements as set out in the Basel Committee's document Basel III: *A global regulatory framework for more resilient banks and banking systems dated December 2010* (revised in June 2011), together with the Basel Committee's 13 January 2011 press release entitled *Basel Committee issues final elements of the reforms to raise the quality of regulatory capital*
Basel III Tier 1 Capital	the highest quality regulatory capital under Basel III, as implemented in the European Union through CRD IV, which is divided into common equity tier 1 and additional tier 1 (each as defined in Basel III)
Basel Accord	the current risk-adjusted capital guidelines promulgated by the Basel Committee
Basel Committee	means the Bank for International Settlements' Basel Committee on Banking Supervision
BIPRU	the Prudential sourcebook for Banks, Building Societies and Investment Firms as set out in the Financial Services Handbooks
BRC	the Board Risk Committee of the Bank

Britannia	Britannia Building Society
Britannia Scheme	the Britannia Pension Scheme as further described in paragraph 17 titled "*Pension Schemes*" in Section 20 (*Additional Information*)
British pounds sterling, pounds sterling, Sterling or **£**	pounds sterling, the lawful currency of the United Kingdom
CABB	the Bank's legacy 'corporate and business banking' division which was constituted in 2011 and redefined in 2012
CCA	Consumer Credit Act 1974, as amended
CEO	Chief Executive Officer
Certificate	a certificate issued to each Noteholder that holds their Notes in certificated form, in respect of their registered holding of Notes
CFSMS	CFS Management Services Limited
CFSMS-Bank 2006 Agreement	agreement dated 16 February 2006 in relation to the provision of assets and personnel to the Bank by CFSMS
CFSMS-Bank Framework Agreement	the proposed draft amendment to the CFSMS-Bank 2006 Agreement contemplated for the 17 June Plan and which is further described in paragraph 20.2 titled "*CFSMS-Bank Framework Agreement*" in Section 20 (*Additional Information*)
CIS General Insurance	CIS General Insurance Limited, an industrial and provident society with registration number IP29999R with its registered office address at CIS Building, Miller Street, Manchester M60 0AL
Clearstream, Luxembourg	Clearstream Banking, *société anonyme*
CML	Council of Mortgage Lenders
CoAM or **Co-operative Asset Management**	the function established by the Bank to oversee the proactive management, disposal and run-off of the Non-core Assets
Common Equity Tier 1	at any time, has the meaning ascribed thereto (or to any equivalent term) at such time in CRD IV
Common Equity Tier 1 Capital	capital meeting the definition of Common Equity Tier 1
Companies Act	the Companies Act 2006, as amended
Conditions	the conditions of the Notes as set out in Appendix B (*Conditions of the Notes*)
Co-operative Group	Co-operative Group Limited, or Co-operative Group Limited and its subsidiaries, depending on the context
Co-operative Life Insurance and Asset Management	Royal London (CIS) Limited (formerly known as Co-operative Insurance Society Limited) and Royal London Asset Management (CIS) Limited (formerly known as The Co-operative Asset Management Limited)
Core Business	the division of the Bank comprising the of core business activities as constituted in 2012 and redefined in 2013 consisting of: (i) Retail Banking business;

	(ii) BACB business; and
	(iii) Treasury/other
Core Tier 1 Capital	means the highest quality regulatory capital under Basel II
CRA Regulation	Regulation (EC) No 1060/2009 on credit rating agencies, as amended
CRD IV	the EU's implementation of Basel III via the PRD and the PRR
CRE	commercial real estate
Credit Guarantee Scheme	the HM Treasury's credit guarantee scheme introduced in October 2008 (and closed to new issuance on 28 February 2010) for the purpose of assisting the funding of the UK banking sector and support the stability of the financial system
CREST	the relevant system (as defined in the Uncertificated Securities Regulations) in respect of which Euroclear UK & Ireland Limited (previously CRESTCo Limited) is the operator (as defined in the CREST Regulations)
CRO	Chief Risk Officer
Dated Notes	the following lower tier 2 bonds issued by the Bank: • the 2016 Notes • the 2019 Notes • the April 2021 Notes • the November 2021 Notes • the 2022 Notes • the 2024 Notes • the 2033 Notes
Dealer Managers	HSBC Bank plc and UBS Limited
Deposit Guarantee Scheme	the deposit guarantee scheme created pursuant to the DGSD
DGSD	Directive 94/19/EC (the **EU Deposit Guarantee Scheme Directive**)
Directors or **Board**	the Executive and Non-Executive Directors of the Bank
Disclosure and Transparency Rules	the disclosure and transparency rules made by the FCA under Part VI of FSMA
Discount Window Facility or **DWF**	bilateral facility offered by the Bank of England designed to address short-term liquidity shocks
Early Participation Deadline	4.30 p.m. (London time) on 29 November 2013 (subject to the right of the Bank and/or the Group to amend such date upon notice to Holders)
Early Participation Threshold	has the meaning given to that term in the Offer Memorandum
EBA	European Banking Authority
EEA	European Economic Area

Eligible Holders	a Holder that is eligible to participate in the Liability Management Exercise, or the relevant component part thereof, in accordance with the Offer Restrictions (and **Holder** shall be construed accordingly unless the context otherwise admits)
ERC	Executive Risk Committee
EU	the European Union
euro or **€**	the lawful currency of the Member States that adopt the single currency in accordance with the Treaty establishing the European Community (signed in Rome on 25 March 1957), as amended by the Treaty on European Union (signed in Maastricht on 7 February 1992), the Treaty of Amsterdam (signed in Amsterdam on 2 October 1997) and the Treaty of Nice (signed in Nice on 26 February 2001)
Euroclear	Euroclear Bank S.A./N.V.
Eurozone	those Member States which have adopted the euro
EU Savings Directive	EC Council Directive 2003/48/EC on the taxation of savings income
Exchange Agent	Lucid Issuer Services Limited, in its capacity as exchange agent in respect of the Offers
Exchange Instruction	has the meaning given to that term in the Offer Memorandum
Exchange Offers	the invitations described in the Offer Memorandum by the Bank and Co-operative Group (as applicable) to Eligible Holders to offer to exchange or sell their Preference Shares and Perpetual Subordinated Bonds for certain New Securities or cash payable in instalments (represented by certain New Securities) (and the offer in respect of each series of Perpetual Subordinated Bonds and the Preference Shares each being an **Exchange Offer**)
Executive Directors	Niall Booker and Rodney Jensen Bulmer
Existing IT Services Agreement	the agreement dated 5 July 2012 (as amended and restated from time to time and including most recently on 22 May 2013) between the Bank, Co-operative Group and CFSMS, pursuant to which Co-operative Group provides members of Banking Group, including the Bank, and Co-operative Insurance Society Limited, with a wide range of IT services
Existing MSA	the agreement dated 14 February 2013 (as amended from time to time) between the Bank, Co-operative Group and CFSMS, pursuant to which Co-operative Group provides the Bank with certain services
Existing Securities	Preference Shares, Perpetual Subordinated Bonds and Dated Notes
Explanatory Statement	the explanatory statement made available or to be made available to Holders of Dated Notes in connection with the Scheme
Extraordinary Resolutions	in respect of the Preference Shares and each series of Perpetual Subordinated Bonds, the extraordinary resolution to be proposed at the relevant Meeting of Holders of such securities
FATCA	US Internal Revenue Code of 1986
FCA	the UK Financial Conduct Authority

Final Repayment Notes	11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630; SEDOL: BFXW063) which may be issued by Co-operative Group pursuant to the Liability Management Exercise and guaranteed (on a subordinated basis) by certain of Co-operative Group's subsidiaries
Financial Services Compensation Scheme or **FSCS**	the UK compensation fund of last resort for customers of financial services firms authorised under FSMA, such fund being established under FSMA
Financial Services Handbooks	the FCA Handbook and the PRA Handbook issued under FSMA
Fitch	Fitch Ratings Limited
FPC	Financial Policy Committee
FSA	the Financial Services Authority as succeeded by the FCA or the PRA, as applicable
FSMA	the Financial Services and Markets Act 2000, as amended
Funding for Lending Scheme	the Bank of England and HM Treasury scheme launched on 31 July 2012 to encourage banks and building societies to increase their lending to UK households and non-financial companies
GENPRU	the General Prudential sourcebook as set out in the Financial Services Handbooks
Government	the Government of the United Kingdom
Group Notes	the Final Repayment Notes and/or the Instalment Repayment Notes, as the context admits
Group Notes Prospectus	the prospectus dated 4 November 2013 and issued by Co-operative Group in connection with the issue, offer and listing and admission to trading of the Group Notes, including any supplement(s) thereto (if any) which may be issued after that date
HMRC	HM Revenue & Customs
Holders	the holders of the Existing Securities
Holding Period Trustee	Lucid Issuer Services Limited, as holding period trustee in connection with the Scheme
HSBC	HSBC Bank plc, public limited company organised under the laws of England and Wales, registered with Companies House under number 00014259
IFRS	International Financial Reporting Standards
Illius	a portfolio of repossessed properties managed through Co-operative Group Property with the Non-core Business as further described in Section 8 (*Description of the Bank*)
Information Agent	Lucid Issuer Services Limited, as information agent in connection with the Scheme
Instalment Repayment Notes	Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29; SEDOL: BFXWHQ2), having their last payment in 2025, which may be issued by Co-operative Group

	pursuant to the Liability Management Exercise and guaranteed (on a subordinated basis) by certain of Co-operative Group's subsidiaries
Insurance Proceeds	proceeds of the sale by Co-operative Group of Co-operative Life Insurance and Asset Management and the proposed sale of CIS General Insurance
Interest Payment Date	as defined in Appendix B (*Conditions of the Notes*)
Interim Financial Information	the historical financial information for the Bank for the six months ended 30 June 2013, as set out in "*Part A*" in Section 16 (*Financial Information*)
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 the permission of the appropriate regulator; in the case of the Bank, the appropriate regulator is the PRA
ISIN	International Securities Identification Number
Issue Date	the date of issue of the first tranche of the Notes
Issuer	The Co-operative Bank p.l.c.
Issuer Agreement	the announcement by the Bank and Co-operative Group on 17 June 2013 that, following the conclusion of the Bank's review of its capital position and discussion with the PRA, the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion
June Announcement	the announcement by the Bank and Co-operative Group on 17 June 2013 that following the Bank's review of its capital position and discussions with the PRA, the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion
Junior Securities	as defined in Appendix B (*Conditions of the Notes*)
KPMG	KPMG Audit Plc, a public limited company organised under the laws of England and Wales, registered with Companies House under number 03110745
Liability Management Exercise or **LME**	the liability management exercise of the Bank and Co-operative Group, including the Exchange Offers and Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds, the Scheme in respect of the Dated Notes and the Additional New Ordinary Shares Offer
LIBOR	London Interbank Offered Rate – the interest rate participating banks offer to other banks for loans on the London market
Liikanen Group	the group set up in November 2011 constituting a high-level expert group on structural aspects of the EU banking sector
Listing Rules	the listing rules of the FCA relating to admission to the Official List made in accordance with section 73A(2) of FSMA

Lloyds or **Lloyds Banking Group**	Lloyds Banking Group plc, a public limited company organised under the laws of Scotland, registered with Companies House under number SC095000
Lock-up Arrangements	as defined in Section 6 (*Details of the Liability Management Exercise*)
London Stock Exchange	London Stock Exchange plc
Maturity Date	the tenth anniversary of the Issue Date
Meeting	in respect of the Preference Shares and each series of Perpetual Subordinated Bonds, the meeting of Holders of such securities convened to consider the relevant Extraordinary Resolution (and any adjournment thereof)
Member State	a member state of the EU
Moody's	Moody's Investors Service Limited
New IT Services Agreement	the proposed draft amendment and restatement of the Existing IT Services Agreement contemplated for the 17 June Plan
New MSA	the proposed draft amendment and restatement of the existing MSA contemplated for the 17 June Plan
New Ordinary Shares	112,500,000 ordinary shares to be issued by the Bank in exchange for the Dated Notes pursuant to the Scheme
New Securities	The New Ordinary Shares, the Final Repayment Notes, the Instalment Repayment Notes and/or the Bank T2 Notes, as the context admits
Non-core Assets	the asset classes of the Non-core Business of the Bank that are not consistent with the Bank's Core Business strategy. Further details are contained in Section 8 (*Description of the Bank*)
Non-core Business	a division of the Bank comprising of non-core business activities as constituted in 2012 and redefined in 2013 consisting of asset classes of the Bank that are not consistent with the Core Business of the Bank
Non-Executive Directors	John Richard Coates, Anne Margaret Gunther, Richard Graeme Barclay Hardie, Merlyn Vivienne Lowther, Richard Pym, Euan Angus Sutherland, Bennett Lyle Edward Reid and William Gennydd Thomas
Noteholder	the holders of the Notes
Notes	new 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853; SEDOL: BFXW085), which may be issued by the Bank pursuant to the Liability Management Exercise
November 2021 Notes	Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984)
Offers	The Exchange Offers and the Proposals
Offer Memorandum	the Consent and Exchange Offer Memorandum attached to this Prospectus as Appendix C (*Consent and Exchange Offer Memorandum*)

Offer Record Date	Expected to be 11 December 2013, unless any Meeting is required to be adjourned for want of a quorum (in which case the Offer Record Date is expected to be on or around 27 December 2013). The Offer Record Date is the last date on which Preference Shares, 13% Bonds and 5.5555% Bond can be traded
Offer Restrictions	the offer restrictions as set out in the Offer Memorandum (in respect of the Exchange Offers) and the offer restrictions set out in the Explanatory Statement (in respect of the Scheme)
Official List	the Official List maintained by the Financial Conduct Authority
Optimum or **Optimum portfolio**	the Optimum closed book mortgage portfolio, as further described in Section 8 (*Description of the Bank*)
Ordinary Shares	the ordinary shares in the Bank's share capital following completion of the Liability Management Exercise from time to time
Pace	The Co-operative Pension Scheme (Pace)
Parity Securities	as defined in Appendix B (Conditions of the Notes)
Paying Agent	Computershare Investor Services PLC
Payment Card Industry Data Security Standard	the Payment Card Industry Data Security Standard issued by the Payment Card Industry Security Standards Council, as amended from time to time
Payment Card Industry Security Standards Council	a council formed on 7 September 2006 for the purpose of issuing and managing the Payment Card Industry Data Security Standard
Pension Protection Fund	a statutory fund run by the Board of the Pension Protection Fund, a statutory corporation established under the provisions of the Pensions Act 2004
Pensions Regulator	the UK regulator of work-based pension schemes, as established under the Pensions Act 2004
Perpetual Subordinated Bonds	the 13% Bonds and the 5.5555% Bonds
Pillar 1 Requirement	the minimum amount of capital resources that the Bank is required to maintain at all times under GENPRU 2.1.40R and 2.1.41R
Platform	the Bank's brand of residential mortgage loans sold through mortgage intermediaries
PPI	payment protection insurance
PRA	the UK Prudential Regulation Authority
PRD	Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC
Preference Shares	the Bank's 9.25 per cent. Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516)
Project Unity	the project whereby between 2011 and 2013 the Bank transferred a number of functions to Co-operative Group and entered into

	arrangements pursuant to which Co-operative Group would provide certain services to the Bank as further described in Section 8 (*Description of the Bank*)
Proposals	the proposals inviting Holders of Preference Shares and Perpetual Subordinated Bonds to vote on the Extraordinary Resolutions at the meetings, in order to approve modifications to the terms and conditions of the relevant series (and each proposal being a **Proposal**)
Prospectus Directive	Directive 2003/71/EC (and amendments thereto, including the Directive 2010/73/EU to the extent implemented in the Member State of the EEA that has implemented the Prospectus Directive (**relevant Member State**)) and includes any relevant implementing measure in each relevant Member State
Prospectus Directive Regulation	means Commission Regulation (EC) no. 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements
Prospectus Rules	the prospectus rules of the FCA made under Part VI of FSMA relating to offers of securities to the public and admission of securities to trading on a regulated market
PRR	Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 Text with EEA relevance
Purchase Agreement	the agreement between the Bank and those Holders of the Dated Notes listed in the agreement as described in paragraph 20.9 "*Purchase Agreement*" in Section 20 (*Additional Information*)
Purchasers	the purchasers under the Purchase Agreement
RBS	The Royal Bank of Scotland plc, a public limited company incorporated in Scotland with registered number SC090312
Recapitalisation Plan	taken together, the Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Bank's Existing Securities surrendered in the Liability Management Exercise
Registrar Agreement	the Principal Registrar Agreement dated the Issue Date as amended and/or supplemented and/or restated from time to time, made between the Issuer, the Registrar and the Paying Agent (including the agreement supplement to the Principal Registrar Agreement dated the Issue Date between the Issuer, the Registrar, the Paying Agent and the Trustee)
Registrar	Computershare Investor Services PLC (in respect of the Notes)
Registrars	Computershare Investor Services PLC (in respect of the Preference Shares) and Equiniti Limited (in respect of each series of Perpetual Subordinated Bonds), and references to the **relevant Registrar** shall be construed accordingly

Regulatory Event	as defined in Appendix B (*Conditions of the Notes*)
Relationship Agreement	the relationship agreement between the Bank, Co-operative Group, and Banking Group as described in paragraph 20.3 "*Relationship Agreement*" in Section 20 (*Additional Information*)
Relevant Authority	the Prudential Regulation Authority or such other authority (whether in the United Kingdom or elsewhere) having primary responsibility for prudential supervision of the Issuer
Relevant Date	as defined in Appendix B (*Conditions of the Notes*)
Resolution Authorities	the Bank of England and HM Treasury
Retail Banking	the core retail banking business, which trades as the "The Co-operative Bank", "Britannia" and "smile", together with the Bank's intermediary brand "Platform", and includes retail secured and unsecured lending, as further described in paragraph 5 "*Business Overview*" in Section 8 (*Description of the Bank*)
RRD	the proposed Recovery Resolution Directive, being the Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010
S&P	Standard & Poor's Credit Market Services Europe Limited
Scheme	the Bank's proposed scheme of arrangement in respect of the Dated Notes under Part 26 of the Companies Act
Scheme Claim	the claim of a Holder of Dated Notes in the Scheme, being an amount equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date; provided that a Holder's Scheme Claim in respect of 2016 Notes (which are denominated in euro) shall be the Sterling-Equivalent of such sum, calculated on the basis of the Scheme FX Rate
Scheme FX Rate	as defined in Section 6 (*Details of the Liability Management Exercise*)
Scheme Creditors	the Holders of the Dated Notes and the common depositary and trustee in respect of each series of Dated Notes
Scheme Meeting	the meeting convened for Scheme Creditors for the purpose of considering and if thought fit, approving the Scheme
Scheme Record Date	10 December 2013
Scheme Settlement Date	the date on which the Scheme settles, currently expected to be 18 December 2013
Senior Creditors	as defined in Appendix B (*Conditions of the Notes*)

Senior Managers or the **Senior Management**	the persons named as members of the senior management in Section 9 (*Directors, Senior Management, Employees and Corporate Governance*)
Settlement Condition	the condition which must be satisfied in order for the Liability Management Exercise to settle, as more fully described in Section 6 (*Details of the Liability Management Exercise*) and in the Offer Memorandum
Settlement Date	the date on which the Liability Mangement Exercise settles, currently expected to be 18 December 2013 (subject to the right of the Bank and/or Co-operative Group to amend such date upon notice to Holders)
SME	small and medium-sized enterprises
smile	the Bank's brand of internet banking
SRR	the special resolution regime as set out in part 1 of the Banking Act
Sterling-Equivalent	as defined in Section 6 (*Details of the Liability Management Exercise*)
Tax Jurisdiction	as defined in Appendix B (*Conditions of the Notes*)
Treasury/other	the Bank's treasury division, as further described in paragraph 5 "*Business Overview*" in Section 8 (*Description of the Bank*) and Unity Trust Bank
Trust Deed	a Trust Deed dated the Issue Date constituting the Notes (as modified and/or supplemented and/or restated from time to time) between the Issuer and the Trustee
Trustee	Law Debenture Trustees Limited and its successors as trustee for the Noteholders
UBS or **UBS Investment Bank**	UBS Limited, a private limited company organised under the laws of England and Wales, registered with Companies House under number 02035362
UK Listing Authority	the FCA in its capacity as the competent authority for the purposes of Part VI of FSMA
Uncertificated Securities Regulations	the Uncertificated Securities Regulations 2001, including any modification or re-enactment thereof for the time being in force
United Kingdom or **UK**	the United Kingdom of Great Britain and Northern Ireland
United States, **US** or **U.S.**	the United States of America, its territories and possessions, any state of the United States of America and the District of Columbia
Unity Agreements	(i) the Existing IT Services Agreement, in relation to the provision by Co-operative Group of certain IT services to Banking Group and its subsidiaries and (ii) a Professional Services Master Services Agreement, dated 14 February 2013, pursuant to which the same parties entered into a number of individual service contracts in relation to the provision of certain other services by Co-operative Group to Banking Group and its subsidiaries

Unity Trust Bank	Unity Trust Bank plc, a public limited company organised under the laws of England and Wales, registered with Companies House under number 01713124
Verde Business	Lloyds TSB branches which formed the basis of a proposed acquisition by the Bank

B
APPENDIX B
CONDITIONS OF THE NOTES

This Appendix sets out the terms and conditions of the Notes in full. The terms and conditions describe the obligations of the Bank and the rights of the Noteholders under the Notes.

CONDITIONS OF THE NOTES

The following (other than text in italicised font, which is descriptive only) is the text of the Conditions of the Notes which (subject to modification) will be endorsed on each Certificate issued in respect of the Notes:

The 11 per cent. Subordinated Notes due 2023 (the **Notes**, which expression shall in these Conditions, unless the context otherwise requires, include any further notes issued pursuant to Condition 14 and forming a single series with the Notes) of The Co-operative Bank p.l.c. (the **Issuer**) are constituted by a trust deed (such trust deed as modified and/or supplemented and/or restated from time to time, the **Trust Deed**) dated the date of issue of the first tranche of the Notes (the **Issue Date**) and made between the Issuer and Law Debenture Trustees Limited (the **Trustee**, which expression shall include its successor(s)) as trustee for the Noteholders (as defined below).

The statements in these Conditions include summaries of, and are subject to, the detailed provisions of and definitions in the Trust Deed. Copies of the Trust Deed, the registrar agreement dated the Issue Date (such Registrar Agreement as amended and/or supplemented and/or restated from time to time, the **Principal Registrar Agreement**) made between the Issuer and Computershare Investor Services PLC as registrar (the **Registrar**, which expression shall include any successor registrar appointed from time to time) and as paying agent (the **Paying Agent**, which expression shall include any successor paying agent appointed from time to time) and the agreement supplemental to the Principal Registrar Agreement dated the Issue Date made between the Issuer, the Registrar, the Paying Agent and the Trustee (together with the Principal Registrar Agreement, the **Registrar Agreement**) are available for inspection (by prior appointment) during normal business hours by the Noteholders at the registered office for the time being of the Trustee, being at the date of issue of the Notes at Fifth Floor, 100 Wood Street, London EC2V 7EX, United Kingdom. The Noteholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and the Registrar Agreement applicable to them.

1. FORM, DENOMINATION AND TITLE

1.1 Form and Denomination

The Notes are issued in registered form in amounts of £10 (referred to as the **principal amount** of a Note) and may be held in either certificated form or uncertificated form in CREST. If held in certificated form, a note certificate (each a **Certificate**) may be issued free of charge at the request of a Noteholder in respect of its registered holding of Notes. Each Certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the register of Noteholders which the Issuer will procure to be kept by the Registrar.

In the case of Notes held in uncertificated form, any references herein to "Certificates" (and related references) shall not be applicable to such Notes and (notwithstanding anything to the contrary contained in these Conditions) any transfers or payments shall be made or notices issued in accordance with the Uncertificated Securities Regulations, as further provided in the Trust Deed.

CREST means the relevant system (as defined in the Uncertificated Securities Regulations) in respect of which Euroclear UK & Ireland Limited (formerly known as CRESTCo Limited) (or any successor) is the operator (as defined in the Uncertificated Securities Regulations).

Uncertificated Securities Regulations means the Uncertificated Securities Regulations 2001, including any modification or re-enactment thereof for the time being in force.

1.2 Title

Title to the Notes passes only by registration in the register of Noteholders. The holder of any Note will (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any interest or any writing on, or the theft or loss of, the Certificate issued in respect of it) and no person will be liable for so treating the holder. In these Conditions **Noteholder** and (in relation to a Note) **holder** means the person in

whose name a Note is registered in the register of Noteholders (or, in the case of a joint holding, to the joint holder whose name appears first on the register of Noteholders in respect of such joint holding (the **representative joint Noteholder**).

2. TRANSFER OF NOTES AND ISSUE OF CERTIFICATES

2.1 Transfers

A Note may, subject to the Conditions below, be transferred by depositing the Certificate issued in respect of that Note, with the form of transfer duly completed and signed, at the specified office of the Registrar.

2.2 Delivery of new Certificates

Each new Certificate to be issued upon transfer of Notes will, within five business days of receipt by the Registrar of the duly completed form of transfer together with a valid Certificate, be mailed by uninsured mail at the risk of the holder entitled to the Note to the address specified in the form of transfer. For the purposes of this Condition, **business day** shall mean a day on which banks are open for business in the city in which the specified office of the Registrar with whom a Certificate is deposited in connection with a transfer is located.

Where some but not all of the Notes in respect of which a Certificate is issued are to be transferred, a new Certificate in respect of the Notes not so transferred will, within five business days of receipt by the Registrar of the original Certificate, be mailed by uninsured mail at the risk of the holder of the Notes not so transferred to the address of such holder appearing on the register of Noteholders or as specified in the form of transfer.

2.3 Formalities free of charge

Registration of transfer of Notes will be effected without charge by or on behalf of the Issuer or the Registrar but upon payment (or the giving of such indemnity as the Issuer or the Registrar may reasonably require) in respect of any tax or other governmental charges which may be imposed in relation to such transfer.

2.4 Closed Periods

No Noteholder may require the transfer of a Note to be registered during the period of 15 days ending on the due date for any payment of principal or interest on that Note.

2.5 Regulations

All transfers of Notes and entries on the register of Noteholders will be made subject to the detailed regulations concerning transfer of Notes scheduled to the Trust Deed. The regulations may be changed by the Issuer with the prior written approval of the Registrar and the Trustee. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests one.

3. STATUS AND SUBORDINATION OF THE NOTES

3.1 Status

The Notes are unsecured and, in accordance with Condition 3.2, subordinated obligations of the Issuer and rank *pari passu* without any preference among themselves.

3.2 Subordination

On a winding-up of the Issuer, claims against the Issuer in respect of or arising under the Notes (including any damages awarded for breach of any obligations in respect of the Notes) will be subordinated in the manner provided in the Trust Deed to the claims of all Senior Creditors (as defined below) but shall rank:

(a) at least *pari passu* with all claims of holders of all other subordinated obligations of the Issuer which constitute, and all claims relating to a guarantee or other like or similar undertaking or arrangement given or undertaken by the Issuer in respect of any obligations of any other person which constitute, or (in either case) would but for any applicable limitation on the amount of such capital constitute, Tier 2 Capital and all obligations which rank, or are expressed to rank, *pari passu* therewith (**Parity Securities**); and

(b) in priority to the claims of holders of:

(i) all obligations of the Issuer which rank or are expressed to rank, and all claims relating to a guarantee or other like or similar undertaking or arrangement given or undertaken by the Issuer in respect of any obligations of any other person which rank or are expressed to rank, junior to the claims in respect of the Notes, including (without limitation) obligations which constitute, or would but for any applicable limitation on the amount of such capital constitute, Tier 1 Capital and all obligations which rank, or are expressed to rank, *pari passu* therewith; and

(ii) all classes of share capital of the Issuer,

(together, the **Junior Securities**).

In these Conditions:

Senior Creditors means creditors of the Issuer whose claims are admitted to proof in the winding-up of the Issuer and who are unsubordinated creditors of the Issuer;

Tier 1 Capital and Tier 2 Capital have the respective meanings given to such terms in the Applicable Banking Regulations from time to time;

Applicable Banking Regulations means at any time the laws, regulations, requirements, guidelines and policies relating to capital adequacy then in effect in the United Kingdom and applicable to the Issuer, including, without limitation to the generality of the foregoing, those regulations, requirements, guidelines and policies relating to capital adequacy then in effect of the Relevant Authority and/or any regulation, directive or other binding rules, standards or decisions adopted by the institutions of the European Union; and

Relevant Authority means the Prudential Regulation Authority or such other authority (whether in the United Kingdom or elsewhere) having primary responsibility for prudential supervision of the Issuer.

3.3 Set-Off

Subject to applicable law, neither any Noteholder nor the Trustee may exercise or claim any right of set-off in respect of any amount owed to it by the Issuer arising under or in connection with the Notes and each Noteholder shall, by virtue of its subscription, purchase or holding of any Note, be deemed to have waived all such rights of set-off.

4. INTEREST

4.1 Interest Rate and Interest Payment Dates

The Notes bear interest on their outstanding principal amount from and including the Issue Date at the rate of 11 per cent. per annum, payable quarterly in arrear on each three-month anniversary of the Issue Date up to (and including) the Maturity Date (each an **Interest Payment Date**). The **Maturity Date** means the tenth anniversary of the Issue Date.

By way of example, if the Issue Date is 18 December 2013 (as currently expected), the Interest Payment Dates will be 18 March, 18 June, 18 September and 18 December in each year and the Maturity Date will be 18 December 2023.

4.2 Interest Accrual

Each Note will cease to bear interest from and including its due date for redemption unless, upon due presentation, payment of the principal due in respect of the Note is improperly withheld or refused or unless default is otherwise made in respect of payment, in which event interest shall continue to accrue as provided in the Trust Deed.

4.3 Calculation of Interest

Interest shall be calculated on the basis of (i) the actual number of days in the period from and including the date from which interest begins to accrue (the **Accrual Date**) to but excluding the date on which it falls due divided by (ii) the actual number of days from and including the Accrual Date to but excluding the next following Interest Payment Date multiplied by four. Such day count fraction shall be applied to the product of 11 per cent. and the aggregate principal amount of Notes held by the relevant Noteholder, with the resultant figure rounded down to the nearest £0.01.

5. PAYMENTS

5.1 Payments in respect of Notes

All payments in respect of the Notes will be made by sterling cheque or warrant drawn on a bank or building society in the United Kingdom, posted no later than the Business Day immediately preceding the relevant due date and made payable to the Noteholder (in the case of a joint holding of Notes, the representative joint Noteholder) appearing in the register of Noteholders in respect of the Note of which he is the holder at the close of business on the fifteenth day before the relevant due date (the **Record Date**) at the addresses shown in the register of Noteholders on the Record Date. Payments of principal and payments of interest due otherwise than on an Interest Payment Date will only be made against surrender of the relevant Certificate at the specified office of the Registrar or any Paying Agent. Upon application of a Noteholder (or in the case of a joint holding of Notes, the representative joint Noteholder) to the Registrar, in the form from time to time prescribed by the Registrar, not less than ten days before the due date for any payment in respect of his Notes, the payment may be made by transfer on the due date or, if the due date is not a Business Day, on the immediately following Business Day to a sterling account with a bank or building society in the United Kingdom.

5.2 Payments subject to applicable laws

Payments in respect of principal and interest on Notes are subject in all cases to (i) any fiscal or other laws and regulations applicable thereto in the place of payment, but without prejudice to the provisions of Condition 7 and (ii) any withholding or deduction required pursuant to an agreement described in Section 1471(b) of the U.S. Internal Revenue Code of 1986 (the **Code**) or otherwise imposed pursuant to Sections 1471 through 1474 (inclusive) of the Code, any regulations or agreements thereunder, any official interpretations thereof, or (without prejudice to the provisions of Condition 7) any law implementing an intergovernmental approach thereto.

5.3 No commissions

No commissions or expenses shall be charged by the Issuer, the Registrar or any Paying Agent to the Noteholders in respect of any payments made in accordance with this Condition.

5.4 Payments on Business Days

Where payment of any principal and/or interest is to be made by transfer to a registered account, payment instructions (for value the due date or, if that is not a Business Day (as defined below), for value the first following day which is a Business Day) will be initiated, and where payment is to be made by cheque, the cheque will be mailed, on the Business Day preceding the due date for payment or, in the case of a payment of principal or a payment of interest due otherwise than on an Interest Payment Date, if later, on the Business Day on which the relevant Certificate is surrendered at the specified office of the Registrar or any Paying Agent.

Noteholders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a Business Day, if the Noteholder is late in surrendering its Certificate (if required to do so) or if a cheque mailed in accordance with this Condition arrives after the due date for payment.

In these Conditions, **Business Day** means a day (other than a Saturday or Sunday) on which commercial banks are open for business in London, and in the case of presentation of a Certificate, in the place in which the Certificate is presented.

5.5 Partial payments

If the amount of principal or interest which is due on the Notes is not paid in full, the Registrar will annotate the register of Noteholders with a record of the amount of principal or interest in fact paid.

5.6 Interpretation of Principal and Interest

Any reference in these Terms and Conditions to principal in respect of the Notes shall be deemed to include any additional amounts which may be payable with respect to principal under Condition 7 or pursuant to any undertakings given in addition thereto or in substitution therefor pursuant to the Trust Deed.

Any reference in these Terms and Conditions to interest in respect of the Notes shall be deemed to include any additional amounts which may be payable with respect to interest under Condition 7 or pursuant to any undertakings given in addition thereto or in substitution therefore pursuant to the Trust Deed.

6. REDEMPTION AND PURCHASE

6.1 Redemption at Maturity

Unless previously redeemed or purchased and cancelled as specified below, the Notes will be redeemed by the Issuer at their principal amount on the Maturity Date.

6.2 Redemption for Tax Reasons

Subject to Condition 6.6 below, the Notes may be redeemed at the option of the Issuer, in whole but not in part, at an amount equal to 101 per cent. of their principal amount together with unpaid interest accrued to (but excluding) the date of redemption, at any time on the Issuer giving not less than 30 nor more than 60 days' notice to the Noteholders (which notice shall be irrevocable), if the Issuer satisfies the Trustee immediately before the giving of the aforementioned notice that:

(a) on the occasion of the next payment due under the Notes, the Issuer has or will become obliged either to pay additional amounts as provided or referred to in Condition 7 or to account to any taxing authority in the Tax Jurisdiction for any amount (other than tax withheld or deducted from interest payable on such Notes) in respect of such payment in each case as a result of any change in, or amendment to, the laws or regulations of the Tax Jurisdiction or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after the Issue Date; or

(b) interest payments under or with respect to the Notes are no longer (partly or fully) deductible for UK corporation tax purposes as a result of any change in, or amendment to, the laws or regulations of the Tax Jurisdiction or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after the Issue Date,

and (in either case) such obligation cannot be avoided by the Issuer taking reasonable measures available to it (each a **Tax Event**), provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would be obliged to pay such additional

amounts or make a payment in respect of which it would be obliged to account to any taxing authority as aforesaid were a payment in respect of the Notes then due.

Tax Jurisdiction means the United Kingdom or any political subdivision or any authority thereof or therein having power to tax.

Prior to the publication of any notice of redemption pursuant to this Condition 6.2, the Issuer shall deliver to the Trustee to make available for inspection (by prior appointment) at its specified office to the Noteholders (i) a certificate signed by two Directors of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred, and (ii) an opinion of independent legal or tax advisers of recognised standing to the effect either that such a circumstance does exist or that, upon a change in or amendment to the laws (including any regulations thereunder) or in the interpretation or administration thereof, of the Tax Jurisdiction which at the date of such certificate is proposed to be made and in the opinion of such independent legal or tax advisers and the Issuer (based on such opinion) is reasonably expected to become effective on or prior to the date when the relevant payment in respect of such Notes would otherwise be made, becoming so effective, such circumstances would exist. The Trustee shall be entitled to accept and rely upon the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on the Noteholders.

6.3 Regulatory Event Redemption

Subject to Condition 6.6 below, the Notes may be redeemed at the option of the Issuer, in whole but not in part, at an amount equal to 101 per cent. of their principal amount together with unpaid interest accrued to (but excluding) the date of redemption, at any time on the Issuer giving not less than 30 nor more than 60 days' notice to the Noteholders (which notice shall be irrevocable), if, at any time after the Issue Date, the Issuer determines that as a result of a change in English law or Applicable Banking Regulations or any change in the official application or interpretation thereof (including as a result of the implementation or applicability thereof in the United Kingdom on or after the Issue Date) the Notes are (or will, within the following 90 days, be) fully excluded from Tier 2 Capital for the purposes of Applicable Banking Regulations (a **Regulatory Event**).

6.4 Purchases

Subject to Condition 6.6 below, the Issuer or any of its subsidiaries may at any time purchase Notes at any price in the open market or otherwise. Such Notes may be held, reissued, resold or, at the option of the Issuer, surrendered to the Registrar or any Paying Agent for cancellation.

6.5 Cancellation

All Notes which are redeemed, and any Notes which are purchased and surrendered for cancellation pursuant to Condition 6.4, shall be immediately cancelled and cannot be reissued or resold.

6.6 Redemption and Purchase Conditions

The Issuer shall not be permitted to redeem or purchase the Notes prior to the Maturity Date unless the following conditions (in each case, if and to the extent then required by Applicable Banking Regulations) are satisfied:

(a) the Issuer has given any requisite notice to the Relevant Authority and has obtained the Relevant Authority's prior permission or non-objection to the redemption or purchase (as the case may be) of the Notes;

(b) such redemption or purchase (as the case may be) complies with Applicable Banking Regulations, including (if then required) that either (i) not later than the redemption or purchase date, the Issuer replaces the Notes so redeemed or purchased with new Tier 2 Capital (or higher quality capital) or (ii) the Issuer has demonstrated to the satisfaction of the Relevant Authority

that, both at the time of and immediately following the redemption or purchase (as the case may be) of the Notes, it meets and will continue to meet, or exceed by such margin as the Relevant Authority shall consider necessary, any capital resources requirement (which may include minimum capital requirements and/or combined buffer capital requirements) then applicable to it under Applicable Banking Regulations;

(c) in the case of any redemption of Notes upon the occurrence of a Tax Event or a Regulatory Event, the Issuer has demonstrated to the satisfaction of the Relevant Authority (i) that the circumstances giving rise to the Tax Event or, as the case may be, the Regulatory Event were not reasonably foreseeable as at the Issue Date and, (ii) in the case of a Tax Event only, that the change in the applicable tax treatment is material or, in the case of a Regulatory Event only, that the change in the applicable regulatory classification is sufficiently certain; and

(d) Notes may be purchased by the Issuer prior to the fifth anniversary of the Issue Date only if then permitted by Applicable Banking Regulations or if otherwise authorised by the Relevant Authority.

7. TAXATION

All payments of principal and interest in respect of the Notes by the Issuer will be made without withholding or deduction for or on account of any present or future taxes or duties of whatever nature imposed or levied by or on behalf of the Tax Jurisdiction (as defined in Condition 6.2), unless such withholding or deduction is required by law. In such event, the Issuer will pay such additional amounts as shall be necessary in order that the net amounts received by the holders of the Notes after such withholding or deduction shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of the Notes, in the absence of such withholding or deduction, except that no such additional amounts shall be payable with respect to any Note:

(a) the holder of which is liable for such taxes or duties in respect of such Note by reason of its having some connection with the Tax Jurisdiction other than the mere holding of such Note; or

(b) presented for payment (where presentation is required) more than 30 days after the Relevant Date (as defined below) except to the extent that the holder thereof would have been entitled to an additional amount on presenting the same for payment on such thirtieth day; or

(c) presented for payment (where presentation is required) in the United Kingdom; or

(d) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or

(e) presented for payment (where presentation is required) by or on behalf of a Noteholder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another Paying Agent in a Member State of the European Union.

As used herein, the **Relevant Date** means the date on which such payment first becomes due, except that, if the full amount of the moneys payable has not been duly received by a Paying Agent or the Trustee on or prior to such due date, it means the date on which, the full amount of such moneys having been so received, notice to that effect is duly given to the Noteholders in accordance with Condition 12.

8. PRESCRIPTION

The Notes will become void unless claims in respect of principal and/or interest are made within a period of ten years (in the case of principal) and five years (in the case of interest) after the Relevant Date (as defined in Condition 7) therefor.

9. EVENTS OF DEFAULT AND ENFORCEMENT

9.1 If default is made in the payment of any principal or interest due on the Notes or any of them on the due date and such default continues in the case of principal for a period of 7 days and in the case of interest for a period of 15 days, the Trustee may, subject as provided below, at its discretion and without further notice, institute proceedings for the winding-up of the Issuer, but may take no other action in respect of such default.

9.2 If, otherwise than for the purposes of a reconstruction or amalgamation on terms previously approved in writing by the Trustee, an order is made or an effective resolution is passed for winding-up the Issuer, the Trustee may, and, if so requested in writing by the holders of at least one-fifth in nominal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution of the holders of the Notes shall (subject in each case to being indemnified and/or secured and/or pre-funded to its satisfaction), give notice to the Issuer that the Notes are, and they shall thereby become, immediately due and repayable at their principal amount, together with accrued interest as provided in the Trust Deed. In such event the Trustee shall be entitled to prove in the winding-up of the Issuer and shall have no other remedy against the Issuer.

9.3 Without prejudice to Condition 9.1, if the Issuer fails to perform, observe or comply with any obligation, condition or provision relating to such Notes binding on it under these Conditions (other than any payment obligations of the Issuer arising from the Notes or the Trust Deed including, without limitation, payment of principal or interest in respect of the Notes and any damages awarded for breach of obligations) the Trustee may, subject as provided below, at its discretion and without further notice, institute such proceedings against the Issuer as it may think fit to enforce such obligation, condition or provision provided that the Issuer shall not as a consequence of such proceeding be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

9.4 The Trustee shall not be bound to take the action referred to in Condition 9.1 or Condition 9.3 unless (i) it shall have been so directed by an Extraordinary Resolution of the Noteholders or so requested in writing by the holders of at least one-fifth in nominal amount of the Notes outstanding and (ii) it shall have been indemnified and/or secured and/or pre-funded to its satisfaction.

9.5 No remedy against the Issuer, other than the institution of proceedings by the Trustee for the winding-up of the Issuer and/or proving in the winding-up of the Issuer, shall be available to the Trustee or the Noteholders for the recovery of amounts owing in respect of the Notes as aforesaid (including damages awarded for breach of any obligations) and no holder of a Note shall be entitled to institute proceedings for the winding-up of the Issuer or to prove in such winding-up unless the Trustee, having become bound so to proceed in accordance with Condition 9.4, fails to do so or fails to prove in such winding-up, in each case within a reasonable time and such failure shall be continuing.

10. REPLACEMENT OF CERTIFICATES

Should any Certificate be lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Registrar upon payment by the claimant of such costs and expenses as may be incurred in connection therewith and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

11. REGISTRAR AND PAYING AGENTS

The names of the initial Registrar and Paying Agent and their initial specified offices are set out below.

The Issuer is, with the prior written approval of the Trustee, entitled to vary or terminate the appointment of the Registrar and/or any Paying Agent and/or appoint additional or other Registrars and/or Paying Agents and/or approve any change in the specified office through which any Registrar and/or Paying Agent acts, provided that:

(a) so long as the Notes are listed on any stock exchange, there will at all times be a Paying Agent with a specified office in such place as may be required by the rules and regulations of the relevant stock exchange (or any other relevant authority);

(b) there will at all times be a Paying Agent with a specified office in a European city (which may be London) approved in writing by the Trustee;

(c) there will at all times be a Paying Agent and a Registrar; and

(d) there will at all times be a Paying Agent in a European Union Member State (if any) that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive.

Notice of any termination or appointment and of any changes in specified offices will be given to the Noteholders promptly by the Issuer in accordance with Condition 12.

In acting under the Registrar Agreement, subject as provided therein, the Registrar and the Paying Agent will act solely as agents of the Issuer, and will not assume any obligations or relationships of agency or trust to or with the Noteholders, except that (without affecting the obligations of the Issuer to the Noteholders to repay the Notes and to pay interest thereon) funds received by the Paying Agent for the payment of any sums due in respect of the Notes shall be held by them on behalf of the Noteholders until the expiry of the relevant period of prescription under Condition 8. The Registrar Agreement contains provisions for the indemnification of the Registrar.

12. NOTICES

All notices to the Noteholders will be valid if mailed to them at their respective addresses in the register of Noteholders maintained by the Registrar. The Issuer shall also ensure that notices are duly given or published in a manner which complies with the rules and regulations of any stock exchange or other relevant authority on which the Notes are for the time being listed. Any notice shall be deemed to have been given on the second day after being so mailed or on the date of publication or, if so published more than once or on different dates, on the date of the first publication.

13. MEETINGS OF NOTEHOLDERS, MODIFICATION AND WAIVER

13.1 Meetings of Noteholders

The Trust Deed contains provisions for convening meetings of the Noteholders to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution of a modification of the Notes or certain provisions of the Trust Deed. Such a meeting may be convened by the Issuer, the Trustee or by Noteholders holding not less than 10 per cent. in nominal amount of the Notes for the time being remaining outstanding. The quorum at any such meeting for passing an Extraordinary Resolution is one or more persons holding or representing a clear majority in nominal amount of the Notes for the time being outstanding, or at any adjourned meeting one or more persons being or representing Noteholders whatever the nominal amount of the Notes so held or represented, except that at any meeting the business of which includes the modification of certain provisions of the Notes (including modifying the date of maturity of the Notes or any date for payment of interest thereon, reducing or cancelling the amount of principal or the rate of interest payable in respect of the Notes or altering the currency of payment of the Notes) or certain of the provisions of the Trust Deed, the necessary quorum for passing an Extraordinary Resolution will be one or more persons holding or representing not less than two-thirds, or at any adjourned such meeting not less than one-third, in nominal amount of the Notes for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Noteholders shall be binding on all the Noteholders, whether or not they are present at the meeting.

13.2 Modification and Waiver

The Trust Deed provides that the Trustee may agree, without the consent of the Noteholders, to any modification (subject to certain exceptions as provided in the Trust Deed) of, or to any waiver or authorisation of any breach or proposed breach of, any of these Terms and Conditions or any of the provisions of the Trust Deed, or may determine that any condition, event or act which, but for such determination, would constitute an event giving rise to the right of the Trustee described in Condition 9, shall not be treated as such which in any such case, in the opinion of the Trustee, is not materially prejudicial to the interests of the Noteholders or to any modification of any of these Terms and Conditions or any of the provisions of the Trust Deed or the Registrar Agreement which is, in the opinion of the Trustee, of a formal, minor or technical nature, which is made to correct a manifest error or which, in the opinion of the Trustee, is not materially prejudicial to the interests of Noteholders. Any such modification, waiver, authorisation or determination shall be binding on the Noteholders and, unless the Trustee agrees otherwise, any such modification shall be notified to the Noteholders as soon as practicable thereafter in accordance with Condition 12.

13.3 Rights of Trustee

In connection with the exercise by it of any of its trusts, powers, authorities or discretions (including, but without limitation, any modification, waiver, authorisation or substitution), the Trustee shall have regard to the interests of the Noteholders as a class and, in particular, but without limitation, shall not have regard to the consequences of such exercise for individual Noteholders resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory and the Trustee shall not be entitled to require, nor shall any Noteholder be entitled to claim, from the Issuer or any other person any indemnification or payment in respect of any tax consequence of any such exercise upon individual Noteholders except to the extent already provided for in Condition 7 and/or any undertaking given in addition to, or in substitution for, Condition 7 pursuant to the Trust Deed.

13.4 Compliance with Applicable Banking Regulations

The Issuer shall comply with Applicable Banking Regulations in connection with any modification or proposed modification of these Terms and Conditions.

14. FURTHER ISSUES

The Issuer shall be at liberty from time to time without the consent of the Noteholders to create and issue further notes having terms and conditions the same as the Notes or the same in all respects save for the amount and date of the first payment of interest thereon and so that the same shall be consolidated and form a single series with the outstanding Notes.

15. SUBSTITUTION

The Trustee may, without the consent of the Noteholders, agree with the Issuer to the substitution in place of the Issuer (or of any previous substitute under this Condition) as the principal debtor under the Notes and the Trust Deed of the Holding Company of the Issuer, a Successor in Business or any Subsidiary of the Issuer (each as defined in the Trust Deed), subject to (i) in the case of a substitution of any Subsidiary of the Issuer, the Notes being unconditionally and irrevocably guaranteed by the Issuer and so that the obligations of the Issuer under such guarantee shall be subordinated on a basis considered by the Trustee to be equivalent to that in respect of the Issuer's obligations in respect of the Notes, (ii) the Trustee being satisfied that the interests of the Noteholders will not be materially prejudiced by the substitution, (iii) the obligations of such Holding Company of the Issuer or Successor in Business or, in the case of substitution of a Subsidiary of the Issuer, the obligations of the Issuer under its guarantee, being subordinated on a basis considered by the Trustee to be equivalent to that in respect of the Issuer's obligations as principal debtor in respect of the Notes, and (iv) certain other conditions set out in the Trust Deed being complied with. In making any such determination of equivalence of subordination for the purposes of paragraphs (i) and (iii) above, the Trustee shall be entitled to request that the Issuer, and the Issuer shall be obliged to, procure an opinion of

independent legal advisers of recognised standing and the Trustee shall be entitled to accept the provision of and rely upon such opinion in satisfaction of its making such determination.

The Issuer shall comply with Applicable Banking Regulations in connection with any substitution of the Issuer (or any previous substitute) under this Condition.

16. INDEMNIFICATION OF THE TRUSTEE

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility in certain circumstances including provisions relieving it from instituting proceedings to enforce repayment or exercise any powers, duties, authorities or discretions unless indemnified and/or secured and/or pre-funded to its satisfaction.

The Trustee may rely without liability to Noteholders on a report, confirmation or certificate or any advice or any accountants, financial advisers, financial institution or any other expert, whether or not addressed to it and whether their liability in relation thereto is limited (by its terms or by any engagement letter relating thereto entered into by the Trustee or in any other manner) by reference to a monetary cap, methodology or otherwise. The Trustee may accept and shall be entitled to rely on any such report, confirmation or certificate or advice and such report, confirmation or certificate or advice shall be binding on the Issuer, the Trustee and the Noteholders.

The Trustee is not responsible for monitoring or supervising the performance by the Registrar, the Paying Agent and/or any other person of its obligations to the Issuer and may assume these are being performed unless and until it has actual knowledge to the contrary.

17. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

No rights are conferred on any person under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Note, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

18. GOVERNING LAW

The Trust Deed, the Registrar Agreement, the Notes and any non-contractual obligations arising out of or in connection with the Trust Deed, the Registrar Agreement and the Notes are governed by, and shall be construed in accordance with, English law.

C
APPENDIX C
CONSENT AND EXCHANGE OFFER MEMORANDUM

This Appendix is the Offer Memorandum which sets out the full terms of the Liability Management Exercise.

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in any doubt as to the action you should take, you are recommended to seek your own personal financial advice immediately from your stockbroker, bank, solicitor, accountant, fund manager or other appropriate financial adviser, who is authorised under the Financial Services and Markets Act 2000 if you are in the United Kingdom or, if not, from another appropriately authorised financial adviser.

IF YOU ARE A U.S. PERSON (WHEREVER LOCATED) OR ARE LOCATED IN THE UNITED STATES, YOU WILL BE ELIGIBLE TO RECEIVE THIS DOCUMENT AND TO PARTICIPATE IN THE SCHEME AND THE MEETINGS DESCRIBED HEREIN BUT YOU WILL NOT BE ELIGIBLE TO PARTICIPATE IN THE EXCHANGE OFFERS DESCRIBED HEREIN. THIS DOCUMENT IS NOT FOR GENERAL RELEASE, PUBLICATION OR DISTRIBUTION IN OR INTO ANY JURISDICTION WHERE TO DO SO WOULD CONSTITUTE A VIOLATION OF THE RELEVANT LAWS OF SUCH JURISDICTION.

This Consent and Exchange Offer Memorandum (the "Offer Memorandum") does not constitute an offer to buy or a solicitation of an offer to sell Existing Securities or New Securities (each as defined herein) in any jurisdiction in which, or to or from any person to or from whom, it is unlawful to make such offer or solicitation under applicable securities laws or otherwise. The offers of the securities referred to in this Offer Memorandum have not been and will not be registered under the United States Securities Act of 1933. In particular, the Exchange Offers are not being made to any person who is a U.S. person (as defined in Regulation S ("Regulation S") under the United States Securities Act of 1933) or who is located in the United States. The New Securities (as defined herein) may not be offered or sold in the United States or to U.S. persons unless an exemption from the registration requirements of the Securities Act is available. Holders who wish to participate in the Exchange Offers will be required to represent that they will not resell or otherwise transfer the New Securities during the 40 day period commencing on the Settlement Date for the Exchange Offers except outside of the United States in a transaction complying with Rule 903 or 904 of Regulation S. Persons into whose possession this Offer Memorandum comes are required by each of the Bank, the Group, the Dealer Managers, the Exchange Agent, the Information Agent and the Registrars (each as defined herein) to inform themselves about, and to observe, any such restrictions.

CONSENT AND EXCHANGE OFFER MEMORANDUM dated 4 November 2013

The co-operative bank The co-operative

Invitations by

The Co-operative Bank p.l.c.

(incorporated with limited liability in England with registered number 990937)

and

Co-operative Group Limited

(incorporated and registered in England under the Industrial and Provident Societies Act 1965 to 2003 with registered number IP525R)

to the holders of the securities listed in the table below, in each case issued by The Co-operative Bank p.l.c.

(together, the "**Existing Securities**")

to participate (as applicable) in

the Exchange Offers, the Proposals and the Scheme

(as defined in this document)

Description of the Securities	*ISIN*	*Outstanding Principal Amount*
Preference Shares:		
9.25% Non-Cumulative Irredeemable Preference Shares	GB0002224516	£60,000,000
Perpetual Subordinated Bonds:		
13% Perpetual Subordinated Bonds*	GB00B3VH4201	£110,000,000
5.5555% Perpetual Subordinated Bonds*	GB00B3VMBW45	£200,000,000
Dated Notes:		
Floating Rate Callable Step-up Dated Subordinated Notes due 2016**	XS0254625998	€34,980,000
5.875% Subordinated Callable Notes due 2019	XS0189539942	£37,775,000
9.25% Subordinated Notes due 28 April 2021	XS0620315902	£275,000,000
Fixed/Floating Rate Subordinated Notes due November 2021	XS0274155984	£8,747,000
7.875% Subordinated Notes due 19 December 2022	XS0864253868	£235,402,000
5.75% Dated Callable Step-up Subordinated Notes due 2024**	XS0188218183	£200,000,000
5.875% Subordinated Notes due 2033**	XS0145065602	£150,000,000

* Issued by the Bank in replacement of Britannia Building Society permanent interest bearing shares on its merger with Britannia on 1 August 2009

** Originally issued by Britannia Building Society and assumed by the Bank at the time of its merger with Britannia on 1 August 2009

AN OVERVIEW OF THE CONSIDERATION TO BE DELIVERED IN EXCHANGE FOR THE ABOVE SECURITIES IS SET OUT IN THE TABLE IN SECTION B OF THIS DOCUMENT

THE EARLY PARTICIPATION DEADLINE IS 4.30 P.M. (LONDON TIME) ON 29 NOVEMBER 2013 AND THE EXPIRATION DEADLINE IS 4.30 P.M. (LONDON TIME) ON 6 DECEMBER 2013, UNLESS IN EACH CASE EXTENDED, RE-OPENED OR TERMINATED AS PROVIDED IN THIS OFFER MEMORANDUM.

THE DEADLINES SET BY ANY INTERMEDIARY OR CLEARING SYSTEM WILL BE EARLIER THAN THESE DEADLINES.

Dealer Managers

HSBC **UBS Investment Bank**

INTRODUCTION TO THIS DOCUMENT

What is this document?

This document (the "**Offer Memorandum**"), which forms part of the Prospectus to which it is appended, contains the details of the liability management exercise being conducted by The Co-operative Bank p.l.c. ("**Co-operative Bank**" or the "**Bank**") and Co-operative Group Limited ("**Co-operative Group**" or the "**Group**").

Is this document relevant to me?

This document will be relevant to you if you hold any of the following securities issued by the Bank:

The "**Preference Shares**":

- 9.25% Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516)

The "**Perpetual Subordinated Bonds**"[1]:

- 13% Perpetual Subordinated Bonds (ISIN: GB00B3VH4201) (the "**13% Bonds**")
- 5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) (the "**5.5555% Bonds**")

The "**Dated Notes**":

- Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN XS0254625998)
- 5.875% Subordinated Callable Notes due 2019 (ISIN XS0189539942)
- 9.25% Subordinated Notes due 28 April 2021 (ISIN XS0620315902)
- Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN XS0274155984)
- 7.875% Subordinated Notes due 19 December 2022 (ISIN XS0864253868)
- 5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN XS0188218183)
- 5.875% Subordinated Notes due 2033 (ISIN XS0145065602)

The Preference Shares, the Perpetual Subordinated Bonds and the Dated Notes are together referred to in this document as the "**Existing Securities**".

I hold some of these Existing Securities. Where do I start?

This document contains detailed information on what the Liability Management Exercise means for you. It is important that you read it carefully in full.

However, holders of Preference Shares, 13% Bonds and 5.5555% Bonds are encouraged to first read the key messages on the following pages.

1. The Perpetual Subordinated Bonds were issued by the Bank at the time of the merger with the Britannia Building Society on 1 August 2009. They replaced the permanent interest bearing shares originally issued by Britannia Building Society.

Key messages for holders of the 9.25% Preference Shares

How do I know if I own Preference Shares?

- You will either have a share certificate (if you own the Preference Shares directly) or, if you have invested through a broker, your account statements should reference the Co-operative Bank 9.25% Non-Cumulative Irredeemable Preference Shares. Their ISIN number is GB0002224516

What decisions do I need to take?

- You need to decide whether you wish to participate in the *Exchange Offer* for the Preference Shares. By participating in the *Exchange Offer*, you will vote in favour of a *Proposal* that will enable Co-operative Group to acquire mandatorily all Preference Shares. If the *Proposal* is approved, and the *Liability Management Exercise* is successful, what you will receive in return for your Preference Shares is explained below
- If you choose not to participate in the *Exchange Offer* you are free to vote against the *Proposal* if you wish. However, if the *Proposal* is approved and implemented, Co-operative Group will mandatorily acquire your Preference Shares on the same economic terms as if you had participated in the *Exchange Offer*

Do I have to participate?

- You do not have to participate. However, you are strongly encouraged to do so. If the *Liability Management Exercise* does not succeed, the Co-operative Bank believes that it would be subject to a formal 'resolution' procedure under the UK Banking Act 2009. The Co-operative Bank believes that success of the *Liability Management Exercise* will be substantially more beneficial to holders of Preference Shares than resolution of the Co-operative Bank

Do I have a choice of what I receive if I do decide to participate in the Exchange Offer?

- Yes. If you decide to participate in the *Exchange Offer*, you must choose what to receive in return for your Preference Shares. You have two alternatives. You must choose between them:
  - If you wish to preserve your level of income from the Preference Shares for the next twelve years you may choose the *Instalment Repayment Notes*. If, for example, you own £1,000 of Preference Shares, then by choosing the *Instalment Repayment Notes* option you would only receive £92.50* each year (payable in one yearly instalment) up to 2025. **You will not be entitled to any further payments after 2025**
  - If you wish to preserve some of your capital instead, you may choose the *Final Repayment Notes*. These pay interest at 11% each year, but you will receive less *Final Repayment Notes* than you currently have Preference Shares. If, for example, you own £1,000 of Preference Shares, then you would receive £601* of *Final Repayment Notes*. You would receive £66.11* of interest each year (payable in one yearly instalment) up to 2025, plus repayment of the £601* capital in 2025. **You will not be entitled to any further payments after 2025**

* *Please note that these amounts will be approximately 8% lower if not enough holders of Preference Shares, 13% Bonds and 5.5555% Bonds participate by 29 November 2013*

Who is responsible for making payments on the Instalment Repayment Notes and Final Repayment Notes?

- Co-operative Group will be responsible for making these payments

When do I have to take action?

- If you wish to participate in the *Exchange Offer*, you should do so by **29 November 2013** at the latest. Whilst it is possible to participate up to 6 December 2013, the terms of the *Exchange Offer* are more favourable for all holders of Preference Shares if enough investors participate by the earlier date

How do I participate?

- If you have a share certificate, you will receive a letter enclosing the relevant forms to complete and return. If you have invested through a broker, please contact your broker

What next?

- Please read the rest of this Prospectus, including this Offer Memorandum, carefully. It contains detailed information on the *Exchange Offer* and the Proposal to help you make your decision
- We expect to announce the results of the *Liability Management Exercise* on 12 December 2013

Key messages for holders of the 13% Perpetual Subordinated Bonds

How do I know if I own 13% Bonds?

- You will either have a bond certificate (if you own the 13% Bonds directly) or, if you have invested through a broker, your account statements should reference the Co-operative Bank 13% Perpetual Subordinated Bonds. Their ISIN number is GB00B3VH4201

What decisions do I need to take?

- You need to decide whether you wish to participate in the *Exchange Offer* for the 13% Bonds. By participating in the *Exchange Offer*, you will vote in favour of a *Proposal* that will enable Co-operative Group to acquire mandatorily all 13% Bonds. If the *Proposal* is approved, and the *Liability Management Exercise* is successful, what you will receive in return for your 13% Bonds is explained below
- If you choose not to participate in the *Exchange Offer* you are free to vote against the *Proposal* if you wish. However, if the *Proposal* is approved and implemented, Co-operative Group will mandatorily acquire your 13% Bonds on the same economic terms as if you had participated in the *Exchange Offer*

Do I have to participate?

- You do not have to participate. However, you are strongly encouraged to do so. If the *Liability Management Exercise* does not succeed, the Co-operative Bank believes that it would be subject to a formal 'resolution' procedure under the UK Banking Act 2009. The Co-operative Bank believes that success of the *Liability Management Exercise* will be substantially more beneficial to holders of 13% Bonds than resolution of the Co-operative Bank

Do I have a choice of what I receive if I do decide to participate in the Exchange Offer?

- Yes. If you decide to participate in the *Exchange Offer*, you must choose what to receive in return for your 13% Bonds. You have two alternatives. You must choose between them:
  - If you wish to preserve your level of income from the 13% Bonds for the next twelve years you may choose the *Instalment Repayment Notes*. If, for example, you own £1,000 of 13% Bonds, then by choosing the *Instalment Repayment Notes* option you would only receive £130* each year (payable in one yearly instalment) up to 2025. **You will not be entitled to any further payments after 2025**
  - If you wish to preserve some of your capital instead, you may choose the *Final Repayment Notes*. These pay interest at 11% each year, but you will receive less *Final Repayment Notes* than you currently have 13% Bonds. If, for example, you own £1,000 of 13% Bonds, then you would receive £844* of *Final Repayment Notes*. You would receive £92.84* of interest each year (payable in one yearly instalment) up to 2025, plus repayment of the £844* capital in 2025. **You will not be entitled to any further payments after 2025**

* *Please note that these amounts will be approximately 6% lower if not enough holders of Preference Shares, 13% Bonds and 5.5555% Bonds participate by 29 November 2013*

Who is responsible for making payments on the Instalment Repayment Notes and Final Repayment Notes?

- Co-operative Group will be responsible for making these payments

When do I have to take action?

- If you wish to participate in the *Exchange Offer*, you should do so by **29 November 2013** at the latest. Whilst it is possible to participate up to 6 December 2013, the terms of the *Exchange Offer* are more favourable for all holders of 13% Bonds if enough investors participate by the earlier date

How do I participate?

- If you have a bond certificate, you will receive a letter enclosing the relevant forms to complete and return. If you have invested through a broker, please contact your broker

What next?

- Please read the rest of this Prospectus, including this Offer Memorandum, carefully. It contains detailed information on the *Exchange Offer* and the *Proposal* to help you make your decision
- We expect to announce the results of the *Liability Management Exercise* on 12 December 2013

Key messages for holders of the 5.5555% Perpetual Subordinated Bonds

How do I know if I own 5.5555% Bonds?

- You will either have a bond certificate (if you own the 5.5555% Bonds directly) or, if you have invested through a broker, your account statements should reference the Co-operative Bank 5.5555% Perpetual Subordinated Bonds. Their ISIN number is GB00B3VMBW45

What decisions do I need to take?

- You need to decide whether you wish to participate in the *Exchange Offer* for the 5.5555% Bonds. By participating in the *Exchange Offer*, you will vote in favour of a *Proposal* that will enable the Co-operative Bank to exchange mandatorily all 5.5555% Bonds. If the *Proposal* is approved, and the *Liability Management Exercise* is successful, what you will receive in return for your 5.5555% Bonds is explained below
- If you choose not to participate in the *Exchange Offer* you are free to vote against the *Proposal* if you wish. However, if the *Proposal* is approved and implemented, the Co-operative Bank will mandatorily exchange your 5.5555% Bonds on the same economic terms as if you had participated in the *Exchange Offer*

Do I have to participate?

- You do not have to participate. However, you are strongly encouraged to do so. If the *Liability Management Exercise* does not succeed, the Co-operative Bank believes that it would be subject to a formal 'resolution' procedure under the UK Banking Act 2009. The Co-operative Bank believes that success of the *Liability Management Exercise* will be substantially more beneficial to holders of 5.5555% Bonds than resolution of the Co-operative Bank

Do I have a choice of what I receive if I do decide to participate in the Exchange Offer?

- No. If you decide to participate in the *Exchange Offer*, you will receive *Bank T2 Notes* in exchange for your 5.5555% Bonds. If, for example, you own £1,000 of 5.5555% Bonds, then you will receive £530* of *Bank T2 Notes*. You will receive £58.28* of interest each year (payable in four instalments of £14.57* every three months) up to 2023, plus repayment of the £530* capital in 2023. **You will not be entitled to any further payments after 2023**

** Please note that these amounts will be approximately 9% lower if not enough holders of Preference Shares, 13% Bonds and 5.5555% Bonds participate by 29 November 2013*

Who is responsible for making payments on the Bank T2 Notes?

- The Co-operative Bank will be responsible for making these payments

When do I have to take action?

- If you wish to participate in the *Exchange Offer*, you should do so by **29 November 2013** at the latest. Whilst it is possible to participate up to 6 December 2013, the terms of the *Exchange Offer* are more favourable for all holders of 5.5555% Bonds if enough investors participate by the earlier date

How do I participate?

- If you have a bond certificate, you will receive a letter enclosing the relevant forms to complete and return. If you have invested through a broker, please contact your broker

What next?

- Please read the rest of this Prospectus, including this Offer Memorandum, carefully. It contains detailed information on the *Exchange Offer* and the *Proposal* to help you make your decision
- We expect to announce the results of the *Liability Management Exercise* on 12 December 2013

Key message for all holders - Resolution of the Co-operative Bank

What happens if the Liability Management Exercise does not succeed?

- If any one of the *Proposals* does not succeed, the *Liability Management Exercise* will fail
- If the *Liability Management Exercise* fails, the Co-operative Bank will not be able to meet the Prudential Regulation Authority's requirement to raise at least £1 billion of fresh common equity tier 1 capital by the end of 2013
- In consequence, the Co-operative Bank would be failing, or likely to fail, to satisfy the conditions which the Prudential Regulation Authority considers necessary for it to operate as a UK bank
- The Co-operative Bank believes that, in those circumstances, the only realistic alternative is *Resolution* of the Co-operative Bank under the UK Banking Act 2009
- *Resolution* would involve the UK resolution authorities (HM Treasury and the Bank of England) exercising very broad powers under the Banking Act in order to recapitalise the Co-operative Bank
- These powers are extensive, and the UK resolution authorities have a number of options available to them. However, such powers could potentially be used in a manner which would result in holders of Existing Securities losing some, or even all, of their investment in their Existing Securities
- The Co-operative Bank has prepared an analysis of what may occur under Resolution. For further information, see Section 4, Part C (*Potential consequences of Holders' failure to support the Liability Management Exercise*) of the Bank T2 Prospectus or Part 2 (*Risk Factors – Risks relating to the Liability Management Exercise*) of the Group Notes Prospectus
- That analysis is necessarily subject to a number of significant caveats and assumptions described within the analysis
- **However, having given careful consideration to the matter and subject to those caveats and assumptions, the Board of Directors of the Co-operative Bank believes that if the Co-operative Bank were to enter into a bank insolvency or administration procedure following Resolution, holders of Existing Securities would receive no recovery at all**
- **As a result, the Board of Directors of the Co-operative Bank believes that implementation of the Liability Management Exercise is substantially more beneficial to holders of all classes of Existing Securities than resolution of the Co-operative Bank**

OVERVIEW OF THE LIABILITY MANAGEMENT EXERCISE

What is a "liability management exercise"?

A liability management exercise is where a company seeks to restructure some or all of its debts and other obligations. Companies conduct liability management exercises for a number of reasons. A number of banks in the United Kingdom and across the world have conducted liability management exercises in recent years as a means to strengthen their capital position in response to the global financial crisis and the resulting efforts by banking regulators worldwide to make the financial systems safer. The Bank and the Group are conducting their liability management exercise for similar reasons, as more fully described below under "*Why has the Liability Management Exercise been launched?*".

What does the Bank's and Group's liability management exercise involve?

The liability management exercise being conducted by the Bank and the Group involves invitations to holders of the Existing Securities to exchange their Existing Securities for new securities to be issued by the Bank and, in certain cases, the Group.

This Offer Memorandum sets out the terms upon which those invitations are being made and related proposals (the "**Proposals**") in respect of the Preference Shares and Perpetual Subordinated Bonds for holders of such securities to agree, amongst other things, to amend the terms of such securities in the manner described below.

The offers in respect of the Preference Shares and Perpetual Subordinated Bonds are being conducted by way of exchange offers (the "**Exchange Offers**" and each an "**Exchange Offer**") and the Proposals. The offer in respect of the Dated Notes is being conducted by way of a scheme of arrangement under Part 26 of the Companies Act 2006 (the "**Scheme**"). Pursuant to, and on the terms of, the Scheme, the holders of the Dated Notes will also be entitled to elect to subscribe for up to 62,500,000 of new ordinary shares in the Bank for an aggregate consideration equal to £125 million.

The Exchange Offers, the Proposals and the Scheme are collectively referred to in this document as the "**Liability Management Exercise**".

The offers in respect of the Preference Shares, the Perpetual Subordinated Bonds and the Dated Notes are summarised briefly below under "*What is being offered?*", but these descriptions are subject to the more detailed offer terms and conditions set out in this Offer Memorandum.

Why has the Liability Management Exercise been launched?

The Liability Management Exercise is being conducted as part of a required recapitalisation of the Bank and is an integral part of the comprehensive recapitalisation plan announced by the Bank and the Group to strengthen the Bank's capital base (the "**Recapitalisation Plan**").

On 17 June 2013, following the conclusion of the Bank's review of its capital position and discussions with the Prudential Regulation Authority (the United Kingdom banking regulator, part of the Bank of England) (the "**PRA**"), the Bank and the Group announced that the Bank required additional aggregate Common Equity Tier 1 capital of £1.5 billion. The Bank and the Group also announced initial details of the Recapitalisation Plan which was intended to address this capital requirement. The Recapitalisation Plan consists of the Liability Management Exercise, a £333 million contribution of Common Equity Tier 1 capital from the Group in 2014 (the "**2014 Commitment**") and any capital generated from interest savings on the Existing Securities surrendered in the Liability Management Exercise. The Liability Management Exercise, if successful, is expected to generate at least £1 billion of Common Equity Tier 1 capital in 2013 and, conditional on successful completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 capital during 2014 pursuant to the 2014 Commitment (of which £170 million is to be contributed by 30 June 2014 (with £70 million of this contribution to be paid by 31 January 2014) and the remaining £163 million by 31 December 2014).

The contributions that a successful Liability Management Exercise will provide by the end of 2013 would increase the Bank's Common Equity Tier 1 capital ratio towards the upper end of previously announced guidance on 29 August 2013, of "below 9 per cent. but above the regulatory minimum requirement" by the end of 2013, including after taking into account the impact of the impairment charges of £496 million incurred for the six month period ended 30 June 2013 and any potential further impairment charges for the remainder of the Bank's financial year ending 31 December 2013.

Successful completion of the Liability Management Exercise is conditional upon the entire principal amount of all Existing Securities being exchanged pursuant to the Liability Management Exercise, as further described below.

On 17 June 2013, the PRA made the following statement:

> *"The PRA's current assessment is that the Co-operative Bank needs to generate an additional £1.5bn in Common Equity Tier One capital in order to absorb potential losses over coming years. We will hold the Co-operative to the delivery of its plans. In relation to the Co-operative Bank this action will deliver the Financial Policy Committee's recommendation to the PRA in March regarding the capital position of the banking system."*

On 29 August 2013, the PRA reconfirmed its assessment of the Bank's capital shortfall of £1.5 billion following the announcement by the Bank of its interim results for the six month period ended 30 June 2013. In addition, the PRA reconfirmed that the £1.5 billion Common Equity Tier 1 capital requirement remained unchanged following the announcement by the Bank on 21 October 2013 of an expectation of an increase in its overall provisions of approximately £103 million relating to customer redress.

What is Common Equity Tier 1 capital?

Common Equity Tier 1 capital is a form of capital which banks and other financial institutions are required to maintain to help absorb losses, including in times of financial distress. In the aftermath of the recent global financial crisis, the PRA is requiring UK banks to bolster their capital resources so that they (and the UK banking system generally) are better able to withstand future losses and financial shocks.

How will the Liability Management Exercise strengthen the Bank's capital base?

The Liability Management Exercise, if successful, will principally generate Common Equity Tier 1 capital in two ways. First, to the extent that the Bank exchanges Existing Securities for new ordinary shares and issues additional new ordinary shares pursuant to the Scheme, the amount of new ordinary shares issued will constitute Common Equity Tier 1 capital of the Bank. Second, to the extent that the amount of new securities issued in exchange for Existing Securities is less than the value ascribed to those Existing Securities in the Bank's accounts, the difference will also be recognisable as Common Equity Tier 1 capital of the Bank. This is similar to paying off a debt for less than the full amount of that debt.

Provided the Liability Management Exercise is successfully completed, the Liability Management Exercise will generate at least £1 billion of the required £1.5 billion of Common Equity Tier 1 capital.

What conditions must be satisfied in order for the Liability Management Exercise to be successfully completed?

The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities is exchanged pursuant to the Liability Management Exercise.

In order for that to happen, all of the following (in each case, as further described in this document) must occur:

(i) the Proposal in respect of the Preference Shares must be (A) approved by the holders of the Preference Shares at the meeting convened for such holders to vote on such Proposal (and a resolution in similar terms must also be approved at a general meeting of the shareholders of the Bank) and (B) capable of being implemented in accordance with the terms of that Proposal as set out in this document;

(ii) the Proposal in respect of the 13% Bonds must be (A) approved by the holders of the 13% Bonds at the meeting convened for such holders to vote on such Proposal and (B) capable of being implemented in accordance with the terms of that Proposal as set out in this document;

(iii) the Proposal in respect of the 5.5555% Bonds must be (A) approved by the holders of the 5.5555% Bonds at the meeting convened for such holders to vote on such Proposal and (B) capable of being implemented in accordance with the terms of that Proposal as set out in this document; and

(iv) (A) the Scheme must be approved by the requisite majority of the holders of the Dated Notes at the scheme meeting and sanctioned by the Court; (B) an office copy of the sanction order must be delivered to the Registrar of Companies at Companies House; and (C) the Scheme must become unconditional in accordance with its terms (subject only to satisfaction of the Settlement Condition).

The requirements of paragraphs (i) to (iv) (inclusive) above are collectively referred to in this document as the "**Settlement Condition**".

If the Settlement Condition is not satisfied, the Liability Management Exercise will not be implemented, and no Existing Securities will be exchanged pursuant to the Liability Management Exercise. The last date on which the Liability Management Exercise may successfully complete is 31 December 2013.

Will Co-operative Group retain control of the Bank?

If the Liability Management Exercise is successfully completed, the Group will retain a 30 per cent. stake in the Bank. This stake will come only as a direct result of the Group's fresh capital injection into the Bank, which it is providing partly through the Liability Management Exercise and partly through the 2014 Commitment. The Group's existing equity stake in the Bank will be converted into deferred shares and effectively reduced to nil upon successful implementation of the Liability Management Exercise, and a total of 250,000,000 new ordinary shares will be issued at that time, of which:

(i) 75,000,000 (representing 30 per cent. of the total) will be issued to the Group in consideration for its fresh capital contribution (representing an effective subscription price of £6.16 per share);

(ii) 112,500,000 (representing 45 per cent. of the total) will be issued in the Scheme to holders of the Dated Notes in exchange for their Dated Notes (such new ordinary shares will be distributed in the Scheme *pro rata* amongst the holders of the Dated Notes, based on the relative size of each holder's scheme claim) (representing, based on the total value of scheme claims and the number of new ordinary shares issued in the Scheme to holders of Dated Notes, an implied subscription price of approximately £7.77 per share); and

(iii) 62,500,000 (representing the balance of 25 per cent. of the total) will be available for subscription by holders of Dated Notes pursuant to, and on the terms of, the Scheme for an aggregate consideration equal to £125 million (representing an effective subscription price of £2.00 per share).

What happens if the Liability Management Exercise does not succeed?

The Bank believes that there are only two realistic outcomes for the Bank following the launch of the Liability Management Exercise, either:

- its recapitalisation following successful implementation of the Liability Management Exercise; or
- its Resolution under the UK Banking Act 2009 (the "**Banking Act**") following failure of the Liability Management Exercise.

"**Resolution**" would involve the United Kingdom resolution authorities (HM Treasury and the Bank of England) exercising very broad stabilisation powers available to them under the Banking Act to impose one of several stabilisation options under a 'special resolution regime' on the Bank. These powers are extensive, and could potentially be used in a manner which would result in holders of Existing Securities losing some, or even all, of their investment in the Existing Securities.

Given the discretionary nature of the powers available to the UK resolution authorities under the Banking Act, the Bank is unable to predict with certainty the precise outcome for holders if the Liability Management Exercise is not successfully implemented during 2013. However, the Bank has no other source available to it to raise the required additional Common Equity Tier 1 capital. As stated in the historical interim financial information for the Bank for the six months ended 30 June 2013, if the Liability Management Exercise is not successfully completed, the Bank will cease to be a going concern and the Bank considers it is likely to fail to satisfy its threshold conditions for authorisation (within the meaning of Section 55B of the Financial Services and Markets Act 2000, as amended). In such circumstances, the UK resolution authorities may then exercise a stabilisation power under the Banking Act. These threshold conditions include a requirement that the PRA is satisfied, in particular, that the Bank has appropriate financial resources and structural arrangements, including that the Bank has made appropriate provisions for its liabilities. In addition, the UK resolution authorities may also exercise their powers to resolve the Bank even where it remains a going concern.

If the Liability Management Exercise is not successfully implemented on or before 31 December 2013, the Bank therefore considers that the PRA would have a basis for determining that the Bank is failing, or is likely to fail, to satisfy its threshold conditions; that the power of the UK resolution authorities to exercise stabilisation powers under the Banking Act had arisen; and that the Bank believes that the Bank would be subject to a resolution procedure under the Banking Act. The Bank therefore believes, as noted above, that there are only two realistic outcomes for the Bank, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Bank becoming subject to a resolution procedure under the Banking Act.

In the event that the Bank enters an insolvency procedure or administration following action taken by the UK resolution authorities under the Banking Act, and as further described in Section 4, Part C (*Potential consequences of Holders' failure to support the Liability Management Exercise*) of the Bank T2 Prospectus (as defined below) and in Part 2 (*Risk Factors – Risks relating to the Liability Management Exercise*) of the Group Notes Prospectus (as defined below), the Board of the Bank believes it likely that holders would not receive any recovery in any such insolvency proceedings or administration and would not be entitled to any compensation as a result of a bank insolvency procedure or administration of the Bank. The Bank also believes that there are fundamental uncertainties as to whether the Bank could be successfully resolved under the current terms of the Banking Act such that the Bank itself remained a going concern. The Board of the Bank therefore believes that the Recapitalisation Plan represents the only realistic opportunity for holders to recover any value in return for their investment in the Bank.

The Bank has prepared a Resolution analysis, which can be found in Part C of Section 4 of the Bank T2 Prospectus, to support this conclusion. This analysis is subject to a number of significant caveats and assumptions described within the analysis. Holders should read the analysis in that light. However, subject to those caveats and assumptions, the Bank believes that the return to the Bank's senior unsecured creditors from a bank insolvency procedure or administration of the Bank would be in the region of 91.5 per cent. and that holders of Existing Securities would receive no recovery at all in such a bank insolvency procedure or administration because their claims are subordinated to the claims of the senior unsecured creditors of the Bank. As a result, the Bank believes that implementation of the Liability Management Exercise is substantially more beneficial to holders of all classes of Existing Securities than resolution of the Bank.

Is there an early participation incentive?

Yes. With a view to incentivising holders of the Preference Shares, 13% Bonds and 5.5555% Bonds to participate in the Liability Management Exercise promptly, the Liability Management Exercise is designed such that if the Early Participation Threshold (as described below) is achieved by 4.30 p.m. (London time) on 29 November 2013 (the "Early Participation Deadline"), the amount of consideration which all holders will be eligible to receive upon the exchange or sale of their Preference Shares, 13% Bonds and 5.5555% Bonds in the Liability Management Exercise (if the Liability Management Exercise is successfully completed) will be higher than if the Early Participation Threshold is not achieved by the Early Participation Deadline.

The "**Early Participation Threshold**" will be achieved only if all of the following have occurred by the Early Participation Deadline:

(i) the aggregate nominal amount of Preference Shares which have been (A) validly offered for exchange or sale in the Liability Management Exercise and/or (B) otherwise validly voted in favour of the Extraordinary Resolution in respect of the Preference Shares (and, in each case, not validly revoked) must be equal to or greater than 75 per cent. of the aggregate nominal amount of Preference Shares outstanding;

(ii) the aggregate nominal amount of 13% Bonds which have been (A) validly offered for exchange or sale in the Liability Management Exercise and/or (B) otherwise validly voted in favour of the Extraordinary Resolution in respect of the 13% Bonds (and, in each case, not validly revoked) must be equal to or greater than 75 per cent. of the aggregate nominal amount of 13% Bonds outstanding; and

(iii) the aggregate nominal amount of 5.5555% Bonds which have been (A) validly offered for exchange and/or (B) otherwise validly voted in favour of the Extraordinary Resolution in respect of the 5.5555% Bonds (and, in each case, not validly revoked) must be equal to or greater than 75 per cent. of the aggregate nominal amount of 5.5555% Bonds outstanding.

If any one or more of the above is not achieved by the Early Participation Deadline, the Early Participation Threshold will not have been achieved, and the amount of consideration to be delivered in exchange for all Preference Shares, 13% Bonds and 5.5555% Bonds pursuant to the Liability Management Exercise (if the Liability Management Exercise is successfully completed) will be lower than if the Early Participation Threshold had been achieved by the Early Participation Deadline. The difference in the amount of consideration is further described below.

What is being offered?

The offers and proposals being made pursuant to the Liability Management Exercise are summarised briefly below, but these descriptions are subject to the more detailed offer terms and conditions set out in this Offer Memorandum.

Preference Shares Offer

Holders of the Preference Shares are being offered a choice of two options:

(1) to offer to transfer their Preference Shares to the Group in exchange for new sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) (the "**Final Repayment Notes**") to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries; or

(2) to offer to sell their Preference Shares to the Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) (the "**Instalment Repayment Notes**") to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries.

The Final Repayment Notes and Instalment Repayment Notes are, together, referred to in this document as the "**Group Notes**".

Final Repayment Notes: The Final Repayment Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid annually on each anniversary of the issue date of the Final Repayment Notes up to (and including) the twelfth anniversary. The Group will be obliged to repay the principal amount of the Final Repayment Notes in full on the twelfth anniversary of their issue date.

Instalment Repayment Notes: The Instalment Repayment Notes (representing instalments of the cash purchase price for the Preference Shares) will not bear interest. However, the principal amount of such Instalment Repayment Notes will be repaid in twelve equal instalments over twelve years. Those payments

will be made on each anniversary of the issue date of the Instalment Repayment Notes, with the final payment falling on the twelfth anniversary of that issue date. If the Early Participation Threshold is achieved by the Early Participation Deadline, the principal amount of Instalment Repayment Notes which a holder will receive upon the sale of its Preference Shares to the Group will be equal to twelve times the annual dividend on those Preference Shares (rounded down to the nearest £0.12 (12 pence), which is the minimum denomination of the Instalment Repayment Notes). **Accordingly, (in circumstances where the Early Participation Threshold is achieved by the Early Participation Deadline), by repaying those Instalment Repayment Notes in twelve equal instalments over twelve years, the Group will pay to the holder, in each of those twelve years, an amount which is broadly equivalent to the amount of dividends which such holder would have received had it continued to hold those Preference Shares which it sells to the Group in the Liability Management Exercise.**

Final Repayment Notes vs Instalment Repayment Notes: Each holder shall be able to choose only one of the two options available.

Since the Group will repay the principal of the Instalment Repayment Notes in equal instalments over twelve years, the amount payable to a holder in each year if it elects the Instalment Repayment Notes option will be higher than the annual interest payment to such holder if it elects the Final Repayment Notes option. However, the final payment on the Instalment Repayment Notes in 2025 will be significantly lower than the final payment under the Final Repayment Notes in 2025 (reflecting the fact that the principal on the Final Repayment Notes is repayable in a single payment in that twelfth year).

After the twelfth and final payment, both the Final Repayment Notes and the Instalment Repayment Notes will have been fully repaid, and the holder will have no further entitlement to any amounts under whichever of those securities it elected to receive.

If a holder intends to hold its Final Repayment Notes or Instalment Repayment Notes for the full twelve years, an important point of distinction for such holder will be whether it wishes to receive (i) the higher amounts payable each year (except the twelfth year) under the Instalment Repayment Notes, or (ii) the lower annual payments of interest under the Final Repayment Notes but a larger one-off payment in twelve years' time, in which latter case it should elect to receive the Final Repayment Notes.

The tax treatment of holders opting to exchange their Preference Shares for Final Repayment Notes will be different to the tax treatment of holders opting to sell their Preference Shares for a cash amount paid in instalments (represented by Instalment Repayment Notes). Holders are recommended to consult their own professional advisers regarding the tax treatment applicable to their specific circumstances.

A table comparing certain key features of the Preference Shares, the Final Repayment Notes and the Instalment Repayment Notes can be found at Section C, Part 6 of this Offer Memorandum.

Group Notes

The principal amount of Group Notes which a holder will (if the Liability Management Exercise is successfully completed) receive for each £1,000 in nominal amount of Preference Shares (excluding the Additional Preference Shares referred to below) exchanged or sold to the Group will depend upon (i) whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option; and (ii) whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

If the holder elects the Final Repayment Notes option, then:

- if the Early Participation Threshold is achieved by the Early Participation Deadline, a holder will receive (subject to rounding) £601 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of Preference Shares exchanged; and
- if the Early Participation Threshold is not achieved by the Early Participation Deadline, a holder will receive (subject to rounding) £551 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of Preference Shares exchanged.

If, on the other hand, the holder elects the Instalment Repayment Notes option, then:

- if the Early Participation Threshold is achieved by the Early Participation Deadline, a holder will receive (subject to rounding) £1,110 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of Preference Shares sold to the Group; and
- if the Early Participation Threshold is not achieved by the Early Participation Deadline, a holder will receive (subject to rounding) £1,060 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of Preference Shares sold to the Group.

The references above to £1,000 in nominal amount of Preference Shares are for illustrative purposes only. Holders of Preference Shares will be able to offer to exchange or sell their Preference Shares in any whole multiple of £1 (subject to a minimum of £2 if such holder elects the Final Repayment Notes option (being the minimum nominal amount of Preference Shares necessary to receive, based on the Late Consideration Amount, at least the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if the holder elects the Instalment Repayment Notes option).

Accrued dividends

An amount equal to accrued and unpaid dividends from (and including) 30 November 2013 to (but excluding) the date of settlement of the Liability Management Exercise (i.e. the date on which the Preference Shares are transferred to the Group and holders become eligible to receive Group Notes) will also be paid in cash in respect of those Preference Shares (other than Additional Preference Shares) which are exchanged or sold to the Group.

In addition, the next instalment of the Preference Share dividend is, under the terms of the Preference Shares, scheduled to be paid on 30 November 2013 which is during the offer period for the Liability Management Exercise. Under the terms of the Preference Shares, the Bank will not be able to pay the dividend in cash, but will instead be required to allot additional Preference Shares to each holder in lieu of cash payment ("**Additional Preference Shares**"). The Bank expects to allot such Additional Preference Shares on 29 November 2013 (since 30 November is a Saturday). If the Liability Management Exercise successfully completes, then upon transfer of those Additional Preference Shares to the Group the holders will not receive Final Repayment Notes or Instalment Repayment Notes in respect thereof but rather will receive an amount in cash equal to the cash dividend which the Bank would have paid on or around 29 November 2013 had it been able to do so under the terms of the Preference Shares.

Since the Additional Preference Shares will be fungible with (i.e. identical to) other Preference Shares such that it may not be possible to distinguish between them, for the purposes of the treatment of Additional Preference Shares in the Liability Management Exercise as described above, 6⅛ per cent. of the aggregate nominal amount of the Preference Shares outstanding will be deemed to be Additional Preference Shares for these purposes.

Proposal

A meeting of the holders of the Preference Shares is also being convened (the "**Preference Shareholders Meeting**"), in accordance with the Articles of Association of the Bank, in order for those holders to vote on proposed resolutions which, if passed and implemented, would result in amendments to the terms of the Preference Shares, as set out in the Bank's Articles of Association, to enable the Bank:

(i) to purchase and cancel any share capital of the Bank (which would include, without limitation, Preference Shares) from time to time, without the need for the further consent of the holders of the Preference Shares; and

(ii) to mandatorily effect the transfer to the Group of all (but not some only) of the Preference Shares, which are not exchanged or sold in the Exchange Offer, either (1) in exchange for Final Repayment Notes, or (2) in return for the cash consideration to be paid over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as those upon which Preference Shares are exchanged or sold in the Exchange Offer.

The proposed resolution also contains, on behalf of all holders of the Preference Shares (i) a release, in favour of certain persons (including, amongst others, the Bank, the Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their Preference Shares; provided, however, that nothing in that resolution shall constitute a release of the Bank or the Group from, or a waiver of the rights and entitlements of holders in respect of, the respective obligations or liabilities of the Bank and the Group in their capacity as persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

A general meeting of all shareholders (both ordinary shareholders and preference shareholders) of the Bank must also approve a resolution, in similar terms to the resolution in (ii) above, in order to give effect to the above resolution (the "**General Meeting**"). By offering to exchange or sell its Preference Shares in the Liability Management Exercise, a holder will instruct both (i) the chairman of the Preference Shareholders Meeting to vote on such holder's behalf in favour of the resolution proposed at the Preference Shareholders Meeting and (ii) the chairman of the General Meeting to vote on such holder's behalf in favour of the resolution proposed at the General Meeting.

If a holder has not made a valid election (in accordance with the procedures set out in this document) whether to receive Final Repayment Notes or Instalment Repayment Notes, and such holder's Preference Shares are mandatorily transferred to the Group following the successful implementation of the Proposal described above, then (i) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes, such holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes, such holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the holder will receive Final Repayment Notes.

13% Bonds Offer

Holders of the 13% Bonds are being offered a choice of two options:

(1) to offer to transfer their 13% Bonds to the Group in exchange for Final Repayment Notes (as defined above) to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries; or

(2) to offer to sell their 13% Bonds to the Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by Instalment Repayment Notes (as defined above) to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries.

Final Repayment Notes: The Final Repayment Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid annually on each anniversary of the issue date of the Final Repayment Notes up to (and including) the twelfth anniversary. The Group will be obliged to repay the principal amount of the Final Repayment Notes in full on the twelfth anniversary of their issue date.

Instalment Repayment Notes: The Instalment Repayment Notes (representing instalments of the cash purchase price for the 13% Bonds) will not bear interest. However, the principal amount of such Instalment Repayment Notes will be repaid in twelve equal instalments over twelve years. Those payments will be made on each anniversary of the issue date of the Instalment Repayment Notes, with the final payment falling on the twelfth anniversary of that issue date. If the Early Participation Threshold is achieved by the Early Participation Deadline, the principal amount of Instalment Repayment Notes which a holder will receive upon the sale of its 13% Bonds to the Group will be equal to twelve times the annual interest on those 13% Bonds (rounded down to the nearest £0.12 (12 pence), which is the minimum denomination of the Instalment Repayment Notes). **Accordingly, (in circumstances where the Early Participation Threshold is achieved**

by the Early Participation Deadline), by repaying those Instalment Repayment Notes in twelve equal instalments over twelve years, the Group will pay to the holder, in each of those twelve years, an amount which is broadly equivalent to the amount of interest which such holder would have received had it continued to hold those 13% Bonds which it sells to the Group in the Liability Management Exercise.

Final Repayment Notes vs Instalment Repayment Notes: Each holder shall be able to choose only one of the two options available.

Since the Group will repay the principal of the Instalment Repayment Notes in equal instalments over twelve years, the amount payable to a holder in each year if it elects the Instalment Repayment Notes option will be higher than the annual interest payment to such holder if it elects the Final Repayment Notes option. However, the final payment on the Instalment Repayment Notes in 2025 will be significantly lower than the final payment under the Final Repayment Notes in 2025 (reflecting the fact that the principal on the Final Repayment Notes is repayable in a single payment in that twelfth year).

After the twelfth and final payment, both the Final Repayment Notes and the Instalment Repayment Notes will have been fully repaid, and the holder will have no further entitlement to any amounts under whichever of those securities it elected to receive.

If a holder intends to hold its Final Repayment Notes or Instalment Repayment Notes for the full twelve years, an important point of distinction for such holder will be whether it wishes to receive (i) the higher amount payable each year (except the twelfth year) under the Instalment Repayment Notes, or (ii) the lower annual payments of interest under the Final Repayment Notes but a larger one-off payment on the twelfth anniversary, in which latter case it should elect to receive the Final Repayment Notes.

The tax treatment of holders opting to exchange their 13% Bonds for Final Repayment Notes will be different to the tax treatment of holders opting to sell their 13% Bonds for a cash amount paid in instalments (represented by Instalment Repayment Notes). Holders are recommended to consult their own professional advisers regarding the tax treatment applicable to their specific circumstances.

A table comparing certain key features of the 13% Bonds, the Final Repayment Notes and the Instalment Repayment Notes can be found in Section C, Part 7 of this Offer Memorandum.

Group Notes

The principal amount of Group Notes which a holder will (if the Liability Management Exercise is successfully completed) receive for each £1,000 in nominal amount of 13% Bonds exchanged or sold to the Group will depend upon (i) whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option; and (ii) whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

If the holder elects the Final Repayment Notes option, then:

- if the Early Participation Threshold is achieved by the Early Participation Deadline, a holder will receive £844 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of 13% Bonds exchanged; and
- if the Early Participation Threshold is not achieved by the Early Participation Deadline, a holder will receive £794 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of 13% Bonds exchanged.

If, on the other hand, the holder elects the Instalment Repayment Notes option, then:

- if the Early Participation Threshold is achieved by the Early Participation Deadline, a holder will receive (subject to rounding) £1,560 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of 13% Bonds sold to the Group; and

- if the Early Participation Threshold is not achieved by the Early Participation Deadline, a holder will receive (subject to rounding) £1,510 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of 13% Bonds sold to the Group.

The 13% Bonds have denominations of £1,000 each, and accordingly must be offered for exchange or sale in nominal amounts of £1,000 or a whole multiple of £1,000.

Accrued interest

An amount equal to accrued and unpaid interest from (and including) 31 July 2013 to (but excluding) the date of settlement of the Liability Management Exercise (i.e. the date on which the 13% Bonds are transferred to the Group and holders become eligible to receive Group Notes) will also be paid in cash in respect of those 13% Bonds which are exchanged or sold to the Group.

In addition, as announced by the Bank on 12 July 2013, upon successful completion (i.e. settlement) of the Exchange Offer in respect of the 13% Bonds, the Bank will pay, in cash, to all investors in the 13% Bonds (whether or not participating in the Exchange Offer) the deferred interest payment originally scheduled for 31 July 2013.

Proposal

A meeting of the holders of the 13% Bonds is also being convened (the "**13% Bondholders Meeting**"), in accordance with the trust deed dated 1 August 2009 constituting the 13% Bonds, in order for those holders to vote on proposed resolutions which, if passed and implemented, would result in amendments to the terms of the 13% Bonds to enable the Bank to mandatorily effect the transfer to the Group of all (but not some only) of the 13% Bonds, which are not offered or sold in the Exchange Offer, either (1) in exchange for Final Repayment Notes, or (2) in return for the cash consideration to be paid over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as those upon which 13% Bonds are exchanged or sold in the Exchange Offer.

The proposed resolution also contains, on behalf of all holders of the 13% Bonds (i) a release, in favour of certain persons (including, amongst others, the Bank, the Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their 13% Bonds; provided, however, that nothing in that resolution shall constitute a release of the Bank or the Group from, or a waiver of the rights and entitlements of holders in respect of, the respective obligations or liabilities of the Bank and the Group in their capacity as persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

By offering to exchange or sell its 13% Bonds in the Liability Management Exercise, a holder will also instruct the chairman of the 13% Bondholders Meeting to vote on such holder's behalf in favour of the resolution proposed at the 13% Bondholders Meeting.

If a holder has not made a valid election (in accordance with the procedures set out in this document) whether to receive Final Repayment Notes or Instalment Repayment Notes, and such holder's 13% Bonds are mandatorily transferred to the Group following the successful implementation of the Proposal described above, then (i) if (in the Liability Management Exercise) the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Instalment Repayment Notes, such holder will receive Final Repayment Notes; or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Final Repayment Notes, such holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the holder will receive Final Repayment Notes.

5.5555% Bonds Offer

Holders of the 5.5555% Bonds are being invited to offer to exchange their 5.5555% Bonds for new sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank (the "**Bank T2 Notes**").

The Bank T2 Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid quarterly on each three-month anniversary of the issue date of the Bank T2 Notes up to (and including) the tenth anniversary. The Bank will be obliged to repay the principal amount of the Bank T2 Notes in full on the tenth anniversary of their issue date.

A table comparing certain key features of the 5.5555% Bonds and the Bank T2 Notes can be found at Section C, Part 8 of this Offer Memorandum.

Bank T2 Notes

The principal amount of Bank T2 Notes which a holder will (if the Liability Management Exercise is successfully completed) receive in exchange for every £1,000 in nominal amount of 5.5555% Bonds will depend upon whether or not the Early Participation Threshold is achieved by the Early Participation Deadline. Accordingly:

- if the Early Participation Threshold is achieved by the Early Participation Deadline, a holder will receive £530 in principal amount of Bank T2 Notes for every £1,000 in nominal amount of 5.5555% Bonds exchanged.
- if the Early Participation Threshold is not achieved by the Early Participation Deadline, a holder will receive £480 in principal amount of Bank T2 Notes for every £1,000 in nominal amount of 5.5555% Bonds exchanged.

The 5.5555% Bonds have denominations of £1,000 each, and accordingly must be offered for exchange in nominal amounts of £1,000 or a whole multiple of £1,000.

Accrued interest

An amount equal to accrued and unpaid interest from (and including) 14 December 2013 to (but excluding) the date of settlement of the Liability Management Exercise (i.e. the date on which the 5.5555% Bonds are exchanged for Bank T2 Notes) will also be paid in cash in respect of those 5.5555% Bonds which are exchanged.

The next interest payment on the 5.5555% Bonds is scheduled for 14 December 2013. The Bank intends to defer that interest payment (which it is entitled to do under the terms of the 5.5555% Bonds). If the Liability Management Exercise subsequently successfully settles, the Bank will pay the deferred interest to all investors in the 5.5555% Bonds, whether or not participating in the Exchange Offer, in cash upon settlement of the Liability Management Exercise.

Proposal

A meeting of the holders of the 5.5555% Bonds is also being convened (the "**5.5555% Bondholders Meeting**"), in accordance with the trust deed dated 1 August 2009 constituting the 5.5555% Bonds, in order for those holders to vote on a proposed resolution which, if passed and implemented, would result in amendments to the terms of the 5.5555% Bonds to enable the Bank to mandatorily effect the exchange of all (but not some only) of the 5.5555% Bonds, which are not exchanged in the Exchange Offer, for Bank T2 Notes on the same economic terms as 5.5555% Bonds are exchanged in the Exchange Offer.

The proposed resolution also contains, on behalf of all holders of the 5.5555% Bonds (i) a release, in favour of certain persons (including, amongst others, the Bank, the Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their 5.5555% Bonds; provided, however, that nothing in that resolution shall constitute a release of the

Bank or the Group from, or a waiver of the rights and entitlements of holders in respect of, the respective obligations or liabilities of the Bank and the Group in their capacity as persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

By offering to exchange its 5.5555% Bonds in the Liability Management Exercise, a holder will also instruct the chairman of the 5.5555% Bondholders Meeting to vote on such holder's behalf in favour of the resolution proposed at the 5.5555% Bondholders Meeting.

Dated Notes Offers

Holders of the Dated Notes are being invited to vote on proposals under the Scheme to authorise the Bank to exchange all outstanding Dated Notes (including those held by holders who do not vote in favour of the proposals) for a combination of (i) new ordinary shares (ISIN: GB00BDW0BX87) to be issued by the Bank ("**New Ordinary Shares**") and (ii) Bank T2 Notes (as defined above under "*5.5555% Bonds Offer*").

Scheme Claims and accrued interest

A holder's claim in the Scheme (its "**Scheme Claim**") will be equal to the sum of (i) the aggregate principal amount outstanding of such holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date; provided that a holder's Scheme Claim in respect of any Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (which are denominated in euro) shall be the sterling equivalent of such sum, calculated on the basis of an exchange rate of £0.85644 per €1.00.

For the purposes of determining a holder's Scheme Claim, the "**Scheme Record Date**" is currently expected to be 10 December 2013.

The amount of a holder's Scheme Claim will be used to determine the number of New Ordinary Shares and principal amount of Bank T2 Notes which such holder will be entitled to receive in exchange for its Dated Notes if the Scheme is settled, as further described below. For the avoidance of doubt, no accrued interest will be paid in cash pursuant to the Scheme.

The Scheme will provide that any interest that accrues or falls due for payment after the Scheme Record Date will be irrevocably cancelled on the Scheme Settlement Date.

New Ordinary Shares and Bank T2 Notes

The number of New Ordinary Shares and the principal amount of Bank T2 Notes which a holder will (if the Liability Management Exercise is successfully completed) receive pursuant to the Scheme based on its Scheme Claim will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

A holder will receive 115 New Ordinary Shares and £102.63 in principal amount of Bank T2 Notes (in each case, subject to rounding) for every £1,000 of its Scheme Claim.

Lock-up Arrangements

Holders of Dated Notes will be invited to enter into lock-up arrangements ("**Lock-up Arrangements**") in accordance with the procedures set out in the Explanatory Statement relating to the Scheme. Such Lock-up Arrangements will result in such holders agreeing (amongst other things) to vote their full Scheme Claim in favour of the Scheme at the Scheme creditors meeting.

Offer of additional New Ordinary Shares for cash

The Scheme will also provide that 62,500,000 additional New Ordinary Shares will be made available to holders of the Dated Notes for subscription for an aggregate consideration equal to £125 million, all pursuant to, and on the terms of, the Scheme.

What options are available to me?

Preference Shares Offer

Holders of Preference Shares have the following options available:

(i) offer to exchange (for Final Repayment Notes) or sell (for cash consideration payable in twelve equal instalments over twelve years, to be represented by Instalment Repayment Notes) some or all of their Preference Shares in the Preference Shares Exchange Offer (in which case such holders will also automatically vote those Preference Shares in favour of the resolutions proposed at the Preference Shareholders Meeting and the General Meeting);

(ii) vote some or all of their Preference Shares in favour of the resolutions proposed at the Preference Shareholders Meeting and the General Meeting without offering to exchange or sell their Preference Shares;

(iii) vote some or all of their Preference Shares against the resolutions proposed at the Preference Shareholders Meeting and/or the General Meeting (in which case such holders will not be able to offer to exchange or sell their Preference Shares in the Preference Shares Exchange Offer); or

(iv) do nothing.

Holders who take the action (or inaction) under (ii), (iii) or (iv) above should note that, if the resolutions proposed at the Preference Shareholders Meeting and the General Meeting are passed and implemented, such holders' Preference Shares will be mandatorily either (1) exchanged for Final Repayment Notes or (2) transferred to the Group in return for the cash consideration payable over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as Preference Shares are exchanged or sold in the Exchange Offer. Holders are encouraged to elect whether, if their Preference Shares are subject to such mandatory arrangements, they would prefer to (1) exchange their Preference Shares for Final Repayment Notes or (2) sell their Preference Shares to the Group in return for the cash consideration payable over twelve years and represented by the Instalment Repayment Notes.

13% Bonds Offer

Holders of 13% Bonds have the following options available:

(i) offer to exchange (for Final Repayment Notes) or sell (for cash consideration payable in twelve equal instalments over twelve years, to be represented by Instalment Repayment Notes) some or all of their 13% Bonds in the Exchange Offer (in which case such holders will also automatically vote those 13% Bonds in favour of the resolution proposed at the 13% Bondholders Meeting);

(ii) vote some or all of their 13% Bonds in favour of the resolution proposed at the 13% Bondholders Meeting without offering to exchange or sell their 13% Bonds;

(iii) vote some or all of their 13% Bonds against the resolution proposed at the 13% Bondholders Meeting (in which case such holders will not be able to offer to exchange or sell their 13% Bonds in the Exchange Offer); or

(iv) do nothing.

Holders who take the action (or inaction) under (ii), (iii) or (iv) above should note that, if the resolution proposed at the 13% Bondholders Meeting is passed and implemented, such holders' 13% Bonds will be mandatorily either (1) exchanged for Final Repayment Notes or (2) transferred to the Group in return for the cash consideration payable over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as 13% Bonds are exchanged or sold in the Exchange Offer. Holders are encouraged to elect whether, if their 13% Bonds are subject to such mandatory arrangements, they would prefer to (1) exchange their 13% Bonds for Final Repayment Notes or (2) sell their 13% Bonds to the Group in return for the cash consideration payable over twelve years and represented by the Instalment Repayment Notes.

5.5555% Bonds Offer

Holders of 5.5555% Bonds have the following options available:

(i) offer to exchange some or all of their 5.5555% Bonds in the Exchange Offer (in which case such holders will also automatically vote those 5.5555% Bonds in favour of the resolution proposed at the 5.5555% Bondholders Meeting);

(ii) vote some or all of their 5.5555% Bonds in favour of the resolution proposed at the 5.5555% Bondholders Meeting without offering to exchange their 5.5555% Bonds;

(iii) vote some or all of their 5.5555% Bonds against the resolution proposed at the 5.5555% Bondholders Meeting (in which case such holders will not be able to offer to exchange their 5.5555% Bonds in the Exchange Offer); or

(iv) do nothing.

Holders who take the action (or inaction) under (ii), (iii) or (iv) above should note that, if the resolution proposed at the 5.5555% Bondholders Meeting is passed and implemented, such holders' 5.5555% Bonds will be mandatorily exchanged for Bank T2 Notes on the same economic terms as 5.5555% Bonds are exchanged in the Exchange Offer.

Dated Notes Offer

Holders of Dated Notes have the following options available:

(i) enter into Lock-up Arrangements pursuant to which they will agree, amongst other things, to vote in favour of the Scheme at the Scheme Meeting;

(ii) vote in favour of the Scheme at the Scheme Meeting without entering into a Lock-up Arrangement;

(iii) vote against the Scheme at the Scheme Meeting; or

(iv) do nothing.

Holders of Dated Notes will also be entitled to elect to subscribe for up to 62,500,000 additional New Ordinary Shares for an aggregate consideration equal to £125 million, all pursuant to, and on the terms of, the Scheme.

Holders should note that, whatever action (or inaction) they take, if the Scheme is approved by the requisite majorities of the holders of Dated Notes and the Scheme is sanctioned by the High Court of Justice of England & Wales (the "**Court**") and implemented, all of the holders of Dated Notes will be bound by the Scheme and, accordingly, their Dated Notes will be mandatorily exchanged for New Ordinary Shares and Bank T2 Notes.

What documents do I need to read?

The Liability Management Exercise is being conducted on the basis of the following documents:

- the Final Repayment Notes and the Instalment Repayment Notes are being offered by the Group to holders of the Preference Shares and 13% Bonds on the basis of a Prospectus dated 4 November 2013 published by the Group and relating to the Group Notes (the "**Group Notes Prospectus**");
- the Bank T2 Notes are being offered by the Bank to holders of the 5.5555% Bonds on the basis of a Prospectus dated 4 November 2013 published by the Bank and relating to the Bank T2 Notes (the "**Bank T2 Prospectus**"); and
- the Scheme will be described in the explanatory statement relating to the Scheme (the "**Explanatory Statement**") and accompanying documents (together, the "**Scheme Documents**"), which will be made available to holders of the Dated Notes on or around 19 November 2013.

The Group Notes Prospectus and the Bank T2 Prospectus are together referred to in this document as the "**Prospectuses**", and each is a "**Prospectus**". This Offer Memorandum is appended to, and forms part of, each Prospectus.

Holders of Existing Securities are recommended to read the following documents, which are relevant for their purposes:

Preference Shares and 13% Bonds

Holders of the Preference Shares and 13% Bonds are recommended to read the Group Notes Prospectus, which contains this Offer Memorandum. The following sections of this Offer Memorandum are directly relevant to holders of Preference Shares and 13% Bonds:

- Section A: Rationale for the Liability Management Exercise
- Section B: Offer Consideration – Overview Table
- Section C: Exchange Offers and Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds
- Section E: Amendment and Termination and Revocation Rights
- Section F: Offer Restrictions
- Section G: Information on the Bank, the Group and the New Securities
- Section H: Risk Factors and Other Considerations
- Section I: Taxation Considerations
- Section J: Dealer Managers, Exchange Agent, Information Agent and Registrars
- Section K: General Notices and Important Information
- Section L: Definitions

5.5555% Bonds

Holders of the 5.5555% Bonds are recommended to read the Bank T2 Prospectus, which contains this Offer Memorandum. The following sections of this Offer Memorandum are directly relevant to holders of 5.5555% Bonds:

- Section A: Rationale for the Liability Management Exercise
- Section B: Offer Consideration – Overview Table
- Section C: Exchange Offers and Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds
- Section E: Amendment and Termination and Revocation Rights
- Section F: Offer Restrictions
- Section G: Information on the Bank, the Group and the New Securities
- Section H: Risk Factors and Other Considerations
- Section I: Taxation Considerations
- Section J: Dealer Managers, Exchange Agent, Information Agent and Registrars
- Section K: General Notices and Important Information
- Section L: Definitions

Dated Notes

Holders of the Dated Notes are recommended to read the Scheme Documents, which include the Bank T2 Prospectus and this Offer Memorandum. The following sections of this Offer Memorandum are directly relevant to holders of Dated Notes:

- Section A: Rationale for the Liability Management Exercise
- Section B: Offer Consideration – Overview Table
- Section D: Scheme of Arrangement in respect of the Dated Notes
- Section E: Amendment and Termination and Revocation Rights
- Section F: Offer Restrictions
- Section G: Information on the Bank, the Group and the New Securities
- Section H: Risk Factors and Other Considerations
- Section I: Taxation Considerations
- Section J: Dealer Managers, Exchange Agent, Information Agent and Registrars
- Section K: General Notices and Important Information
- Section L: Definitions

Where can I obtain the relevant documents?

The Prospectuses and the Scheme Documents will be made available on the Bank's website at: *http://www.co-operative.coop/bondholders*. The Prospectuses are available from the date of their publication. The Scheme Documents will be available following the Court hearing for convening the Scheme (which is expected to be held on 18 November 2013).

The Prospectuses are also available on the Regulatory News Service (RNS) operated by the London Stock Exchange plc at *http://www.londonstockexchange.com/exchange/news/market-news/market-news-home.html*.

The Prospectuses and Scheme Documents may also be obtained from Lucid Issuer Services Limited (the "**Exchange Agent**" and the "**Information Agent**"), who can be contacted at the following email address: *co-op@lucid-is.com*.

Am I eligible to participate in the Liability Management Exercise?

All holders of Existing Securities will be eligible to participate in the Liability Management Exercise, subject only to applicable laws and regulations in the country where they are located.

Holders located in the United Kingdom

All holders of Existing Securities who are located in the United Kingdom (and who are not "U.S. persons" as defined in Section L of this Offer Memorandum) will be eligible to participate in the Exchange Offers, the Proposals and the Scheme.

Holders located in the United States and U.S. persons

Holders who are resident or located in the United States, or who are "U.S. persons" (as defined in Section L of this Offer Memorandum) wherever they are located, are not eligible to participate in the Exchange Offers.

However, they will be eligible to participate in the Preference Shareholders Meeting (and the General Meeting), 13% Bondholders Meeting and/or 5.5555% Bondholders Meeting (if they hold Preference Shares, 13% Bonds or 5.5555% Bonds, respectively). They will also be eligible to participate in the Scheme (if they hold Dated Notes).

Other countries

In countries other than the United Kingdom and the United States, whether or not holders of Existing Securities are able to participate in the Liability Management Exercise, or certain of its component parts, may be restricted by law. Holders are responsible for ensuring that they inform themselves about, and comply with, any such restrictions.

However, for the avoidance of doubt, all holders of Preference Shares, 13% Bonds and 5.5555% Bonds will be eligible to participate in the Preference Shareholders Meeting (and the General Meeting), 13% Bondholders Meeting and 5.5555% Bondholders Meeting, respectively, even if such holders are not eligible to participate in the Exchange Offers.

Should I support the Liability Management Exercise?

Each holder must make its own decision whether or not to support the Liability Management Exercise, and should consult its own professional advisers if it is unsure as to any action it should take. None of the Bank, the Group, the Dealer Managers or any other person named in this document is providing any advice or recommendation to any holder as to what action it should take in respect of the Liability Management Exercise.

The Bank has sought an independent opinion from Canaccord Genuity Limited ("**Canaccord Genuity**") on the fairness of the Liability Management Exercise from a financial value perspective to the holders of the Preference Shares, the 13% Bonds and the 5.5555% Bonds. Canaccord Genuity's opinions are set out in Section N of this document.

Holders should note that these opinions do not constitute financial or legal advice. By consenting to the inclusion of its opinions in this document, Canaccord Genuity is not providing any advice or recommendation to any holder as to what action it should take in respect of the Liability Management Exercise. Canaccord Genuity will not be responsible or liable to any holder for that holder's decisions in respect of the Liability Management Exercise.

How do I participate in the Liability Management Exercise?

Holders of Preference Shares, 13% Bonds and 5.5555% Bonds are referred to Section C Part 4 of this Offer Memorandum for information on how to participate in the Offers.

Holders of Dated Notes are referred to the Explanatory Statement for information on how to participate in the Scheme.

Holders who hold their Existing Securities through a custodian, broker or other financial intermediary are urged to contact that intermediary as a matter of priority to discuss their arrangements and to determine what instructions that intermediary will require in order for the relevant holder to participate in the Liability Management Exercise.

I want to participate in the Liability Management Exercise. When do I need to take action?

The earliest date on which a holder of Preference Shares, 13% Bonds or 5.5555% Bonds can offer to exchange or sell its Existing Securities in the Exchange Offers is 4 November 2013.

The Early Participation Deadline for the Offers is **4.30 p.m. (London time) on 29 November 2013**. As noted above, if the Early Participation Threshold is achieved by the Early Participation Deadline, the amount of consideration to be delivered in exchange for all Preference Shares, 13% Bonds and 5.5555% Bonds which are exchanged or sold pursuant to the Liability Management Exercise will be higher than if (in circumstances where the Settlement Condition is ultimately satisfied) the Early Participation Threshold is not achieved by the Early Participation Deadline. **Therefore, holders of Preference Shares, 13% Bonds and 5.5555% Bonds are strongly urged to make appropriate arrangements to participate in the Liability Management Exercise before the Early Participation Deadline.**

The earliest date on which a holder of Dated Notes is able to submit an Account Holder Letter is expected to be 19 November 2013.

The offer period for each of the Offers expires at **4.30 p.m. (London time) on 6 December 2013** (the "**Expiration Deadline**"). That is also the voting instruction deadline (the "**Voting Instruction Deadline**") for holders of Dated Notes to make appropriate arrangements to vote in the Scheme.

Holders who hold their Existing Securities through a custodian, broker or other financial intermediary are urged to contact that intermediary as a matter of priority to discuss their arrangements and to determine when that intermediary will require instructions in order for the relevant holder to participate in the Liability Management Exercise by the Early Participation Deadline, the Expiration Deadline or (in the case of holders of Dated Notes) the Voting Instruction Deadline. These times will be earlier than the times specified above.

What are the risks associated with the Liability Management Exercise?

There are a number of risks and other considerations which may be relevant to a holder's decision whether or not to participate in the Liability Management Exercise, including risks relating to the Liability Management Exercise, risks relating to an investment in the Bank and the Group generally and risks relating to the particular nature of the Bank T2 Notes, the Group Notes and the New Ordinary Shares. Certain of these risks and other considerations have been described by the Bank and the Group (as applicable) in the Prospectuses they have prepared in connection with the offer of Bank T2 Notes and Group Notes pursuant to the Liability Management Exercise, and the Explanatory Statement prepared by the Bank in connection with the Scheme.

Holders of Existing Securities are urged to read carefully and consider those sections which are relevant to them. In particular:

Holders of the **Preference Shares** and **13% Bonds** are directed to:

- the section headed "*Risk Factors*" in Section 2 of the Group Notes Prospectus

Holders of the **5.5555% Bonds** are directed to:

- the section headed "*Risk Factors*" in Section 2 of the Bank T2 Prospectus

Holders of the **Dated Notes** are directed to:

- the section headed "*Risk Factors*" in Section 2 of the Bank T2 Prospectus
- Part C ("*Risk Factors*") of the Explanatory Statement

Use of defined terms in this Offer Memorandum

Capitalised terms used in this Offer Memorandum have the meanings given in Section L of this Offer Memorandum.

In addition, there are a number of references in this document to Existing Securities being "offered for exchange", "exchanged" and similar expressions. Where these expressions are used in the context of holders of Preference Shares or 13% Bonds who elect the Instalment Repayment Notes option, such expressions are used for the holders' convenience only in understanding what is being proposed, and must not be treated as a technical legal description of the mechanism through which they will receive the Instalment Repayment Notes. As set out above in the brief description of the invitations being made to holders of Preference Shares and 13% Bonds, holders who opt for Instalment Repayment Notes will actually be selling their Preference Shares or 13% Bonds (as the case may be) to the Group in return for the cash consideration which will be payable in twelve equal instalments and it is these instalment payments which will be represented by the Instalment Repayment Notes.

Where can I find further information about the Liability Management Exercise?

Website

Certain information relating to the Liability Management Exercise is set out on the Bank's website at: http://www.co-operative.coop/bondholders.

Questions regarding the terms of the Liability Management Exercise

Questions about the terms of the Liability Management Exercise can be directed to the Dealer Managers at the following contact details:

HSBC Bank plc 8 Canada Square London E14 5HQ United Kingdom Telephone: +44 20 7992 6237 Attention: Liability Management Group Email: coop.exchange@hsbcib.com	**UBS Limited** 1 Finsbury Avenue London EC2M 2PP United Kingdom Telephone: +44 20 7567 0525 Attention: Liability Management Group Email: mark-t.watkins@ubs.com/ mahmoud.abdelaal@ubs.com

Questions regarding participation mechanics

Questions of a practical nature regarding how to participate in the Liability Management Exercise should be directed to the Exchange Agent and Information Agent at the following contact details:

Lucid Issuer Services Limited
436 Essex Road
London N1 3QP
United Kingdom

Telephone: 0800 279 7346
(if calling from outside the UK: +44 20 7704 0880)

Fax: +44 20 7067 9098
Attention: Sunjeeve Patel / David Shilson / Yves Theis
Email: co-op@lucid-is.com

In addition, holders of the Preference Shares may contact Computershare as registrar for the Preference Shares, and holders of the 13% Bonds and 5.5555% Bonds may contact Equiniti as registrar for those bonds, at the following contact details:

Preference Shares	*13% Bonds and 5.5555% Bonds*
Computershare Investor Services PLC Corporate Actions Projects Bristol BS99 6AH United Kingdom Telephone: 0800 694 0470 (if calling from outside the UK: +44 117 902 7672)	**Equiniti Limited** Corporate Actions Aspect House Spencer Road Lancing West Sussex BN99 6DA United Kingdom Telephone: 0800 169 7006 (if calling from outside the UK: +44 121 415 0260)
Lines are open from 8.30 a.m. to 5.30 p.m. (London time) Monday to Friday (except UK public holidays). Calls from UK landlines to the "0800" numbers will not be chargeable. Calls from outside the UK will be charged at the applicable international rate. Different charges may apply to calls from mobile telephones and calls may be recorded and randomly monitored for security and training purposes. Please note that the telephone operators cannot provide advice on the merits of the Liability Management Exercise or any part of it, nor can they give financial, tax, investment or legal advice.	

No advice or recommendation

None of the Bank, the Group, the Dealer Managers, the Exchange Agent, the Information Agent, the Trustee (as defined in Section L of this Offer Memorandum) or the Registrars are able to, and they do not, express any opinion on the merits of the Liability Management Exercise or any component part of the Liability Management Exercise, or make any recommendation or offer any advice regarding whether or not a holder of Existing Securities should participate in the Liability Management Exercise. Each holder must carefully review the applicable documents in connection with the Liability Management Exercise and come to a decision, either on its own or with the assistance of its professional advisers, whether or not it wishes to participate in the Liability Management Exercise.

Any investor who does not fully understand any part of the Liability Management Exercise relevant to it, or any of the information relating to the relevant part of the Liability Management Exercise as set out in the relevant Prospectus(es), this Offer Memorandum or (in the case of the Dated Notes) the Scheme Documents, should seek independent advice from such financial, legal and/or other professional advisers as it considers appropriate.

Note to holders of Dated Notes who hold significant amounts of Dated Notes:

The Co-operative Bank p.l.c. is an authorised person, authorised and regulated by the Prudential Regulation Authority under the Financial Services and Markets Act 2000. In the United Kingdom, it is a criminal offence to acquire 10 per cent. or more of the shares or voting power in an authorised person without notifying the Prudential Regulation Authority or without obtaining the prior approval of the Prudential Regulation Authority. If any holder of Dated Notes considers that it may, as a result of the Liability Management Exercise, acquire 10 per cent. or more of the ordinary shares in the Bank, it is advised to seek independent legal advice.

TABLE OF CONTENTS

Section	*Title*		*Page*
Section A	**Rationale for the Liability Management Exercise**		C-29
Section B	**Offer Consideration – Overview Tables**		C-30
Section C	**Exchange Offers and Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds**		C-32
	Part 1	Details of the Exchange Offers	C-34
	Part 2	Details of the Proposals	C-56
	Part 3	Indicative Timetable for the Offers	C-65
	Part 4	Procedures for Participating in the Offers	C-67
	Part 5	Representations, Warranties, Acknowledgements, Agreements and Undertakings	C-82
	Part 6	Comparison of Certain Key Features of the Preference Shares, the Final Repayment Notes and the Instalment Repayment Notes and Worked Examples	C-88
	Part 7	Comparison of Certain Key Features of the 13% Bonds, the Final Repayment Notes and the Instalment Repayment Notes and Worked Examples	C-94
	Part 8	Comparison of Certain Key Features of the 5.5555% Bonds and the Bank T2 Notes and Worked Examples	C-100
	Part 9	Form of Notice convening the Meeting in respect of the Preference Shares	C-105
	Part 10	Form of Notice convening the Meeting in respect of the 13% Bonds	C-116
	Part 11	Form of Notice convening the Meeting in respect of the 5.5555% Bonds	C-127
Section D	**Scheme of Arrangement in respect of the Dated Notes**		C-136
	Part 1	Details of the Scheme of Arrangement	C-138
	Part 2	Indicative Timetable for the Scheme of Arrangement	C-149
Section E	**Amendment and Termination and Revocation Rights**		C-151
Section F	**Offer Restrictions**		C-153
Section G	**Information on the Bank, the Group and the New Securities**		C-156
Section H	**Risk Factors and Other Considerations**		C-157
Section I	**Taxation Considerations**		C-158
Section J	**Dealer Managers, Exchange Agent, Information Agent and Registrars**		C-163
Section K	**General Notices and Important Information**		C-164
Section L	**Definitions**		C-166
Section M	**Indicative timetable for the Liability Management Exercise**		C-176
Section N	**Canaccord Genuity Limited Fairness Opinions**		C-180
	Part 1	Canaccord Genuity's consent letter	C-181
	Part 2	Canaccord Genuity's Fairness Opinion relating to the Preference Shares	C-185
	Part 3	Canaccord Genuity's Fairness Opinion relating to the 13% Bonds	C-189
	Part 4	Canaccord Genuity's Fairness Opinion relating to the 5.5555% Bonds	C-193

SECTION A

RATIONALE FOR THE LIABILITY MANAGEMENT EXERCISE

The Liability Management Exercise is being conducted as part of a required recapitalisation of the Bank and is an integral part of the Recapitalisation Plan.

Holders of the Preference Shares and 13% Bonds are referred to "*Risks relating to the Liability Management Exercise*" in Section 2 (*Risk Factors*) and "*Recent Developments – Capital Shortfall and Recapitalisation Plan*" in Section 8 (*Description of the Issuer*) of the Group Notes Prospectus.

Holders of the 5.5555% Bonds are referred to Section 4 (*Letter from the Chairman of the Bank, background to and reasons for the Recapitalisation Plan and potential consequences of Holders failing to support the Liability Management Exercise*) of the Bank T2 Prospectus.

Holders of the Dated Notes are referred to Section 4 (*Letter from the Chairman of the Bank, background to and reasons for the Recapitalisation Plan and potential consequences of Holders failing to support the Liability Management Exercise*) of the Bank T2 Prospectus (which forms part of the Scheme Documents).

SECTION B

OFFER CONSIDERATION – OVERVIEW TABLES

The tables in this section set out, in overview form, the consideration that holders of Existing Securities will be eligible to receive if their Existing Securities are exchanged or sold (as the case may be) pursuant to the Liability Management Exercise. The details of the offers for each series of the Existing Securities are set out later in this Offer Memorandum.

Offers in respect of the Preference Shares and the 13% Bonds

Existing Securities	**ISIN**	**Early Consideration Amount[1]** (per £1,000 nominal of Existing Securities)			**Late Consideration Amount[1]** (per £1,000 nominal of Existing Securities)		
		Final Repayment Notes[2]	OR[4]	**Instalment Repayment Notes[3]**	**Final Repayment Notes[2]**	OR[4]	**Instalment Repayment Notes[3]**
Preference Shares[5]	GB0002224516	£601		£1,110	£551		£1,060
13% Bonds	GB00B3VH4201	£844		£1,560	£794		£1,510

Notes:

1 If the Early Participation Threshold is achieved by the Early Participation Deadline (4.30 p.m. (London time) on 29 November 2013) and the Liability Management Exercise successfully completes, all Preference Shares and 13% Bonds will be exchanged or sold at the Early Consideration Amount. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise successfully completes, all Preference Shares and 13% Bonds will be exchanged or sold at the Late Consideration Amount.

2 New sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) to be issued by the Group and guaranteed (on a subordinated basis) by certain subsidiaries of the Group.

3 New sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) (having their last instalment payment date in 2025) to be issued by the Group and guaranteed (on a subordinated basis) by certain subsidiaries of the Group. The Instalment Repayment Notes represent the instalments of consideration to be received by Holders whose Preference Shares or 13% Bonds are sold to the Group in the Liability Management Exercise.

4 The amounts of Final Repayment Notes and Instalment Repayment Notes specified in the table above are alternative options. A holder will not receive both of these amounts. Holders will be able to elect (in accordance with the procedures set out in this document) either the Final Repayment Notes option or the Instalment Repayment Notes option only.

5 The Early Consideration Amount and Late Consideration Amount for the Preference Shares are presented in this table on a "per £1,000 in nominal amount" basis for ease of comparison with the 13% Bonds. Preference Shares can be offered for exchange or sale in any whole multiple of £1 (subject to a minimum of £2 if a holder elects the Final Repayment Notes option (which is the minimum amount required, based on the Late Consideration Amount, in order to receive the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if a holder elects the Instalment Repayment Notes option).

Offer in respect of the 5.5555% Bonds

Existing Securities	**ISIN**	**Early Consideration Amount[1]** (per £1,000 nominal of Existing Securities)	**Late Consideration Amount[1]** (per £1,000 nominal of Existing Securities)
		Bank T2 Notes[2]	**Bank T2 Notes[2]**
5.5555% Bonds	GB00B3VMBW45	£530	£480

Notes:

1 If the Early Participation Threshold is achieved by the Early Participation Deadline (4.30 p.m. (London time) on 29 November 2013) and the Liability Management Exercise successfully completes, all 5.5555% Bonds will be exchanged at the Early Consideration Amount. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise successfully completes, all 5.5555% Bonds will be exchanged at the Late Consideration Amount.

2 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank.

Scheme in respect of the Dated Notes

Existing Securities	ISIN	Consideration Amount[1,5] (per £1,000 of Scheme Claim[4])		New Ordinary Shares Conversion Price[5]
		Bank T2 Notes[2]	New Ordinary Shares[3]	
Floating Rate Callable Step-up Dated Subordinated Notes due 2016	XS0254625998	£102.63	£897.37	£7.7718292 per share
5.875% Subordinated Callable Notes due 2019	XS0189539942	£102.63	£897.37	
9.25% Subordinated Notes due 28 April 2021	XS0620315902	£102.63	£897.37	
Fixed/Floating Rate Subordinated Notes due November 2021	XS0274155984	£102.63	£897.37	
7.875% Subordinated Notes due 19 December 2022	XS0864253868	£102.63	£897.37	
5.75% Dated Callable Step-up Subordinated Notes due 2024	XS0188218183	£102.63	£897.37	
5.875% Subordinated Notes due 2033	XS0145065602	£102.63	£897.37	

Notes:

1 The number of New Ordinary Shares and principal amount of Bank T2 Notes which a holder of Dated Notes will be eligible to receive in respect of its Scheme Claim will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

2 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank.

3 New Ordinary Shares to be issued by the Bank. If the Liability Management Exercise is successfully completed, the Group's existing equity stake in the Bank will be converted into deferred shares and effectively reduced to nil and a total of 250,000,000 New Ordinary Shares will be issued at that time, of which:

(i) 75,000,000 (representing 30 per cent. of the total) will be issued to the Group in consideration for its fresh injection of capital into the Bank through the Liability Management Exercise and the 2014 Commitment (representing an effective subscription price of £6.16 per share);

(ii) 112,500,000 (representing 45 per cent. of the total) will be issued to holders of the Dated Notes in the Scheme in exchange for their Dated Notes, to be distributed in the Scheme *pro rata* amongst such holders based on their respective Scheme Claims (representing, based on the total value of Scheme Claims and the number of New Ordinary Shares issued in the Scheme to holders of Dated Notes, an implied subscription price equal to the New Ordinary Shares Conversion Price). The New Ordinary Shares referred to in the table above are these 112,500,000 New Ordinary Shares; and

(iii) 62,500,000 (representing the balance of 25 per cent. of the total) will be available for subscription by holders of Dated Notes pursuant to, and on the terms of, the Scheme for an aggregate consideration equal to £125 million (representing an effective subscription price of £2.00 per share).

4 A Holder's claim in the Scheme (its "**Scheme Claim**") will be equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date (expected to be 10 December 2013), provided that a Holder's Scheme Claim in respect of Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (which are denominated in euro) shall be the Sterling-Equivalent of such sum, calculated on the basis of an exchange rate of £0.85644 per €1.00.

5 Since Scheme Claims will include a component of accrued and unpaid interest on the Dated Notes and there is a finite amount of New Ordinary Shares and Bank T2 Notes available in the Scheme, the Consideration Amounts and the New Ordinary Shares Conversion Price in this table are indicative only, pending determination of the floating rate of interest applicable to the interest period commencing 18 November 2013 in respect of the Floating Rate Callable Step-up Dated Subordinated Notes due 2016. For the purpose of the indicative figures above, an assumed 3-month EURIBOR rate of 0.228 per cent. (the rate prevailing as at 30 October 2013) has been applied. The actual rate is expected to be determined on 14 November 2013 and, once determined, the Bank will announce the final Consideration Amounts and New Ordinary Shares Conversion Price via the Regulatory News Service (RNS) operated by the London Stock Exchange. The final Consideration Amounts and New Ordinary Shares Conversion Price are not expected to differ materially from the indicative Consideration Amounts and New Ordinary Shares Conversion Price specified above.

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SECTION C

EXCHANGE OFFERS AND PROPOSALS IN RESPECT OF THE PREFERENCE SHARES AND THE PERPETUAL SUBORDINATED BONDS

Application of this Section C

This Section C applies to the following securities issued by the Bank:

9.25% Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516) (the "**Preference Shares**")
13% Perpetual Subordinated Bonds (ISIN: GB00B3VH4201) (the "**13% Bonds**")
and
5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) (the "**5.5555% Bonds**" and, together with the 13% Bonds, the "**Perpetual Subordinated Bonds**")

The Perpetual Subordinated Bonds were issued by the Bank at the time of the merger with the Britannia Building Society, in replacement of two series of Permanent Interest Bearing Shares originally issued by the Britannia Building Society.

Introduction to this Section C

This Section C describes the Exchange Offers and the Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds. References in this Section C to:

- the "**Exchange Offers**" are to the Exchange Offers in respect of the Preference Shares and the Perpetual Subordinated Bonds (the Preference Shares, the 13% Bonds and the 5.5555% Bonds are each subject to a separate Exchange Offer);
- the "**Proposals**" are to the Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds (the Preference Shares, the 13% Bonds and the 5.5555% Bonds are each subject to separate Proposals);
- the "**Offers**" are to the Exchange Offers and the Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds; and
- "**Eligible Holders**" are to holders of Preference Shares and holders of Perpetual Subordinated Bonds who are eligible to participate in the relevant Exchange Offer in accordance with the Offer Restrictions set out in Section F of this Offer Memorandum (and "**Holders**" shall be construed accordingly unless the context otherwise requires).

  All Holders who are located and resident in the United Kingdom (and who are not "U.S. persons" as defined in Section L of this Offer Memorandum) will be eligible to participate in the Exchange Offers.

  Further, and for the avoidance of doubt, all Holders of Preference Shares, 13% Bonds and 5.5555% Bonds will be eligible to participate in the Preference Shareholders Meeting (and General Meeting), 13% Bondholders Meeting and 5.5555% Bondholders Meeting, respectively, referred to in this section, even if such Holders are not eligible to participate in the Exchange Offers described in this section.

Other capitalised terms used in this Section are defined in Section L of this Offer Memorandum.

This Section is split into the following parts:

Part 1: Details of the Exchange Offers

Part 2: Details of the Proposals

Part 3: Indicative Timetable for the Offers

Part 4: Procedures for Participating in the Offers

Part 5: Representations, Warranties, Acknowledgements, Agreements and Undertakings

Part 6: Comparison of certain key features of the Preference Shares, the Final Repayment Notes and the Instalment Repayment Notes and worked examples

Part 7: Comparison of certain key features of the 13% Bonds, the Final Repayment Notes and the Instalment Repayment Notes and worked examples

Part 8: Comparison of certain key features of the 5.5555% Bonds and the Bank T2 Notes and worked examples

Part 9: Form of Notice convening the Meeting in respect of the Preference Shares

Part 10: Form of Notice convening the Meeting in respect of the 13% Bonds

Part 11: Form of Notice convening the Meeting in respect of the 5.5555% Bonds

Other relevant information

Holders of Preference Shares and Perpetual Subordinated Bonds are also directed to the following Sections of this Offer Memorandum, which contain further information relevant to the Exchange Offers and Proposals:

- Section A: Rationale for the Liability Management Exercise
- Section B: Offer Consideration – Overview Table
- Section E: Amendment and Termination and Revocation Rights
- Section F: Offer Restrictions
- Section G: Information on the Bank, the Group and the New Securities
- Section H: Risk Factors and Other Considerations
- Section I: Taxation Considerations
- Section J: Dealer Managers, Exchange Agent, Information Agent and Registrars
- Section K: General Notices and Important Information
- Section L: Definitions

In addition:

- holders of the Preference Shares and the 13% Bonds are recommended to read carefully the full Group Notes Prospectus; and
- holders of the 5.5555% Bonds are recommended to read carefully the full Bank T2 Prospectus.

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 1

DETAILS OF THE EXCHANGE OFFERS

1. SUMMARY OFFERING TABLES

1.1 The following table summarises the consideration that Holders of Preference Shares and 13% Bonds will be eligible to receive if their Preference Shares and 13% Bonds (as applicable) are exchanged or sold pursuant to the Liability Management Exercise:

Existing Securities	**ISIN**	**Early Consideration Amount[1]** (per £1,000 nominal of Existing Securities)			**Late Consideration Amount[1]** (per £1,000 nominal of Existing Securities)		
		Final Repayment Notes[2]		**Instalment Repayment Notes[3]**	**Final Repayment Notes[2]**		**Instalment Repayment Notes[3]**
Preference Shares[5]	GB0002224516	£601	OR[4]	£1,110	£551	OR[4]	£1,060
13% Bonds	GB00B3VH4201	£844		£1,560	£794		£1,510

Notes:

1 If the Early Participation Threshold is achieved by the Early Participation Deadline (4.30 p.m. (London time) on 29 November 2013) and the Liability Management Exercise successfully completes, all Preference Shares and 13% Bonds will be exchanged or sold at the Early Consideration Amount. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise successfully completes, all Preference Shares and 13% Bonds will be exchanged or sold at the Late Consideration Amount.

2 New sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) to be issued by the Group and guaranteed (on a subordinated basis) by certain subsidiaries of the Group.

3 New sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) (having their last instalment payment date in 2025) to be issued by the Group and guaranteed (on a subordinated basis) by certain subsidiaries of the Group. The Instalment Repayment Notes represent the instalments of consideration to be received by Holders whose Preference Shares or 13% Bonds are sold to the Group in the Liability Management Exercise.

4 The amounts of Final Repayment Notes and Instalment Repayment Notes specified in the table above are alternative options. A holder will not receive both of these amounts. Holders will be able to elect (in accordance with the procedures set out in this document) either the Final Repayment Notes option or the Instalment Repayment Notes option only.

5 The Early Consideration Amount and Late Consideration Amount for the Preference Shares are presented in this table on a "per £1,000 in nominal amount" basis for ease of comparison with the 13% Bonds. Preference Shares can be offered for exchange or sale in any whole multiple of £1 (subject to a minimum of £2 if a holder elects the Final Repayment Notes option (which is the minimum amount required, based on the Late Consideration Amount, in order to receive the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if a holder elects the Instalment Repayment Notes option).

1.2 The following table summarises the consideration that Holders of 5.5555% Bonds will be eligible to receive if their 5.5555% Bonds are exchanged pursuant to the Liability Management Exercise:

Existing Securities	ISIN	Early Consideration Amount[1] (per £1,000 nominal of Existing Securities)	Late Consideration Amount[1] (per £1,000 nominal of Existing Securities)
		Bank T2 Notes[2]	Bank T2 Notes[2]
5.5555% Bonds	GB00B3VMBW45	£530	£480

Notes:

1 If the Early Participation Threshold is achieved by the Early Participation Deadline (4.30 p.m. (London time) on 29 November 2013) and the Liability Management Exercise successfully completes, all 5.5555% Bonds will be exchanged at the Early Consideration Amount. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise successfully completes, all 5.5555% Bonds will be exchanged at the Late Consideration Amount.

2 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank.

2. INTRODUCTION TO THE EXCHANGE OFFERS

2.1 ***The Exchange Offers***

(a) All Eligible Holders of Preference Shares are invited to either (1) offer to exchange any and all of their Preference Shares that are outstanding for Final Repayment Notes, or (2) offer to sell any and all of their Preference Shares that are outstanding to the Group for cash consideration payable in instalments over twelve years (represented by Instalment Repayment Notes), upon the terms and subject to the conditions described below.

(b) All Eligible Holders of 13% Bonds are invited to either (1) offer to exchange any and all of their 13% Bonds that are outstanding for Final Repayment Notes, or (2) offer to sell any and all of their 13% Bonds that are outstanding to the Group for cash consideration payable in instalments over twelve years (represented by Instalment Repayment Notes), upon the terms and subject to the conditions described below.

(c) All Eligible Holders of 5.5555% Bonds are invited to offer to exchange any and all of their 5.5555% Bonds that are outstanding for Bank T2 Notes, upon the terms and subject to the conditions described below.

2.2 ***Key Dates and Times***

An indicative timetable for the Exchange Offers and Proposals is set out in Part 3 of this Section C. Certain key dates relevant to the Exchange Offers are set out below:

- the earliest date on which a Holder of Preference Shares, 13% Bonds or 5.5555% Bonds can offer to exchange or sell its Existing Securities is 4 November 2013.
- the Early Participation Deadline is scheduled for 4.30 p.m. (London time) on 29 November 2013.
- the Expiration Deadline (the last time at which it is possible to participate in the Exchange Offers) is scheduled for 4.30 p.m. (London time) on 6 December 2013.
- the Settlement Date for the Exchange Offers is expected to occur on 18 December 2013.

The times and dates given above for the Early Participation Deadline, Expiration Deadline and Settlement Date are indicative only, and may be changed at the option of the Bank. If the Bank changes any scheduled dates in the Exchange Offers, the Bank will prepare and publish a supplement

to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

A holder who holds Preference Shares or Perpetual Subordinated Bonds through a custodian, broker or other financial intermediary and/or who holds its Preference Shares or Perpetual Subordinated Bonds in CREST, Euroclear or Clearstream, Luxembourg should note that it will need to provide instructions to such intermediary and/or CREST, Euroclear or Clearstream, Luxembourg (as applicable) before the times and dates specified above in order to meet the relevant deadlines.

2.3 ***Procedures for participating in the Exchange Offers***

A description of the procedures to be followed in order to participate in the Exchange Offers is set out in Part 4 of this Section C. The procedures involve a Holder submitting (or arranging for the submission on its behalf of) a valid Exchange Instruction. The form of the Exchange Instruction depends upon how Holders hold their Preference Shares or Perpetual Subordinated Bonds, and is more fully described in Part 4 of this Section C.

A Holder's offer to exchange or sell Preference Shares will be deemed to be made at the time of receipt by Computershare of such Holder's valid Exchange Instruction.

A Holder's offer to exchange or (in the case of 13% Bonds where the Holder elects the Instalment Repayment Notes option) sell Perpetual Subordinated Bonds will be deemed to be made at the time of receipt by Equiniti of such Holder's valid Exchange Instruction.

2.4 ***Preference Shares and Perpetual Subordinated Bonds to be offered for exchange or sale in whole specified denominations***

The Preference Shares have a nominal amount of £1 each. Preference Shares may be offered for exchange or sale in any whole multiple of £1, subject to a minimum of £2 if a Holder elects the Final Repayment Notes option (which is the minimum amount required, based on the Late Consideration Amount, in order to receive the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if a Holder elects the Instalment Repayment Notes option.

The specified denomination of each Perpetual Subordinated Bond is £1,000. Accordingly, Perpetual Subordinated Bonds must be offered for exchange or (in the case of 13% Bonds where the Holder elects the Instalment Repayment Notes option) sale in principal amounts equal to £1,000 or a whole multiple of £1,000.

3. EARLY PARTICIPATION THRESHOLD, EARLY CONSIDERATION AMOUNT AND LATE CONSIDERATION AMOUNT

If the Early Participation Threshold (as defined below) is achieved by 4.30 p.m. (London time) on 29 November 2013 (the "**Early Participation Deadline**"), the amount of consideration which all Holders will be eligible to receive upon the exchange or sale of their Preference Shares, 13% Bonds and 5.5555% Bonds pursuant to the Liability Management Exercise (if the Liability Management Exercise is successfully completed) will be higher than if the Early Participation Threshold is not achieved by the Early Participation Deadline.

Accordingly, if the Early Participation Threshold is achieved by the Early Participation Deadline (and the Liability Management Exercise is successfully completed), the principal amount of Final Repayment Notes or Instalment Repayment Notes which a Holder will receive upon exchange or sale of its Preference Shares or 13% Bonds, and the principal amount of Bank T2 Notes which a Holder will receive in exchange for its 5.5555% Bonds, will be determined on the basis of the relevant figure in the "*Early Consideration Amount*" columns in the tables under paragraph 1 above. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise is successfully completed, the principal amount of Final Repayment Notes or Instalment Repayment Notes which a Holder will receive upon exchange or sale of its Preference

Shares or 13% Bonds, and the principal amount of Bank T2 Notes which a Holder will receive in exchange for its 5.5555% Bonds, will be determined on the basis of the relevant figure in the "*Late Consideration Amount*" columns in the tables under paragraph 1 above.

The "**Early Participation Threshold**" will be achieved only if all of the following have occurred by the Early Participation Deadline:

(i) the aggregate nominal amount of Preference Shares (including Additional Preference Shares) which have been (A) validly offered for exchange or sale in the Liability Management Exercise and/or (B) otherwise validly voted in favour of the Extraordinary Resolution in respect of the Preference Shares (and, in each case, not validly revoked) must be equal to or greater than 75 per cent. of the aggregate nominal amount of Preference Shares outstanding;

(ii) the aggregate nominal amount of 13% Bonds which have been (A) validly offered for exchange or sale in the Liability Management Exercise and/or (B) otherwise validly voted in favour of the Extraordinary Resolution in respect of the 13% Bonds (and, in each case, not validly revoked) must be equal to or greater than 75 per cent. of the aggregate nominal amount of 13% Bonds outstanding; and

(iii) the aggregate nominal amount of 5.5555% Bonds which have been (A) validly offered for exchange and/or (B) otherwise validly voted in favour of the Extraordinary Resolution in respect of the 5.5555% Bonds (and, in each case, not validly revoked) must be equal to or greater than 75 per cent. of the aggregate nominal amount of 5.5555% Bonds outstanding.

If any one or more of the above is not achieved by the Early Participation Deadline, the Early Participation Threshold will not have been achieved.

The amount of consideration to be delivered in exchange for (i) Preference Shares is described further in paragraph 4 below; (ii) 13% Bonds is described further in paragraph 5 below; and (iii) 5.5555% Bonds is described further in paragraph 6 below.

4. PREFERENCE SHARES EXCHANGE OFFER

4.1 *Final Repayment Notes and Instalment Repayment Notes*

(a) *Exchange or sale*

Holders of the Preference Shares are being offered a choice of two options:

(i) to offer to transfer their Preference Shares to the Group in exchange for new sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) (the "**Final Repayment Notes**") to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries; or

(ii) to offer to sell their Preference Shares to the Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) (the "**Instalment Repayment Notes**") to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries.

The Final Repayment Notes and the Instalment Repayment Notes are together referred to as the "**Group Notes**".

There are a number of references in this document to Existing Securities being "offered for exchange", "exchanged" and similar expressions. Where these expressions are used in the context of Holders of Preference Shares who elect the Instalment Repayment Notes option, such expressions are used for the Holders' convenience only in understanding what is being proposed, and must not be treated as a technical legal description of the mechanism through which they will receive the Instalment Repayment Notes. As set out above, Holders who opt for

Instalment Repayment Notes will actually be selling their Preference Shares to the Group in return for the cash consideration which will be payable in twelve equal instalments and it is these instalment payments which will be represented by the Instalment Repayment Notes. Such cash consideration will be paid only in those twelve instalments over twelve years, and Holders will not be entitled to immediate payment of that cash consideration.

(b) *Final Repayment Notes*

The Final Repayment Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid annually in arrear on each anniversary of the issue date of the Final Repayment Notes up to (and including) the twelfth anniversary. The Group will be obliged to repay the principal amount of the Final Repayment Notes in full on the twelfth anniversary of their issue date.

(c) *Instalment Repayment Notes*

The Instalment Repayment Notes will not bear interest. However, the principal amount of such Instalment Repayment Notes (representing instalments of the cash purchase price for the Preference Shares) will be repaid in twelve equal instalments over twelve years. Those payments will be made on each anniversary of the issue date of the Instalment Repayment Notes, with the final payment falling on the twelfth anniversary of that issue date. If the Early Participation Threshold is achieved by the Early Participation Deadline, the principal amount of Instalment Repayment Notes which a Holder will receive upon the sale of its Preference Shares to the Group will be equal to twelve times the annual dividend on those Preference Shares (rounded down to the nearest £0.12 (12 pence), which is the minimum denomination of the Instalment Repayment Notes). **Accordingly, (in circumstances where the Early Participation Threshold is achieved by the Early Participation Deadline), by repaying those Instalment Repayment Notes in twelve equal instalments over twelve years, the Group will pay to the Holder, in each of those twelve years, an amount which is broadly equivalent to the amount of dividends which such Holder would have received had it continued to hold those Preference Shares which it sells to the Group in the Liability Management Exercise.**

(d) *Holders have a choice between Final Repayment Notes and Instalment Repayment Notes*

Each Holder of the Preference Shares will have the opportunity to choose one of the two options available.

A Holder should make its election in accordance with the procedures set out in paragraph 1.3 of Part 4 of this Section C.

If a Holder of Preference Shares fails to make a valid election in accordance with the procedures set out in this document but such Holder's Preference Shares are transferred to the Group pursuant to the Liability Management Exercise, then (i) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes, such Holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes, such Holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the Holder will receive Final Repayment Notes.

(e) *Final Repayment Notes vs Instalment Repayment Notes*

Since the Group will repay the principal of the Instalment Repayment Notes in equal instalments over twelve years, the amount payable to a Holder in each year if it elects the Instalment Repayment Notes option will be higher than the annual interest payment to such

Holder if it elects the Final Repayment Notes option. However, the final payment on the Instalment Repayment Notes in 2025 will be significantly lower than the final payment under the Final Repayment Notes in 2025 (reflecting the fact that the principal on the Final Repayment Notes is repayable in a single payment in that twelfth year).

After the twelfth and final payment, both the Final Repayment Notes and the Instalment Repayment Notes will have been fully repaid, and the Holder will have no further entitlement to any amounts under whichever of those securities it elected to receive.

If a Holder intends to hold its Final Repayment Notes or Instalment Repayment Notes for the full twelve years, an important point of distinction for such Holder will be whether it wishes to receive (i) the higher amount payable each year (except the twelfth year) under the Instalment Repayment Notes, or (ii) the lower annual payments of interest under the Final Repayment Notes but a larger one-off payment in twelve years' time, in which latter case it should elect to receive the Final Repayment Notes.

The tax treatment of Holders opting to exchange their Preference Shares for Final Repayment Notes will be different to the tax treatment of Holders opting to sell their Preference Shares for a cash amount paid in instalments (represented by Instalment Repayment Notes). Holders are directed to section I (Taxation Considerations) and the section headed "Taxation" in the Group Notes Prospectus which contain further information relevant to the tax consequences of choosing one of the two options. Holders are advised to consult their own professional advisers regarding the differences for them in the tax treatment of the two options based on their own circumstances.

(f) *Form of the Group Notes*

The Final Repayment Notes will have denominations of £1 each. The Instalment Repayment Notes will have denominations of £0.12 (12 pence) each.

Upon issue, some of the Group Notes will be held in dematerialised book-entry form in CREST and the remainder of the Group Notes will be held in certificated form outside CREST.

With respect to Group Notes held in certificated form outside CREST, Computershare (in its capacity as registrar for the Group Notes) will arrange for certificates evidencing such holding to be mailed to the relevant holders.

With respect to Group Notes held in CREST, it will be possible to trade interests in such Group Notes indirectly in Euroclear and Clearstream, Luxembourg. In this case, the Group Notes themselves will be held in a CREST account by a nominee for Euroclear or Clearstream, Luxembourg (as applicable), and Euroclear and Clearstream, Luxembourg will enable interests representing the Group Notes held in those nominee accounts to be traded in Euroclear and Clearstream, Luxembourg.

Detailed information relating to the Group, the guarantors, the Final Repayment Notes and the Instalment Repayment Notes, including the full terms and conditions of the Final Repayment Notes and the Instalment Repayment Notes and a description of certain risks relating to an investment in Final Repayment Notes or Instalment Repayment Notes, is set out in the Group Notes Prospectus.

The Group has, pursuant to the Group Notes Prospectus, made an application to the Financial Conduct Authority for the Final Repayment Notes and the Instalment Repayment Notes to be admitted to the Official List maintained by the Financial Conduct Authority and to the London Stock Exchange plc for such Final Repayment Notes and the Instalment Repayment Notes to be admitted to trading on its regulated market. It is intended that admission to listing and trading will become effective on the Settlement Date.

(g) *Comparisons of certain key features of the different securities*

A table comparing certain key features of the Preference Shares, the Final Repayment Notes and the Instalment Repayment Notes is set out in Part 6 of this Section C.

4.2 ***Principal amount of Group Notes to be delivered upon exchange or sale of Preference Shares***

The principal amount of Group Notes which a holder will (if the Liability Management Exercise is successfully completed) receive for each £1,000 in nominal amount of Preference Shares (excluding the Additional Preference Shares referred to in paragraph 4.4 below) exchanged or sold to the Group will depend upon (i) whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option; and (ii) whether or not the Early Participation Threshold is achieved by the Early Participation Deadline:

(a) *Final Repayment Notes*

An Eligible Holder who validly offers to exchange its Preference Shares in the Exchange Offer for Final Repayment Notes will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £601 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) exchanged (calculated by multiplying the aggregate nominal amount of such Holder's Preference Shares (excluding Additional Preference Shares) so exchanged by 60.1 per cent. and rounding the resulting figure down to the nearest whole multiple of £1 (being the minimum denomination of the Final Repayment Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof)); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £551 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) exchanged (calculated by multiplying the aggregate nominal amount of such Holder's Preference Shares (excluding Additional Preference Shares) so exchanged by 55.1 per cent. and rounding the resulting figure down to the nearest whole multiple of £1 (being the minimum denomination of the Final Repayment Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof)).

(b) *Instalment Repayment Notes*

An Eligible Holder who validly offers to sell its Preference Shares to the Group in the Exchange Offer under the Instalment Repayment Notes option will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £1,110 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) sold to the Group (calculated by multiplying the aggregate nominal amount of such Holder's Preference Shares (excluding Additional Preference Shares) so sold by 111.0 per cent. and rounding the resulting figure down to the nearest whole multiple of £0.12 (being the minimum denomination of the Instalment Repayment Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof)); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £1,060 in principal amount of Instalment Repayment Notes for

every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) sold to the Group (calculated by multiplying the aggregate nominal amount of such Holder's Preference Shares (excluding Additional Preference Shares) so sold by 106.0 per cent. and rounding the resulting figure down to the nearest whole multiple of £0.12 (being the minimum denomination of the Instalment Repayment Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof)).

(c) *References to exchange or sale of £1,000 in nominal amount of Preference Shares*

The references above to an exchange or sale of £1,000 in nominal amount of Preference Shares are for illustrative purposes only. Holders of Preference Shares will be able to offer to exchange or sell (as the case may be) Preference Shares in any whole multiple of £1, subject to a minimum of £2 if such Holder elects the Final Repayment Notes option (being the minimum nominal amount of Preference Shares necessary to receive, based on the Late Consideration Amount, at least the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if such Holder elects the Instalment Repayment Notes option.

4.3 ***Accrued dividends***

In addition to Final Repayment Notes or Instalment Repayment Notes, a Holder whose Preference Shares are exchanged or sold in the Liability Management Exercise will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid dividends on its Preference Shares (other than Additional Preference Shares) from (and including) 30 November 2013 to (but excluding) the Settlement Date, calculated on the basis of the terms of the Preference Shares as set out in the Bank's Articles of Association and on the assumption that dividends accrue from day-to-day on a non-compounding basis (the "**Accrued Dividends**").

4.4 ***Preference Share dividend instalment scheduled for 30 November / Additional Preference Shares***

The next instalment of the Preference Share dividend is, under the terms of the Preference Shares, scheduled to be paid on 30 November 2013 (which is during the offer period for the Liability Management Exercise).

Under the terms of the Preference Shares, the Bank will not be permitted to pay the dividend in cash, but will instead be required to allot additional Preference Shares to each holder in lieu of cash payment ("**Additional Preference Shares**"). The Bank expects to allot such Additional Preference Shares on 29 November 2013 (since 30 November is a Saturday). The allotment of additional Preference Shares in lieu of cash will satisfy the Bank's obligations in respect of such dividend instalment and, for the avoidance of doubt, Holders will not be entitled to any cash amount in respect of that dividend (whether on 29 November 2013 or at any other time).

However, if the Liability Management Exercise successfully completes, then upon exchange or sale to the Group of those Additional Preference Shares, the Holders will not receive Final Repayment Notes or Instalment Repayment Notes in respect thereof but rather will receive an amount in cash (in pounds sterling) equal to the cash dividend which the Bank would have paid on 29 November 2013 had it been able to do so under the terms of the Preference Shares.

Since the Additional Preference Shares will be fungible with (i.e. identical to) other Preference Shares such that it may not be possible to distinguish between them, for the purposes of the treatment of Additional Preference Shares in the Liability Management Exercise as described above, 6⅛ per cent. of the aggregate nominal amount of the Preference Shares outstanding will be deemed to be Additional Preference Shares for these purposes.

4.5 ***An offer to exchange or sell Preference Shares is also an offer to exchange or sell Additional Preference Shares***

By offering to exchange or sell Preference Shares on or before 28 November 2013 (which is the record date for determining the Holders of Preference Shares for the purpose of allotment of the Additional Preference Shares), a Holder will also be deemed (without the need for such Holder or the nominee referred to below to take any further action) to offer to exchange or sell (as the case may be), on the same terms, any such Additional Preference Shares to be allotted to it on 29 November 2013 (including instructing the chairman of the Preference Shareholders Meeting and the chairman of the General Meeting to vote on such Holder's behalf at the Preference Shareholders Meeting and the General Meeting, respectively, to exercise the votes attaching to those Additional Preference Shares in favour of the resolution proposed at each such meeting). Accordingly, by submitting an Exchange Instruction in respect of Preference Shares on or prior to 28 November 2013, the Holder of those Preference Shares will:

(a) irrevocably direct the Bank to allot any Additional Preference Shares, which would otherwise be allotted to such Holder, to Computershare Investor Services PLC as nominee for such Holder; and

(b) irrevocably direct such nominee:

(i) if the Exchange Offers are settled, to deliver such Additional Preference Shares on behalf of such Holder to the Group on the Settlement Date in exchange for a cash payment equal to the cash dividend which would have been paid to such Holder on 29 November 2013 had the Bank been permitted, under the terms of the Preference Shares, to make payment in cash; or

(ii) if the Exchange Offers are not settled, to promptly deliver such Additional Preference Shares to such Holder.

4.6 ***Worked Examples***

Worked examples illustrating what a Holder of Preference Shares may receive upon the exchange or sale of its Preference Shares in the Liability Management Exercise are set out in Part 6 of this Section C.

5. 13% BONDS EXCHANGE OFFER

5.1 ***Final Repayment Notes and Instalment Repayment Notes***

(a) *Exchange or sale*

Holders of the 13% Bonds are being offered a choice of two options:

- to offer to transfer their 13% Bonds to the Group in exchange for new sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) (the "**Final Repayment Notes**") to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries; or

- to offer to sell their 13% Bonds to the Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) (the "**Instalment Repayment Notes**") to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries.

The Final Repayment Notes and the Instalment Repayment Notes are together referred to as the "**Group Notes**".

There are a number of references in this document to Existing Securities being "offered for exchange", "exchanged" and similar expressions. Where these expressions are used in the

context of Holders of 13% Bonds who elect the Instalment Repayment Notes option, such expressions are used for the Holders' convenience only in understanding what is being proposed, and must not be treated as a technical legal description of the mechanism through which they will receive the Instalment Repayment Notes. As set out above, Holders who opt for Instalment Repayment Notes will actually be selling their 13% Bonds to the Group in return for the cash consideration which will be payable in twelve equal instalments and it is these instalment payments which will be represented by the Instalment Repayment Notes. Such cash consideration will be paid only in those twelve instalments over twelve years, and Holders will not be entitled to immediate payment of that cash consideration.

(b) *Final Repayment Notes*

The Final Repayment Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid annually in arrear on each anniversary of the issue date of the Final Repayment Notes up to (and including) the twelfth anniversary. The Group will be obliged to repay the principal amount of the Final Repayment Notes in full on the twelfth anniversary of their issue date.

(c) *Instalment Repayment Notes*

The Instalment Repayment Notes will not bear interest. However, the principal amount of such Instalment Repayment Notes (representing instalments of the cash purchase price for the 13% Bonds) will be repaid in twelve equal instalments over twelve years. Those payments will be made on each anniversary of the issue date of the Instalment Repayment Notes, with the final payment falling on the twelfth anniversary of that issue date. If the Early Participation Threshold is achieved by the Early Participation Deadline, the principal amount of Instalment Repayment Notes which a Holder will receive upon sale of its 13% Bonds to the Group will be equal to twelve times the annual interest on those 13% Bonds (rounded down to the nearest £0.12 (12 pence), which is the minimum denomination of the Instalment Repayment Notes). **Accordingly, (in circumstances where the Early Participation Threshold is achieved by the Early Participation Deadline), by repaying those Instalment Repayment Notes in twelve equal instalments over twelve years, the Group will pay to the Holder, in each of those twelve years, an amount which is broadly equivalent to the amount of interest which such Holder would have received had it continued to hold those 13% Bonds which it sells to the Group in the Liability Management Exercise**.

(d) *Holders have a choice between Final Repayment Notes and Instalment Repayment Notes*

Each Holder of 13% Bonds will have the opportunity to choose one of the two options available.

A Holder should make its election in accordance with the procedures set out in paragraph 1.3 of Part 4 of this Section C.

If a Holder of 13% Bonds fails to make a valid election in accordance with the procedures set out in this document but such Holder's 13% Bonds are transferred to the Group pursuant to the Liability Management Exercise then (i) if (in the Liability Management Exercise) the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Instalment Repayment Notes, such Holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Final Repayment Notes, such Holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the Holder will receive Final Repayment Notes.

(e) *Final Repayment Notes vs Instalment Repayment Notes*

Since the Group will repay the principal of the Instalment Repayment Notes in equal instalments over twelve years, the amount payable to a Holder in each year if it elects the Instalment Repayment Notes option will be higher than the annual interest payment to such Holder if it elects the Final Repayment Notes option. However, the final payment on the Instalment Repayment Notes in 2025 will be significantly lower than the final payment under the Final Repayment Notes in 2025 (reflecting the fact that the principal on the Final Repayment Notes is repayable in a single payment in that twelfth year).

After the twelfth and final payment, both the Final Repayment Notes and the Instalment Repayment Notes will have been fully repaid, and the Holder will have no further entitlement to any amounts under whichever of those securities it elected to receive.

If a Holder intends to hold its Final Repayment Notes or Instalment Repayment Notes for the full twelve years, an important point of distinction for such Holder will be whether it wishes to receive (i) the higher amount payable each year (except the twelfth year) under the Instalment Repayment Notes, or (ii) the lower annual payments of interest under the Final Repayment Notes but a larger one-off payment in twelve years' time, in which latter case it should elect to receive the Final Repayment Notes.

The tax treatment of Holders opting to exchange their 13% Bonds for Final Repayment Notes will be different to the tax treatment of Holders opting to sell their 13% Bonds for a cash amount paid in instalments (represented by Instalment Repayment Notes). Holders are directed to section I (Taxation Considerations) and the section headed "Taxation" in the Group Notes Prospectus which contain further information relevant to the tax consequences of choosing one of the two options. Holders are advised to consult their own professional advisers regarding the differences for them in the tax treatment of the two options based on their own circumstances.

(f) *Form of the Group Notes*

The Final Repayment Notes will have denominations of £1 each. The Instalment Repayment Notes will have denominations of £0.12 (12 pence) each.

Upon issue, some of the Group Notes will be held in dematerialised book-entry form in CREST and the remainder of the Group Notes will be held in certificated form outside CREST.

With respect to Group Notes held in certificated form outside CREST, Computershare (in its capacity as registrar for the Group Notes) will arrange for certificates evidencing such holding to be mailed to the relevant holders.

With respect to Group Notes held in CREST, it will be possible to trade interests in such Group Notes indirectly in Euroclear and Clearstream, Luxembourg. In this case, the Group Notes themselves will be held in a CREST account by a nominee for Euroclear or Clearstream, Luxembourg (as applicable), and Euroclear and Clearstream, Luxembourg will enable interests representing the Group Notes held in those nominee accounts to be traded in Euroclear and Clearstream, Luxembourg.

Detailed information relating to the Group, the guarantors, the Final Repayment Notes and the Instalment Repayment Notes, including the full terms and conditions of the Final Repayment Notes and the Instalment Repayment Notes and a description of certain risks relating to an investment in Final Repayment Notes or Instalment Repayment Notes, is set out in the Group Notes Prospectus.

The Group has, pursuant to the Group Notes Prospectus, made an application to the Financial Conduct Authority for the Final Repayment Notes and the Instalment Repayment Notes to be admitted to the Official List maintained by the Financial Conduct Authority and to the London Stock Exchange plc for such Final Repayment Notes and the Instalment Repayment Notes to

be admitted to trading on its regulated market. It is intended that admission to listing and trading will become effective on the Settlement Date.

(g) *Comparisons of certain key features of the different securities*

A table comparing certain key features of the 13% Bonds, the Final Repayment Notes and the Instalment Repayment Notes is set out in Part 7 of this Section C.

5.2 ***Principal amount of Group Notes to be delivered upon exchange or sale of 13% Bonds***

The principal amount of Group Notes which a Holder will (if the Liability Management Exercise is successfully completed) receive for each £1,000 in nominal amount of 13% Bonds exchanged or sold to the Group will depend upon (i) whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option; and (ii) whether or not the Early Participation Threshold is achieved by the Early Participation Deadline:

(a) *Final Repayment Notes*

An Eligible Holder who validly offers to exchange its 13% Bonds in the Exchange Offer for Final Repayment Notes will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £844 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of 13% Bonds exchanged (calculated by multiplying the aggregate nominal amount of such Holder's 13% Bonds so exchanged by 84.4 per cent.); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £794 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of 13% Bonds exchanged (calculated by multiplying the aggregate nominal amount of such Holder's 13% Bonds so exchanged by 79.4 per cent.).

(b) *Instalment Repayment Notes*

An Eligible Holder who validly offers to sell its 13% Bonds to the Group in the Exchange Offer under the Instalment Repayment Notes option will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £1,560 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of 13% Bonds sold to the Group (calculated by multiplying the aggregate nominal amount of such Holder's 13% Bonds so sold by 156.0 per cent. and, if necessary, rounding the resulting figure down to the nearest whole multiple of £0.12 (being the minimum denomination of the Instalment Repayment Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof)); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £1,510 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of 13% Bonds sold to the Group (calculated by multiplying the aggregate nominal amount of such Holder's 13% Bonds so sold by 151.0 per cent. and, if necessary, rounding the resulting figure down to the nearest whole multiple of £0.12 (being the minimum denomination of the Instalment Repayment Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof)).

(c) *References to exchange or sale of £1,000 in nominal amount of 13% Bonds*

The references above to an exchange or sale of £1,000 in nominal amount of 13% Bonds are for illustrative purposes only. The 13% Bonds have denominations of £1,000 each, and accordingly must be offered for exchange or sale in nominal amounts of £1,000 or a whole multiple of £1,000.

5.3 ***Accrued interest***

In addition to Final Repayment Notes or Instalment Repayment Notes, a Holder whose 13% Bonds are exchanged or sold in the Liability Management Exercise will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid interest on its 13% Bonds from (and including) 31 July 2013 to (but excluding) the Settlement Date, calculated in accordance with the terms of the 13% Bonds as set out in the trust deed dated 1 August 2009 constituting the 13% Bonds (the "**13% Bonds Accrued Interest**").

5.4 ***Deferred interest payment originally scheduled for 31 July 2013***

In addition, as announced by the Bank on 12 July 2013, upon successful completion of the Exchange Offer the Bank will pay to all Holders of the 13% Bonds (whether or not participating in the Exchange Offers) the deferred interest payment originally scheduled for 31 July 2013. Such payment will be made in cash on the Settlement Date.

5.5 ***Worked Examples***

Worked examples illustrating what a Holder of 13% Bonds may receive upon the exchange or sale of its 13% Bonds in the Liability Management Exercise are set out in Part 7 of this Section C.

6. 5.5555% BONDS EXCHANGE OFFER

6.1 ***Bank T2 Notes***

(a) *Exchange*

Holders of the 5.5555% Bonds are being invited to exchange their 5.5555% Bonds for new sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank

(b) *Bank T2 Notes*

The Bank T2 Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid quarterly in arrear on each three-month anniversary of the issue date of the Bank T2 Notes up to (and including) the tenth anniversary of the issue date. The Bank will be obliged to repay the principal amount of the Bank T2 Notes on the tenth anniversary of their issue date.

(c) *Form of the Bank T2 Notes*

The Bank T2 Notes will have denominations of £10 each.

Upon issue, some of the Bank T2 Notes will be held in dematerialised book-entry form in CREST and the remainder of the Bank T2 Notes will be held in certificated form outside CREST.

With respect to Bank T2 Notes held in certificated form outside CREST, Computershare (in its capacity as registrar for the Bank T2 Notes) will arrange for certificates evidencing such holding to be mailed to the relevant holders.

With respect to Bank T2 Notes held in CREST, it will be possible to trade interests in such Bank T2 Notes indirectly in Euroclear and Clearstream, Luxembourg. In this case, the Bank T2 Notes themselves will be held in a CREST account by a nominee for Euroclear or Clearstream, Luxembourg (as applicable), and Euroclear and Clearstream, Luxembourg will enable interests

representing the Bank T2 Notes held in those nominee accounts to be traded in Euroclear and Clearstream, Luxembourg.

Detailed information relating to the Bank and the Bank T2 Notes, including the full terms and conditions of the Bank T2 Notes and a description of certain risks relating to an investment in Bank T2 Notes, is set out in the Bank T2 Prospectus.

The Bank has, pursuant to the Bank T2 Prospectus, made an application to the Financial Conduct Authority for the Bank T2 Notes to be admitted to the Official List maintained by the Financial Conduct Authority and to the London Stock Exchange plc for such Bank T2 Notes to be admitted to trading on its regulated market. It is intended that admission to listing and trading will become effective on the Settlement Date.

(d) *Comparisons of certain key features of the different securities*

A table comparing certain key features of the 5.5555% Bonds and the Bank T2 Notes is set out in Part 8 of this Section C.

6.2 ***Principal amount of Bank T2 Notes to be delivered in exchange for 5.5555% Bonds***

(a) *Principal amount of Bank T2 Notes to be delivered*

The principal amount of Bank T2 Notes which a Holder will (if the Liability Management Exercise is successfully completed) receive in exchange for every £1,000 in nominal amount of 5.5555% Bonds will depend upon whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

Accordingly, an Eligible Holder who validly offers to exchange its 5.5555% Bonds in the Exchange Offer will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £530 in principal amount of Bank T2 Notes for every £1,000 in nominal amount of 5.5555% Bonds exchanged (calculated by multiplying the aggregate nominal amount of such Holder's 5.5555% Bonds so exchanged by 53.0 per cent.); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £480 in principal amount of Bank T2 Notes for every £1,000 in nominal amount of 5.5555% Bonds exchanged (calculated by multiplying the aggregate nominal amount of such Holder's 5.5555% Bonds so exchanged by 48.0 per cent.).

(b) *References to exchange of £1,000 in nominal amount of 5.5555% Bonds*

The references above to an exchange of £1,000 in nominal amount of 5.5555% Bonds are for illustrative purposes only. The 5.5555% Bonds have denominations of £1,000 each, and accordingly must be offered for exchange in nominal amounts of £1,000 or a whole multiple of £1,000.

6.3 ***Accrued interest***

In addition to Bank T2 Notes, a Holder whose 5.5555% Bonds are exchanged will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid interest on its 5.5555% Bonds from (and including) 14 December 2013 to (but excluding) the Settlement Date, calculated in accordance with the terms of the 5.5555% Bonds as set out in the trust deed dated 1 August 2009 constituting the 5.5555% Bonds (the "**5.5555% Bonds Accrued Interest**").

6.4 ***Interest payment scheduled for 14 December 2013***

The next scheduled interest payment date for the 5.5555% Bonds is 14 December 2013. The Bank intends to defer that interest payment (which it is entitled to do under the terms of the 5.5555% Bonds). If the Liability Management Exercise subsequently successfully settles, the Bank will (in addition to the 5.5555% Bonds Accrued Interest referred to above) pay the deferred interest payment originally scheduled for 14 December 2013 (to all investors in the 5.5555% Bonds, whether or not

participating in the Exchange Offer) upon successful completion of the Liability Management Exercise. Such payment will be made in cash on the Settlement Date.

6.5 ***Worked Examples***

Worked examples illustrating what a Holder of 5.5555% Bonds may receive in exchange for its 5.5555% Bonds in the Liability Management Exercise are set out in Part 8 of this Section C.

7. DELIVERY OF GROUP NOTES AND BANK T2 NOTES AND PAYMENT OF THE ACCRUED DIVIDENDS AND ACCRUED INTEREST AND OTHER AMOUNTS

7.1 ***Delivery of Bank T2 Notes and Group Notes***

References in this section to "Group Notes" include both the Final Repayment Notes and the Instalment Repayment Notes, whichever is applicable to a Holder.

The manner of delivery of Bank T2 Notes or Group Notes to a Holder will depend upon whether the Holder offers to exchange or sell its Preference Shares, 13% Bonds or 5.5555% Bonds (as the case may be) (1) in CREST, (2) in Euroclear or Clearstream, Luxembourg or (3) in certificated form outside the clearing systems.

(a) *Preference Shares and 13% Bonds held in CREST*

Holders who offer to exchange or sell their Preference Shares or 13% Bonds (as the case may be) in CREST will, if the Liability Management Exercise is successfully completed, receive their Group Notes in the same CREST account from which the Preference Shares or 13% Bonds (as the case may be) are offered for exchange or sale.

(b) *5.5555% Bonds held in CREST*

Holders who offer to exchange their 5.5555% Bonds in CREST will, if the Liability Management Exercise is successfully completed, receive their Bank T2 Notes in the same CREST account from which the 5.5555% Bonds are offered for exchange.

(c) *Preference Shares and 13% Bonds held in Euroclear or Clearstream, Luxembourg*

Holders who offer to exchange or sell their Preference Shares or 13% Bonds in Euroclear or Clearstream, Luxembourg will, if the Liability Management Exercise is successfully completed, receive interests in their Group Notes in the same Euroclear or Clearstream, Luxembourg account from which the Preference Shares or 13% Bonds (as applicable) are offered for exchange or sale.

(d) *5.5555% Bonds held in Euroclear or Clearstream, Luxembourg*

Holders who offer to exchange their 5.5555% Bonds in Euroclear or Clearstream, Luxembourg will, if the Liability Management Exercise is successfully completed, receive interests in their Bank T2 Notes in the same Euroclear or Clearstream, Luxembourg account from which the 5.5555% Bonds are offered for exchange.

(e) *Preference Shares and 13% Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg*

Holders who hold their Preference Shares or 13% Bonds in certificated form outside CREST, Euroclear and Clearstream, Luxembourg and who offer to exchange or sell their Preference Shares or 13% Bonds (as applicable) will, if the Liability Management Exercise is successfully completed, hold their Group Notes in certificated form outside CREST, and will be eligible to receive a certificate evidencing such holding from Computershare (as registrar for the Group Notes). Such certificate will be sent to the address of such Holder appearing in the register for the Preference Shares or, as the case may be, 13% Bonds in exchange for which the Group Notes are delivered, unless such Holder specifies an alternative address in its Exchange Instruction in which case the certificate will be sent to such alternative address.

(f) *5.5555% Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg*

Holders who hold their 5.5555% Bonds in certificated form outside CREST, Euroclear and Clearstream, Luxembourg and who offer to exchange their 5.5555% Bonds will, if such offer is accepted by the Bank, hold their Bank T2 Notes in certificated form outside CREST, and will be eligible to receive a certificate evidencing such holding of Bank T2 Notes from Computershare (as registrar for the Bank T2 Notes). Such certificate will be sent to the address of such Holder appearing in the register for the 5.5555% Bonds in exchange for which the Bank T2 Notes are delivered, unless such Holder specifies an alternative address in its Exchange Instruction in which case the certificates will be sent to such alternative address.

7.2 ***Payment of the Accrued Dividends, Accrued Interest and other amounts***

Payment of the Accrued Dividends in respect of the Preference Shares (and the cash amount to be paid in exchange for Additional Preference Shares) will be made in accordance with the usual procedures of Computershare (as registrar in respect of the Preference Shares) for the payment of dividends on the Preference Shares.

Payment of the Accrued Interest on the 13% Bonds and the 5.5555% Bonds (as well as the deferred interest payment on the 13% Bonds originally scheduled for 31 July 2013 and the deferred interest payment on the 5.5555% Bonds originally scheduled for 14 December 2013) will be made in accordance with the usual procedures of Equiniti (as registrar in respect of the Perpetual Subordinated Bonds) for the payment of interest on the relevant Perpetual Subordinated Bonds.

7.3 ***Delivery of the Preference Shares***

Any Preference Shares which are offered for exchange or sale will, if the Liability Management Exercise successfully completes, be transferred to the Group, which expects to surrender its economic rights under the Preference Shares (in order to generate Common Equity Tier 1 capital for the Bank) in consideration for the issue of ordinary shares by the Bank to the Group.

7.4 ***Delivery and cancellation of the 13% Bonds***

Any 13% Bonds which are offered for exchange or sale will, if the Liability Management Exercise successfully completes, be transferred to the Group, which expects to surrender those 13% Bonds to the Bank for cancellation in consideration for the issue of ordinary shares by the Bank to the Group.

7.5 ***Cancellation of the 5.5555% Bonds***

Any 5.5555% Bonds which are offered for exchange will, if the Liability Management Exercise successfully completes, be cancelled.

8. THE SETTLEMENT CONDITION

8.1 The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities is exchanged or sold pursuant to the Liability Management Exercise.

8.2 In order for the entire principal amount of all Existing Securities to be exchanged or sold pursuant to the Liability Management Exercise, all of the following must occur:

(a) the Proposal in respect of the Preference Shares must be (i) approved by the Holders of the Preference Shares at the Preference Shareholders Meeting (including, if such Meeting is adjourned, at the adjourned meeting) (and substantially the same resolution must be approved at the General Meeting also) and (ii) capable of being implemented in accordance with the terms of that Proposal as set out in this Offer Memorandum;

(b) the Proposal in respect of the 13% Bonds must be (i) approved by the Holders of the 13% Bonds at the 13% Bondholders Meeting (including, if such Meeting is adjourned, at the

adjourned meeting) and (ii) capable of being implemented in accordance with the terms of that Proposal as set out in this Offer Memorandum;

(c) the Proposal in respect of the 5.5555% Bonds must be (i) approved by the Holders of the 5.5555% Bonds at the 5.5555% Bondholders Meeting (including, if such Meeting is adjourned, at the adjourned meeting) and (ii) capable of being implemented in accordance with the terms of that Proposal as set out in this Offer Memorandum; and

(d) (i) the Scheme (as further described in Section D of this Offer Memorandum) must be approved by the requisite majority of the Holders of the Dated Notes at the Scheme Meeting and sanctioned by the Court; (ii) an office copy of the sanction order must be delivered to the Registrar of Companies at Companies House; and (iii) the Scheme must become unconditional in accordance with its terms (subject only to satisfaction of the Settlement Condition).

The requirements of sub-paragraphs (a) to (d) (inclusive) above are collectively referred to in this document as the "**Settlement Condition**".

8.3 The Exchange Offers will only settle, and the Proposals will only be implemented, if the Settlement Condition is satisfied. The last date on which the Liability Management Exercise may successfully complete is 31 December 2013.

8.4 **The Settlement Condition is not capable of being waived**. Accordingly, if the Settlement Condition is not satisfied, the Liability Management Exercise will not be implemented, and no Existing Securities will be exchanged or sold (and no New Securities will be issued) pursuant to the Liability Management Exercise.

8.5 The Bank undertakes that it shall not:

(a) accept any offers to exchange or sell Preference Shares or Perpetual Subordinated Bonds; or

(b) implement the Proposals or any of them (even if the relevant Extraordinary Resolutions are passed),

in each case unless the Settlement Condition is satisfied.

9. ACCEPTANCE OF OFFERS AND ACCEPTANCE CONDITIONS

9.1 The Exchange Offers are invitations to treat by the Bank and the Group, and any reference to an offer or invitation being made by the Bank and/or the Group as part of the Exchange Offers should be read accordingly. An offer to exchange or sell (as the case may be) Preference Shares or Perpetual Subordinated Bonds will be made by each Holder who submits (or arranges the submission on its behalf of) a valid Exchange Instruction in accordance with the terms of the Exchange Offers. All such offers will only be accepted by the Bank and the Group (if at all) upon, and at the time of, the announcement by the Bank and the Group of acceptance, such announcement to be made via the Regulatory News Service (RNS) operated by the London Stock Exchange.

9.2 The Bank and the Group undertake to accept all valid offers to exchange or sell Preference Shares and Perpetual Subordinated Bonds, subject to satisfaction of the Acceptance Conditions.

9.3 The Bank and the Group shall not accept any offer to exchange or sell Preference Shares or Perpetual Subordinated Bonds unless and until the Acceptance Conditions are satisfied. The "**Acceptance Condition**s" are:

(a) that the Settlement Condition has been satisfied; and

(b) that, between the time of conclusion of the Meeting for each Series of Perpetual Subordinated Bonds and the Preference Shares (including, if any such Meeting is adjourned and the Bank postpones settlement of the Exchange Offers until after the adjourned meeting, such adjourned meeting) and the time of announcement by the Bank and the Group as to whether or not any offers to exchange or sell Preference Shares and Perpetual Subordinated Bonds are accepted,

there has been no material adverse change in the financial condition of the Bank or the Group which requires the publication of one or more supplements to the Prospectuses or any of them.

10. REPRESENTATIONS, WARRANTIES, ACKNOWLEDGEMENTS, AGREEMENTS AND UNDERTAKINGS

Holders submitting (or having submitted on their behalf) Exchange Instructions will be required to make and give, and will be deemed to have made and given, the representations, warranties, acknowledgements, agreements and undertakings set out in Part 5 of this Section C of this Offer Memorandum. Holders who have concerns about making or giving any such representations, warranties, acknowledgements, agreements and/or undertakings should contact Computershare (in the case of Holders of Preference Shares) or Equiniti (in the case of Holders of Perpetual Subordinated Bonds) immediately.

If the Bank and the Group amend the terms of the Exchange Offers, the Proposals or any of them, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

11. SEPARATE OFFERS

Each Series of Perpetual Subordinated Bonds and the Preference Shares is the subject of a separate Exchange Offer and a separate Proposal. As at the date of this Offer Memorandum, the Bank and the Group expect that the Offers in respect of each such Series will run to the same timetable. However, the Bank and the Group reserve the right to amend the timetable and/or terms of any one or more Exchange Offers and/or Proposals independently of any amendments which may (or may not) be made to the timetable and/or terms of any other Exchange Offer or Proposal.

If the Bank and the Group amend the terms of the Exchange Offers, the Proposals or any of them, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

12. RECEIPT OF NEW SECURITIES AND RELEVANT CASH PAYMENTS

12.1 If the Exchange Offers are settled, the Bank and the Group (as applicable) will procure the delivery of the Bank T2 Notes and the Group Notes to the Holders entitled thereto and the payment of the relevant Accrued Dividends and/or Accrued Interest (and other amounts due under the terms of the Exchange Offers), as applicable, on the Settlement Date for the relevant Exchange Offer.

12.2 The record date for the purposes of ceasing trading in the Preference Shares, 13% Bonds and 5.5555% Bonds, and for determining entitlement to receive the relevant Group Notes, Bank T2 Notes, Accrued Dividends, Accrued Interest and other amounts payable under the terms of the Liability Management Exercise (the "**Offer Record Date**"), is expected to be 11 December 2013 (unless any Meeting is required to be adjourned for want of a quorum, in which case the Offer Record Date is expected to be on or around 27 December 2013). The Offer Record Date is the last date on which (if the Liability Management Exercise successfully completes) Preference Shares, 13% Bonds and 5.5555% Bond can be traded. At close of business on the Offer Record Date, all holdings of Preference Shares, 13% Bonds and 5.5555% Bonds will be fixed, and the registered holders of the Preference Shares, 13% Bonds and 5.5555% Bonds at that time will be the persons entitled to receive the relevant Group Notes, Bank T2 Notes, Accrued Dividends, Accrued Interest and other amounts payable under the terms of the Liability Management Exercise on the Settlement Date.

12.3 Delivery of the Bank T2 Notes and Group Notes and payment of Accrued Dividends and Accrued Interest (and other amounts due under the terms of the Exchange Offers) will be effected in the manner described in paragraph 7 above.

12.4 With respect to Bank T2 Notes and Group Notes (or interests therein) which are to be delivered to accounts in CREST, Euroclear or Clearstream, Luxembourg, Holders should note that:

(a) the Bank and the Group (as applicable) will procure the issue of such Bank T2 Notes and Group Notes in CREST on the Settlement Date;

(b) CREST (and, where applicable, Euroclear and Clearstream, Luxembourg) will thereafter arrange for such Bank T2 Notes and Group Notes (or, where applicable, interests therein) to be delivered to the relevant accounts in CREST, Euroclear and Clearstream, Luxembourg. It is possible that this process may not be completed on the Settlement Date (and is expected to take up to ten working days), and accordingly the Holders entitled to such Bank T2 Notes and Group Notes may not receive their Bank T2 Notes and Group Notes (or, where applicable, interests therein) until after the Settlement Date;

(c) the issue of the Bank T2 Notes and Group Notes in CREST on or before the Settlement Date will discharge the Bank's and the Group's respective obligations in respect of the delivery of such Bank T2 Notes and Group Notes. Thereafter, the Holders entitled to such Bank T2 Notes and Group Notes must look to CREST, Euroclear and/or Clearstream, Luxembourg (as applicable) for receipt of such Bank T2 Notes and Group Notes (or, where applicable, interests therein); and

(d) provided that the Bank and the Group (as applicable) procure the issue of the Bank T2 Notes and the Group Notes in CREST on or before the Settlement Date, neither the Bank nor the Group (nor the Registrars) will be liable to pay any compensation or other additional amounts in the event that a Holder receives its entitlement to such Bank T2 Notes or Group Notes after the Settlement Date.

12.5 With respect to Bank T2 Notes and Group Notes which are to be held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg, Holders should note that:

(a) the Bank and the Group will, on the Settlement Date, instruct Computershare (as registrar for the Bank T2 Notes and Group Notes) to prepare and mail the certificates evidencing the holdings of such Bank T2 Notes and Group Notes as soon as reasonably practicable;

(b) Computershare will thereafter arrange for such certificates to be prepared and mailed to the relevant addresses. Accordingly, the Holders entitled to such Bank T2 Notes and Group Notes will not receive their certificate(s) until after the Settlement Date (and may not receive them for up to ten working days);

(c) the instructions of the Bank and the Group to Computershare on or before the Settlement Date will discharge the Bank's and the Group's respective obligations in respect of the delivery of such certificate(s), and Holders should look to Computershare for such certificate(s); and

(d) provided that the Bank and the Group (as applicable), on or before the Settlement Date, instruct Computershare to prepare and mail the certificates, neither the Bank nor the Group will be liable to pay any compensation or other additional amounts in the event that a Holder receives its certificate(s) after the Settlement Date.

12.6 With respect to the payment of Accrued Dividends (and the cash amount to be paid in exchange for Additional Preference Shares) and Accrued Interest (as well as the deferred interest payments on the 13% Bonds and the 5.5555% Bonds), Holders should note that:

(a) the Bank will pay, or procure the payment of, (i) an amount equal to all Accrued Dividends (and the cash amount to be paid in exchange for Additional Preference Shares) to Computershare and (ii) an amount equal to all Accrued Interest (and deferred interest payments) to Equiniti, in each case on or before the Settlement Date;

(b) Computershare and Equiniti (as applicable) will thereafter arrange for the payment of such Accrued Dividends, Accrued Interest and other amounts to the relevant Holders in accordance with their usual procedures for making payments of dividend and interest (as applicable) on such Preference Shares, 13% Bonds and 5.5555% Bonds. Accordingly, the Holders entitled to

such Accrued Dividends and/or Accrued Interest (and such other amounts) may not receive such amounts until after the Settlement Date (and it is expected to take up to ten working days for such payments to be received);

(c) the payment by or on behalf of the Bank of (i) an amount equal to all Accrued Dividends (and the cash amount to be paid in exchange for Additional Preference Shares) to Computershare and (ii) an amount equal to all Accrued Interest (and deferred interest payments) to Equiniti, in each case on or before the Settlement Date, will discharge the Bank's obligations in respect of the payment of such Accrued Dividends (and the cash amount to be paid in exchange for Additional Preference Shares) and Accrued Interest (and such deferred interest payments), and Holders should look to Computershare or Equiniti (as applicable) for their share of such amounts; and

(d) provided that the Bank pays, or procures the payment of, (i) an amount equal to all Accrued Dividends (and the cash amount to be paid in exchange for Additional Preference Shares) to Computershare and (ii) an amount equal to all Accrued Interest (and deferred interest payments) to Equiniti, in each case on or before the Settlement Date, neither the Bank nor the Group (nor, provided that they make the relevant onward payments within ten working days, the Registrars) will be liable to pay any interest, compensation or other additional amounts in the event that a Holder receives such amounts after the Settlement Date.

13. ANNOUNCEMENTS

Unless stated otherwise, announcements in relation to the Offers will be made: (i) by the issue of a press release to a Notifying News Service; (ii) by the delivery of notices to Euroclear and Clearstream, Luxembourg for communication to Direct Participants; (iii) via the Regulatory News Service (RNS) operated by the London Stock Exchange; and (iv) as otherwise required by the rules of the London Stock Exchange. Copies of all announcements, notices and press releases can also be obtained from the Exchange Agent, the contact details for which are at the end of this Offer Memorandum.

14. IRREGULARITIES

All questions as to the validity, form and eligibility (including the time of receipt) of any Exchange Instruction or the withdrawal, revocation or revision thereof or delivery of Preference Shares or Perpetual Subordinated Bonds will be determined by the Bank and the Group (as applicable) in their sole and absolution discretion, which determination will be final and binding. The Bank and the Group reserve the absolute right to reject any and all Exchange Instructions not in proper form or for which any corresponding agreement by the Bank and/or the Group would, in the opinion of the Bank or the Group, be unlawful. The Bank and the Group also reserve the absolute right to waive any defects in any Exchange Instruction. None of the Bank, the Group, the Exchange Agent or the Registrars shall be under any duty to give notice to Holders, Direct Participants, CREST Participants or beneficial owners of any irregularities in Exchange Instructions.

15. RELEASE AND WAIVER

By offering to exchange (or, where applicable, sell) Existing Securities pursuant to any Exchange Offer, or by voting in favour of the relevant Extraordinary Resolution pursuant to the relevant Proposal, each Holder will, in respect of its Existing Securities which it offers for exchange or sale, or votes in favour (as applicable), be deemed to have:

(a) released, to the fullest extent permitted by law, the Bank, the Group, Co-operative Banking Group Limited, the Dealer Managers, the Exchange Agent, the Registrars, the Trustee and their respective financial and legal advisers (together in each case with their respective directors, members, employees and representatives) from any liabilities in relation to or arising in connection with the preparation, negotiation or implementation of the Liability Management Exercise or any part thereof;

(b) waived, to the fullest extent permitted by law, all rights and entitlement it may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against the Bank, the Group, Co-operative Banking Group Limited, the Dealer Managers, the Exchange Agent, the Registrars, the Trustee and their respective financial and legal advisers (together in each case with their respective directors, members, employees and representatives) in connection with the Liability Management Exercise and/or its Existing Securities; and

(c) (if its Existing Securities are exchanged (or sold) in the Liability Management Exercise) waived, to the fullest extent permitted by law, all its rights, title and interest to and claims in respect of such Existing Securities;

provided, however, that nothing in this paragraph 15 shall release the Bank or the Group from their respective obligations or liabilities as the persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

16. SCALING OF ENTITLEMENTS TO FINAL REPAYMENT NOTES

16.1 Notwithstanding any other term of the Offers, if, in respect of the Offers for the Preference Shares and the 13% Bonds, the number of Holders electing to exchange their Preference Shares and 13% Bonds for Final Repayment Notes would (but for this paragraph 16) require the Group to issue more than £117 million in principal amount of Final Repayment Notes pursuant to the Liability Management Exercise, then subject to paragraph 16.2 below:

(a) the entitlement of each relevant Holder to receive Final Repayment Notes will be scaled back *pro rata* by such amount (the "**Scale Back Amount**") as will result in the principal amount of Final Repayment Notes issued by the Group pursuant to the Liability Management Exercise being equal to (or as near as practicable to, but without exceeding) £117 million; and

(b) each such Holder will, in respect of the Scale Back Amount applicable to it, be entitled to receive (in lieu of Final Repayment Notes) consideration in the form of Instalment Repayment Notes.

16.2 If the Group, on or before the Settlement Date, obtains the consent of its Syndicated Lenders to issue up to £129 million of Final Repayment Notes pursuant to the Liability Management Exercise, there shall be no scaling of entitlements to receive Final Repayment Notes as described in paragraph 16.1 above, and each Holder who elected (or otherwise becomes entitled) to receive Final Repayment Notes will receive its full entitlement in the form of Final Repayment Notes. For these purposes, "**Syndicated Lenders**" means the lending banks under the Group's syndicated banking loan facility.

Explanation of this paragraph 16: *On 25 October 2013, the Group obtained certain required consents for the Liability Management Exercise from its Syndicated Lenders. Since that date, the Group has increased its offer to holders of the Preference Shares and 13% Bonds. As a result, the Group's agreement with its Syndicated Lenders as to the maximum amount of Final Repayment Notes which the Group is permitted to issue (£117 million) would be insufficient if (which the Group considers extremely unlikely) an overwhelming majority of Holders of the Preference Shares and 13% Bonds elect to receive Final Repayment Notes rather than Instalment Repayment Notes. The Group intends to enter into discussions with its Syndicated Lenders in early November to obtain their consent to issue up to £129 million Final Repayment Notes, which is the maximum amount of Final Repayment Notes which the Group would need to issue if all Holders of Preference Shares and 13% Bonds elect to exchange their Preference Shares and 13% Bonds for Final Repayment Notes. Given that such discussions will not be concluded ahead of launch of the Liability Management Exercise, this paragraph 16 has been included as a term of the Offer so that if the Group would otherwise be required to issue a greater principal amount of Final Repayment Notes than its current agreement with its Syndicated Lenders permits, it will not breach the terms of its agreement with its Syndicated Lenders. In such circumstances, Holders of Preference Shares and 13% Bonds who elect (or otherwise become entitled) to receive Final Repayment Notes would receive the substantial majority*

of their entitlement in the form of Final Repayment Notes, and the balance of their entitlement in the form of Instalment Repayment Notes.

17. CALCULATIONS AND DETERMINATIONS BY THE BANK

The terms of the Offers provide for the Bank to make certain determinations and perform certain calculations in respect of the Offers. All such determinations and calculations by the Bank in good faith will, in the absence of manifest error, be conclusive and binding on the Bank, the Group and the Holders.

18. GOVERNING LAW AND SUBMISSION TO JURISDICTION

18.1 The terms of the Offers, including (without limitation) each Exchange Instruction, and any non-contractual obligations arising out of or in connection with the Offers, any such Exchange Instructions or any of them shall be governed by, and construed in accordance with, English law.

18.2 By submitting an Exchange Instruction, a Holder (and each Direct Participant or CREST Participant acting on the instructions of such Holder) irrevocably and unconditionally agrees for the benefit of the Bank, the Group, the Dealer Managers, the Exchange Agent and the Registrars that the courts of England are to have exclusive jurisdiction to settle any disputes which may arise out of or in connection with the Offers or any component part or parts thereof and that, accordingly, any suit, action or proceedings arising out of or in connection with the foregoing may be brought in such courts.

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 2

DETAILS OF THE PROPOSALS

1. THE PROPOSALS

1.1 *Overview of the Proposals*

In conjunction with the Exchange Offers:

(a) all Holders of the Preference Shares are being invited to consent, by way of an Extraordinary Resolution to be proposed at a meeting of the Holders of the Preference Shares (the "**Preference Shareholders Meeting**") to the making of certain modifications to the terms of the Preference Shares as set out in the Bank's Articles of Association and to certain releases and waivers (the "**Preference Shares Proposal**");

(b) all Holders of the 13% Bonds are being invited to consent, by way of an Extraordinary Resolution to be proposed at a meeting of the Holders of the 13% Bonds (the "**13% Bondholders Meeting**") to the making of certain modifications to the terms of the 13% Bonds as set out in the trust deed dated 1 August 2009 constituting the 13% Bonds and to certain releases and waivers (the "**13% Bonds Proposal**"); and

(c) all Holders of the 5.5555% Bonds are being invited to consent, by way of an Extraordinary Resolution to be proposed at a meeting of the Holders of the 5.5555% Bonds (the "**5.5555% Bondholders Meeting**") to the making of certain modifications to the terms of the 5.5555% Bonds as set out in the trust deed dated 1 August 2009 constituting the 5.5555% Bonds and to certain releases and waivers (the "**5.5555% Bonds Proposal**").

The Preference Shareholders Meeting, the 13% Bondholders Meeting and the 5.5555% Bondholders Meeting are, together, referred to as the "**Meetings**" and each a "**Meeting**". The Preference Shares Proposal, the 13% Bonds Proposal and the 5.5555% Bonds Proposal are, together, referred to as the "**Proposals**" and each a "**Proposal**".

In addition, a general meeting (the "**General Meeting**") of all shareholders (both ordinary shareholders and preference shareholders) of the Bank must also approve a resolution in similar terms to that which is proposed at the Preference Shareholders Meeting, in order to give effect to that resolution.

1.2 *Proposed modifications to the terms of the Preference Shares and release and waiver arrangements*

The terms of the Extraordinary Resolution to be proposed at the Preference Shareholders Meeting are set out in full in the form of notice convening the meeting set out at Part 9 of this Section C of this Offer Memorandum. A resolution, in substantially the same terms, will also be considered at the General Meeting.

If both the Extraordinary Resolution is approved at the Preference Shareholders Meeting and the corresponding resolution is approved at the General Meeting, and such resolutions are implemented by the Bank, the effect of such resolutions will be to enable the Bank:

(a) to purchase and cancel any share capital of the Bank (which would include, without limitation, Preference Shares) from time to time, without the need for the further consent of the holders of the Preference Shares; and

(b) to mandatorily effect, at the Bank's option, the transfer to the Group of all (but not some only) of the Preference Shares, which are not offered for exchange or sale in the Exchange Offer,

either (1) in exchange for Final Repayment Notes, or (2) in return for the cash consideration to be paid over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as those upon which Preference Shares are exchanged or sold in the Exchange Offer for the Preference Shares (the "**Preference Shares Mandatory Exchange Option**").

The proposed Extraordinary Resolution also contains, on behalf of all Holders of the Preference Shares (i) a release, in favour of certain persons (including, amongst others, the Bank, the Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such Holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their Preference Shares; provided, however, that nothing in that resolution shall constitute a release of the Bank or the Group from, or a waiver of the rights and entitlements of Holders in respect of, the respective obligations or liabilities of the Bank and the Group in their capacity as persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

1.3 ***Proposed modifications to the terms of the 13% Bonds and release and waiver arrangements***

The terms of the Extraordinary Resolution to be proposed at the 13% Bondholders Meeting are set out in full in the form of notice convening the meeting set out at Part 10 of this Section C of this Offer Memorandum.

The effect of the Extraordinary Resolution, if approved at the 13% Bondholders Meeting and implemented by the Bank, will be to modify the terms and conditions of the 13% Bonds such that the Bank is able to mandatorily effect, at the Bank's option, the transfer to the Group of all (but not some only) of the 13% Bonds, which are not exchanged in the Exchange Offer, either (1) in exchange for Final Repayment Notes, or (2) in return for the cash consideration to be paid over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as those upon which 13% Bonds are exchanged or sold in the Exchange Offer for the 13% Bonds (the "**13% Bonds Mandatory Exchange Option**").

The proposed Extraordinary Resolution also contains, on behalf of all Holders of the 13% Bonds (i) a release, in favour of certain persons (including, amongst others, the Bank, the Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such Holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their 13% Bonds; provided, however, that nothing in that resolution shall constitute a release of the Bank or the Group from, or a waiver of the rights and entitlements of Holders in respect of, the respective obligations or liabilities of the Bank and the Group in their capacity as persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

1.4 ***Proposed modifications to the terms of the 5.5555% Bonds and release and waiver arrangements***

The terms of the Extraordinary Resolution to be proposed at the 5.5555% Bondholders Meeting are set out in full in the form of notice convening the meeting set out at Part 11 of this Section C of this Offer Memorandum.

The effect of the Extraordinary Resolution, if approved at the 5.5555% Bondholders Meeting and implemented by the Bank, will be to modify the terms and conditions of the 5.5555% Bonds such that the Bank is able to mandatorily effect the exchange, at the Bank's option, of all (but not some only) of the 5.5555% Bonds, which are not exchanged in the Exchange Offer, for Bank T2 Notes, on the same economic terms as those upon which 5.5555% Bonds are exchanged in the Exchange Offer for the 5.5555% Bonds (the "**5.5555% Bonds Mandatory Exchange Option**" and, together with the Preference Shares Mandatory Exchange Option and the 13% Bonds Mandatory Exchange Option, the "**Mandatory Exchange Options**" and each a "**Mandatory Exchange Option**").

The proposed Extraordinary Resolution also contains, on behalf of all Holders of the 5.5555% Bonds (i) a release, in favour of certain persons (including, amongst others, the Bank, the Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such Holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their 5.5555% Bonds; provided, however, that nothing in that resolution shall constitute a release of the Bank or the Group from, or a waiver of the rights and entitlements of Holders in respect of, the respective obligations or liabilities of the Bank and the Group in their capacity as persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

1.5 ***Connection between the Proposals and the Exchange Offers***

The submission of a valid Exchange Instruction pursuant to the Exchange Offers will also constitute the relevant Holder's instructions (i) to appoint the chairman of the relevant Meeting (including, if such meeting is adjourned, the chairman of the adjourned meeting) as proxy to vote on behalf of the relevant Holder in favour of the Extraordinary Resolution proposed; and (ii) (in the case of the Holders of Preference Shares only) to appoint the chairman of the General Meeting (including, if such meeting is adjourned, the chairman of the adjourned meeting) as proxy to vote on behalf of the relevant Holder in favour of the corresponding resolution proposed.

Accordingly, a Holder who validly submits (or arranges to have submitted on its behalf) Exchange Instructions (and does not subsequently revoke such Exchange Instructions, in the limited circumstances in which such revocation is permitted) will not be able to attend the relevant Meeting itself, nor to vote against the Extraordinary Resolution proposed at such Meeting. If that Holder is a Holder of Preference Shares, it will also not be able to attend the General Meeting itself, nor to vote against the corresponding resolution proposed at such meeting.

1.6 ***Votes in respect of Additional Preference Shares***

In addition, by offering to exchange or sell Preference Shares in the Liability Management Exercise on or before 28 November 2013 (which is the record date for determining the Holders of the Preference Shares for the purposes of allotment of the Additional Preference Shares on 29 November 2013), a Holder will also be deemed to offer to exchange or sell (as the case may be), on the same terms, any such Additional Preference Shares to be allotted to it on 29 November 2013. This will automatically include instructing the proxies appointed to vote on such Holder's behalf at the Preference Shareholders Meeting and the General Meeting to exercise the votes attaching to those Additional Preference Shares in favour of the proposed Extraordinary Resolution at the Preference Shareholders Meeting and the corresponding resolution proposed at the General Meeting.

2. EXERCISE OF THE MANDATORY EXCHANGE OPTIONS

2.1 ***Undertaking to implement the Proposals and exercise the Mandatory Exchange Option***

If the Extraordinary Resolution at any Meeting is approved, the Bank (subject to satisfaction of the Settlement Condition and to paragraph 4.6 below) undertakes to implement the relevant Extraordinary Resolution promptly and to exercise the Mandatory Exchange Option which is the subject of such Extraordinary Resolution. The Bank expects that it would exercise the Mandatory Exchange Options in a manner that would result in the relevant Existing Securities being mandatorily transferred to the Group on the settlement date for the Exchange Offer in respect of such Series of Existing Securities (currently expected to be 18 December 2013). In the event that the Mandatory Exchange Option relating to the Preference Shares and/or the 13% Bonds is exercised, the Group undertakes to accept transfer of the relevant Preference Shares and/or 13% Bonds, as the case may be, and to issue the relevant Group Notes in respect thereof.

2.2 ***Consideration for mandatory transfer or exchange of Preference Shares and Perpetual Subordinated Bonds***

(a) Any Preference Shares which are transferred to the Group pursuant to the exercise of the Mandatory Exchange Option in respect of the Preference Shares will be exchanged for Final Repayment Notes or sold to the Group for the cash consideration payable in instalments over twelve years and represented by Instalment Repayment Notes (as the case may be) on the same economic terms as those upon which Preference Shares are exchanged or sold in the Exchange Offer.

(b) Any 13% Bonds which are transferred to the Group pursuant to the exercise of the Mandatory Exchange Option in respect of the 13% Bonds will be exchanged for Final Repayment Notes or sold to the Group for the cash consideration payable in instalments over twelve years and represented by Instalment Repayment Notes (as the case may be) on the same economic terms as those upon which 13% Bonds are exchanged or sold in the Exchange Offer.

(c) Any 5.5555% Bonds which are exchanged pursuant to the exercise of the Mandatory Exchange Option in respect of the 5.5555% Bonds will be exchanged on the same economic terms as those upon which 5.5555% Bonds are exchanged in the Exchange Offer.

The references above to an exchange or sale on the same "economic terms" means that the principal amount of Group Notes or the Bank T2 Notes (as applicable) to be delivered, and the payments of accrued and unpaid dividends, accrued and unpaid interest and other amounts to be paid, will be the same as if such Holder's Preference Shares, 13% Bonds or 5.5555% Bonds (as the case may be) had been exchanged or sold pursuant to the Exchange Offer. If, for any reason, any Mandatory Exchange Option does not settle on the same day as the Exchange Offers, the amount of accrued and unpaid dividends or interest (as applicable) will be adjusted accordingly.

2.3 ***Holder of Preference Shares who has not elected whether to receive Final Repayment Notes or Instalment Repayment Notes***

If a Holder of Preference Shares has not made a valid election (in accordance with the procedures set out in this document) whether to receive Final Repayment Notes or Instalment Repayment Notes, and such Holder's Preference Shares are mandatorily transferred to the Group pursuant to the Preference Shares Mandatory Exchange Option, then (i) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes, such Holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes, such Holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the Holder will receive Final Repayment Notes.

2.4 ***Holder of 13% Bonds who has not elected whether to receive Final Repayment Notes or Instalment Repayment Notes***

If a Holder of 13% Bonds has not made a valid election (in accordance with the procedures set out in this document) whether to receive Final Repayment Notes or Instalment Repayment Notes, and such Holder's 13% Bonds are mandatorily pursuant to the 13% Bonds Mandatory Exchange Option, then (i) if (in the Liability Management Exercise) the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Instalment Repayment Notes, such Holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Final Repayment Notes, such Holder will receive Instalment Repayment Notes.

In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the Holder will receive Final Repayment Notes.

3. DELIVERY OF BANK T2 NOTES AND GROUP NOTES AND PAYMENT OF THE ACCRUED DIVIDENDS, ACCRUED INTEREST AND OTHER AMOUNTS

3.1 ***Delivery of Bank T2 Notes and Group Notes and Cash Payments***

References in this section to "Group Notes" include both the Final Repayment Notes and the Instalment Repayment Notes, whichever is applicable to a Holder.

The manner of delivery of Bank T2 Notes or Group Notes to a Holder will depend upon whether the Holder holds its Preference Shares, 13% Bonds or 5.5555% Bonds (as the case may be) (1) in CREST, (2) in Euroclear or Clearstream, Luxembourg or (3) in certificated form outside the clearing systems.

(a) *Preference Shares and 13% Bonds held in CREST*

Holders who hold their Preference Shares or 13% Bonds (as the case may be) in CREST will, if the relevant Mandatory Exchange Option is exercised, receive their Group Notes in the same CREST account in which they hold their Preference Shares or 13% Bonds (as the case may be).

(b) *5.5555% Bonds held in CREST*

Holders who hold their 5.5555% Bonds in CREST will, if the relevant Mandatory Exchange Option is exercised, receive their Bank T2 Notes in the same CREST account from which they hold their 5.5555% Bonds.

(c) *Preference Shares and 13% Bonds held in Euroclear or Clearstream, Luxembourg*

Holders who hold their Preference Shares or 13% Bonds in Euroclear or Clearstream, Luxembourg will, if the relevant Mandatory Exchange Option is exercised, receive interests in their Group Notes in the same Euroclear or Clearstream, Luxembourg account in which they hold their Preference Shares or 13% Bonds (as the case may be).

(d) *5.5555% Bonds held in Euroclear or Clearstream, Luxembourg*

Holders who hold their 5.5555% Bonds in Euroclear or Clearstream, Luxembourg will, if the relevant Mandatory Exchange Option is exercised, receive interests in their Bank T2 Notes in the same Euroclear or Clearstream, Luxembourg account in which they hold their 5.5555% Bonds.

(e) *Preference Shares and 13% Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg*

If a Holder holds Preference Shares or 13% Bonds (as the case may be) in certificated form outside CREST, Euroclear and Clearstream, Luxembourg, any Group Notes to be delivered upon exercise of the relevant Mandatory Exchange Option will be issued to such Holder in certificated form outside CREST, and such Holder will be eligible to receive a certificate evidencing such holding from Computershare (as registrar for the Group Notes). Such certificate will be sent to the address of such Holder appearing in the register for the Preference Shares or, as the case may be, 13% Bonds in exchange for which the Group Notes are delivered.

(f) *5.5555% Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg*

If a Holder holds 5.5555% Bonds in certificated form outside CREST, Euroclear and Clearstream, Luxembourg, any Bank T2 Notes to be delivered upon exercise of the relevant Mandatory Exchange Option will be issued to such Holder in certificated form outside CREST, and such Holder will be eligible to receive a certificate evidencing such holding of Bank T2

Notes from Computershare (as registrar for the Bank T2 Notes). Such certificate will be sent to the address of such Holder appearing in the register for the 5.5555% Bonds in exchange for which the Bank T2 Notes are delivered.

3.2 ***Payment of the accrued dividends, accrued interest and other amounts***

Payment of the accrued dividends in respect of the Preference Shares (and the cash amount to be paid in exchange for Additional Preference Shares) will be made in accordance with the usual procedures of Computershare (as registrar in respect of the Preference Shares) for the payment of dividends on the Preference Shares.

Payment of the accrued interest on the 13% Bonds and the 5.5555% Bonds (as well as the deferred interest payment on the 13% Bonds originally scheduled for 31 July 2013 and the deferred interest payment on the 5.5555% Bonds originally scheduled for 14 December 2013) will be made in accordance with the usual procedures of Equiniti (as registrar in respect of the Perpetual Subordinated Bonds) for the payment of interest on the relevant Perpetual Subordinated Bonds.

4. THE PREFERENCE SHAREHOLDERS MEETING

4.1 ***Notice of Meeting***

Notice convening the Preference Shareholders Meeting will be given in accordance with the provisions of the Articles of Association of the Bank. The notice, which will contain the full form of the Extraordinary Resolution proposed to be passed, is expected to be in substantially the form set out at Part 9 of this Section C of this Offer Memorandum.

4.2 ***Time and place of Preference Shareholders Meeting***

The Preference Shareholders Meeting is expected to be convened for 1.00 p.m. on Wednesday, 11 December 2013 at Holiday Inn London (Bloomsbury), Coram Street, London WC1N 1HT.

4.3 ***Quorum and voting requirements***

In order to pass the Extraordinary Resolution, both:

(a) a quorum must be present at the Meeting (or, if applicable, any adjournment thereof); and

(b) not less than three-quarters of the votes cast at the Meeting (or, if applicable, the adjourned meeting) must be voted in favour of the Extraordinary Resolution. A Holder or other representative present at the Meeting will have one vote for each £1 in nominal amount of Preference Shares held or represented.

The quorum at the first scheduled Meeting shall be two or more persons holding or representing by proxy at least one-third in nominal amount of the aggregate amount of Preference Shares outstanding.

4.4 ***Adjourned meeting***

If, at the first scheduled Meeting, a quorum is not present, then an adjourned meeting will be convened in accordance with the Articles of Association. At any such adjourned meeting, the quorum shall be those holders present in person or by proxy, whatever the nominal amount of Preference Shares they hold.

If an adjourned meeting is required to be convened, the Bank will, provided such meeting will be held on or before 27 December 2013, postpone settlement of the Exchange Offer in respect of the Preference Shares to a date falling after that adjourned meeting. If such adjourned meeting will be held after 27 December 2013, the Bank shall have discretion whether or not to postpone settlement.

If the Bank and the Group amend the timetable for the Exchange Offers, the Proposals or any of them, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

4.5 ***Voting***

Holders who wish to vote in respect of the Extraordinary Resolution have the following options:

(a) *Eligible Holders may submit Exchange Instructions in the Exchange Offer*

Eligible Holders may elect to submit a valid Exchange Instruction pursuant to the Exchange Offer, which will also constitute the relevant Holder's instructions to appoint (i) the chairman of the Preference Shareholders Meeting (including, if such meeting is adjourned, the chairman of the adjourned meeting) as proxy to vote on behalf of the relevant Holder in favour of the Extraordinary Resolution proposed; and (ii) the chairman of the General Meeting (including, if such meeting is adjourned, the chairman of the adjourned meeting) as proxy to vote on behalf of the relevant Holder in favour of the corresponding resolution proposed.

Accordingly, a Holder who validly submits (or arranges to have submitted on its behalf) an Exchange Instruction will not be able to attend the Preference Shareholders Meeting or the General Meeting itself, nor to vote against the Extraordinary Resolution or corresponding resolution proposed at the respective meetings.

(b) *Holders may otherwise attend, in person or by proxy, and vote at the Preference Shareholder Meeting*

Eligible Holders who do not wish to submit Exchange Instructions, and Holders that are not Eligible Holders, will be entitled to attend, in person or by proxy, the Preference Shareholder Meeting (and the General Meeting) and vote in favour of or against the Extraordinary Resolution (and the corresponding resolution). Holders may make such arrangements in the manner described in the notice convening the Preference Shareholder Meeting and the General Meeting, respectively.

Such Holders should be aware that attending the Preference Shareholder Meeting in person or making separate arrangements to appoint a proxy to do so on its behalf will not (even if such Holder votes in favour of the Extraordinary Resolution) make such Holder eligible to participate in the Exchange Offer.

Holders who wish to appoint a proxy to vote in favour of the Extraordinary Resolution at the Preference Shareholders Meeting and the corresponding resolution at the General Meeting will be required to block or immobilise their Preference Shares (in a manner consistent with that described in paragraph 1.8 of Part 4 of this Section C) in respect of which they cast their votes, and such votes will be irrevocable with effect from the Early Participation Deadline (except that such votes may be revoked in the same limited circumstances in which revocation of Exchange Instructions is permitted under Section E of this Offer Memorandum).

Holders of Preference Shares are encouraged (even if not voting in favour of the Extraordinary Resolution) to elect, through their voting form, whether they would prefer to receive Final Repayment Notes or Instalment Repayment Notes in the event their Preference Shares are subject to mandatory transfer to the Group pursuant to the implementation of the Proposals under the Liability Management Exercise.

4.6 ***Resolution to be passed without the benefit of the votes of U.S. persons***

Notwithstanding any other provision of this Offer Memorandum, the Bank will not implement the Proposal in respect of the Preference Shares, even if the Extraordinary Resolution is passed, unless it is content that the Extraordinary Resolution was passed without the benefit of votes cast by U.S. persons (or would still have been passed even if such votes had been disregarded).

For these purposes, the Bank will not implement the Proposal (notwithstanding the Extraordinary Resolution being passed) in either of the following circumstances:

(a) had such votes by U.S. persons not been cast, less than 75 per cent. of the votes cast would have been in favour of the Extraordinary Resolution; or

(b) had such votes by U.S. persons not been cast, a quorum would not have been present at the Preference Shareholder Meeting (or the adjourned meeting).

5. THE PERPETUAL SUBORDINATED BONDHOLDERS MEETINGS

5.1 ***Notices of Meeting***

Notice convening each Perpetual Subordinated Bondholders Meeting will be given in accordance with the terms of the relevant trust deed constituting the Perpetual Subordinated Bonds. The notices, which will contain the full form of the Extraordinary Resolution proposed at each such Meeting, are expected to be in substantially the form set out at Part 10 (in the case of the 13% Bonds) and Part 11 (in the case of the 5.5555% Bonds) of this Section C of this Offer Memorandum.

5.2 ***Time and place of Perpetual Subordinated Bondholders Meetings***

The Meeting in respect of the 13% Bonds is expected to be convened for 2.00 p.m. on Wednesday, 11 December 2013 at Holiday Inn London (Bloomsbury), Coram Street, London WC1N 1HT.

The Meeting in respect of the 5.5555% Bonds is expected to be convened for 3.00 p.m. on Wednesday, 11 December 2013 at Holiday Inn London (Bloomsbury), Coram Street, London WC1N 1HT.

5.3 ***Quorum and voting requirements***

In order to pass an Extraordinary Resolution at the relevant Perpetual Subordinated Bondholders Meeting, both:

(a) a quorum must be present at the relevant Meeting (or, if applicable, any adjournment thereof); and

(b) not less than three-quarters of the votes cast at the Meeting (or, if applicable, the adjourned meeting) must be voted in favour of the Extraordinary Resolution. A Holder or other representative present at the Meeting will have one vote for each £1,000 in principal amount of Perpetual Subordinated Bonds of the relevant Series held or represented.

The quorum at each first scheduled Perpetual Subordinated Bondholders Meeting shall be one or more persons holding or representing by proxy not less than two-thirds of the principal amount of the relevant Series of Perpetual Subordinated Bonds for the time being outstanding.

5.4 ***Adjourned meeting***

If, in respect of either Series of Perpetual Subordinated Bonds, a quorum is not present at the first scheduled Meeting, then an adjourned meeting will be convened in accordance with the provisions set out in the relevant trust deed. At any such adjourned meeting, the quorum shall be one or more persons holding or representing by proxy not less than one-third of the principal amount of the relevant Series of Perpetual Subordinated Bonds for the time being outstanding.

If one or more adjourned meetings is required to be convened, the Bank will, provided such meeting(s) will be held on or before 27 December 2013, postpone settlement of the Exchange Offers in respect of the Perpetual Subordinated Bonds to a date falling after such adjourned meeting(s). If any such adjourned meeting will be held after 27 December 2013, the Bank shall have discretion whether or not to defer or postpone settlement.

If the Bank and the Group amend the timetable for the Exchange Offers, the Proposals or any of them, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

5.5 ***Voting***

Holders who wish to vote in respect of the relevant Extraordinary Resolution have the following options:

(a) *Eligible Holders may submit Exchange Instructions in the relevant Exchange Offer*

Eligible Holders may elect to submit a valid Exchange Instruction pursuant to the relevant Exchange Offer, which will also constitute the relevant Holder's instructions to appoint the chairman of the relevant Perpetual Subordinated Bondholders Meeting (including, if such meeting is adjourned, the chairman of that adjourned meeting) as proxy to vote on behalf of the relevant Holder in favour of the Extraordinary Resolution proposed.

Accordingly, a Holder who validly submits (or arranges to have submitted on its behalf) an Exchange Instruction will not be able to attend the relevant Perpetual Subordinated Bondholders Meeting itself, nor to vote against the Extraordinary Resolution proposed at such meeting.

(b) *Holders may otherwise attend, in person or by proxy, and vote at the relevant Perpetual Subordinated Bondholder Meeting*

Eligible Holders who do not wish to submit Exchange Instructions, and Holders that are not Eligible Holders, will be entitled to attend, in person or by proxy, the relevant Perpetual Subordinated Bondholder Meeting and vote in favour of or against the Extraordinary Resolution proposed at such meeting. Holders may make such arrangements in the manner described in the notice convening the relevant Meeting.

Such Holders should be aware that attending the relevant Meeting in person or making separate arrangements to appoint a proxy to do so on its behalf will not (even if such Holder votes in favour of the Extraordinary Resolution) make such Holder eligible to participate in the relevant Exchange Offer.

Holders who wish to appoint a proxy to vote in favour of the Extraordinary Resolution will be required to block or immobilise their Perpetual Subordinated Bonds (in a manner consistent with that described in paragraph 1.8 of Part 4 of this Section C) in respect of which they cast their votes, and such votes will be irrevocable with effect from the Early Participation Deadline (except that such votes may be revoked in the same limited circumstances in which revocation of Exchange Instructions is permitted under Section E of this Offer Memorandum).

Holders of 13% Bonds are encouraged (even if not voting in favour of the relevant Extraordinary Resolution) to elect, through their voting form, whether they would prefer to receive Final Repayment Notes or Instalment Repayment Notes in the event their 13% Bonds are subject to mandatory transfer to the Group pursuant to the implementation of the relevant Proposal under the Liability Management Exercise.

5.6 ***Resolutions to be passed without the benefit of votes of U.S. persons***

Notwithstanding any other provision of this Offer Memorandum, the Bank will not implement the Proposal in respect of a Series of Perpetual Subordinated Bonds, even if the Extraordinary Resolution for that Series is passed, unless it is content that such Extraordinary Resolution was passed without the benefit of votes cast by U.S. persons (or would still have been passed even if such votes had been disregarded).

For these purposes, the Bank will not implement the relevant Proposal (notwithstanding the Extraordinary Resolution being passed) in either of the following circumstances:

(a) had such votes by U.S. persons not been cast, less than 75 per cent. of the votes cast would have been in favour of the Extraordinary Resolution; or

(b) had such votes by U.S. persons not been cast, a quorum would not have been present at the relevant Meeting (or the adjourned meeting).

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 3

INDICATIVE TIMETABLE FOR THE OFFERS

The times and dates referred to below are indicative only and are subject to the right of the Bank and/or the Group to extend, re-open, amend and/or terminate the Exchange Offers or any of them at any time. Accordingly, the actual timetable may differ significantly from the expected timetable set out below.

If any of the below times and/or dates change, the revised time(s) and/or date(s) will be announced by the Bank as soon as reasonably practicable.

Events	*Dates and Times (all times are London time)*
Announcement of the Exchange Offers Exchange Offers announced. Prospectuses published. Eligible Holders of Preference Shares, 13% Bonds or 5.5555% Bonds can offer to exchange or sell their Existing Securities and/or vote in respect of the Proposals.	4 November 2013
Early Participation Deadline The deadline by which the Early Participation Threshold must be achieved in order for Preference Shares and Perpetual Subordinated Bonds to be exchanged or sold (as applicable) on the basis of the relevant "Early Consideration Amount" specified in the tables under paragraph 1 of Part 1 of this Section C.	4.30 p.m. on 29 November 2013
Expiration Deadline Deadline for receipt of all Exchange Instructions from Eligible Holders in respect of Preference Shares and Perpetual Subordinated Bonds.	4.30 p.m. on 6 December 2013
Meetings Meetings of the Holders of the Preference Shares, 13% Bonds and 5.5555% Bonds held to consider the Extraordinary Resolutions pursuant to the Proposals.	11 December 2013 1.00 p.m. in respect of the Preference Shares 2.00 p.m. in respect of the 13% Bonds 3.00 p.m. in respect of the 5.5555% Bonds
Offer Record Date The record date for the purposes of ceasing trading in the Preference Shares, 13% Bonds and 5.5555% Bonds, and for determining entitlement to receive the relevant Group Notes, Bank T2 Notes, Accrued Dividends, Accrued Interest and other amounts payable under the terms of the Liability Management Exercise (if it is successfully completed).	11 December 2013
Results Announcement Announcement of the results of the Liability Management Exercise.	12 December 2013
Settlement Date Expected settlement of the Offers (subject to satisfaction of the Settlement Condition), including issue and delivery of Bank T2 Notes and Group Notes and payment of Accrued Dividends, Accrued Interest and other relevant amounts.	18 December 2013

The above timetable does not account for any adjournment of the Meetings or any of them. In the event that any such Meeting is adjourned, the Bank may elect to amend the terms of the Exchange Offers or any of them including (without limitation) extending or re-opening the Exchange Offers or any of them and/or postponing the Settlement Date. If the timetable changes for any reason, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

If any of the Meetings are required to be adjourned, the Bank currently expects that the adjourned Meeting(s) will be held on or around 27 December 2013 and that the settlement date will be postponed to on or around 31 December 2013. In any event, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and the Group will prepare and publish a supplement to the Group Notes Prospectus.

Unless stated otherwise, announcements in relation to the Offers will be made: (i) by the issue of a press release to a Notifying News Service; (ii) by the delivery of notices to Euroclear and Clearstream, Luxembourg for communication to Direct Participants; (iii) via the Regulatory News Service (RNS) operated by the London Stock Exchange; and (iv) as otherwise required by the rules of the London Stock Exchange. Copies of all announcements, notices and press releases can also be obtained from the Exchange Agent, the contact details for which are at the end of this Offer Memorandum.

Holders are advised to check with any custodian, broker or other intermediary through which they hold Preference Shares or Perpetual Subordinated Bonds when such intermediary needs to receive instructions from a Holder in order for such Holder to participate in (or, in the circumstances in which revocation is permitted, revoke their instructions to participate in) the relevant Exchange Offer and/or the relevant Proposal.

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 4

PROCEDURES FOR PARTICIPATING IN THE OFFERS

Holders of Preference Shares or Perpetual Subordinated Bonds wishing to offer to exchange or sell their Preference Shares and Perpetual Subordinated Bonds in the Exchange Offers or otherwise vote on the Proposals should do so in accordance with the procedures described in this Section C Part 4.

1. GENERAL CONDITIONS TO PARTICIPATION IN THE EXCHANGE OFFERS AND THE PROPOSALS

1.1 ***Offer Restrictions***

Only Eligible Holders (being Holders who are eligible to participate in the Exchange Offers in accordance with the Offer Restrictions set out in Section F of this Offer Memorandum) may offer to exchange or sell Preference Shares and Perpetual Subordinated Bonds pursuant to the Exchange Offers.

1.2 ***Participating in the Proposals – options available to Holders***

Holders who wish to vote in respect of the relevant Extraordinary Resolution at the relevant Meeting have the following options:

(a) *Eligible Holders may submit Exchange Instructions in the Exchange Offers*

Eligible Holders may elect to submit a valid Exchange Instruction pursuant to the relevant Exchange Offer, which will also constitute the relevant Holder's instructions to appoint (i) the chairman of the Preference Shareholders Meeting, 13% Bondholders Meeting or (as the case may be) 5.5555% Bondholders Meeting (including, if any such meeting is adjourned, the chairman of that adjourned meeting) as proxy to vote on behalf of the relevant Holder in favour of the Extraordinary Resolution proposed at such Meeting; and (ii) (in the case of Holders of Preference Shares only) the chairman of the General Meeting (including, if such meeting is adjourned, the chairman of that adjourned meeting) as proxy to vote on behalf of the relevant Holder in favour of the corresponding resolution proposed at such meeting.

Accordingly, a Holder who validly submits (or arranges to have submitted on its behalf) an Exchange Instruction will not be able to attend the relevant Meeting itself, nor to vote against the Extraordinary Resolution proposed at such Meeting.

(b) *Holders may otherwise attend, in person or by proxy, and vote at the relevant Meeting*

Eligible Holders who do not wish to submit Exchange Instructions, and Holders that are not Eligible Holders, will be entitled to attend, in person or by proxy, the Preference Shareholder Meeting, 13% Bondholders Meeting or 5.5555% Bondholders Meeting (as appropriate) and vote in favour of or against the Extraordinary Resolution proposed at such Meeting. Holders may make such arrangements in the manner described in the notice convening the relevant Meeting.

Such Holders should be aware that attending a Meeting in person or making separate arrangements to appoint a proxy to do so on its behalf will not (even if such Holder votes in favour of the Extraordinary Resolution) make such Holder eligible to participate in the Exchange Offer (and will prevent such Holder from participating in the Exchange Offer).

Holders who wish to appoint a proxy to vote in favour of the Extraordinary Resolution will be required to block or immobilise their Preference Shares, 13% Bonds or (as the case may be)

5.5555% Bonds (in a manner consistent with that described in paragraph 1.8 of this Part 4 of Section C) in respect of which they cast their votes.

1.3 ***Election of Final Repayment Notes or Instalment Repayment Notes by Holders of Preference Shares and 13% Bonds***

(a) *Holders election*

Holders of Preference Shares and 13% Bonds are able to elect whether they would like to receive Final Repayment Notes or Instalment Repayment Notes if the Liability Management Exercise is successfully completed. Such Holders are permitted to choose only one option.

Such Holders may make such election in Exchange Instructions or in voting-only instructions relating to the Proposals (and, for the avoidance of doubt, such Holders are able to make such election even if they vote against the relevant Extraordinary Resolution).

(b) *Manner of election*

If a Holder holds Preference Shares or 13% Bonds in CREST, Euroclear or Clearstream, Luxembourg, it should elect the option in the Exchange Instruction corresponding to either Final Repayment Notes or Instalment Repayment Notes.

If a Holder holds its Preference Shares or 13% Bonds in certificated form outside the clearing systems, such Holder should specify, on its Certificated Holding Exchange Instruction to be sent to it in paper form, whether it wishes to elect the Final Repayment Notes option or the Instalment Repayment Notes option.

(c) *Failure to make valid election*

If a Holder fails to make a valid election (including if it attempts to elect both options rather than choosing just one) and its Preference Shares or 13% Bonds (as applicable) are transferred to the Group in the Liability Management Exercise, then (i) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares or 13% Bonds (respectively) which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of Preference Shares or 13% Bonds (respectively) which are the subject of elections to receive Instalment Repayment Notes, such holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares or 13% Bonds (respectively) which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of Preference Shares or 13% Bonds (respectively) which are the subject of elections to receive Final Repayment Notes, such holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the holder will receive Final Repayment Notes.

1.4 ***Deadlines for submission of Exchange Instructions***

Holders are reminded of the following key dates and times:

- the earliest date on which a Holder of Preference Shares, 13% Bonds or 5.5555% Bonds can offer to exchange or sell its Existing Securities is 4 November 2013.
- the Early Participation Deadline is scheduled for 4.30 p.m. (London time) on 29 November 2013.
- the Expiration Deadline (the last time at which it is possible to participate in the Exchange Offers) is scheduled for 4.30 p.m. (London time) on 6 December 2013.

The times and dates given above are indicative only, and may be changed at the option of the Bank. If the Bank changes any scheduled dates in the Exchange Offers or any of them, the Bank will prepare

and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

A holder who holds Preference Shares or Perpetual Subordinated Bonds through a custodian, broker or other financial intermediary and/or who holds its Preference Shares or Perpetual Subordinated Bonds in CREST, Euroclear or Clearstream, Luxembourg should note that it will need to provide instructions to such intermediary and/or CREST, Euroclear or Clearstream, Luxembourg (as applicable) before the times and dates specified above in order to meet the relevant deadlines.

1.5 ***Timing of receipt of Exchange Instructions***

The offering of Preference Shares for exchange or sale by a Holder will be deemed to have occurred upon receipt by Computershare of a valid Exchange Instruction submitted in accordance with the procedures described in this Section C Part 4.

The offering of 13% Bonds or 5.5555% Bonds for exchange or sale by a Holder will be deemed to have occurred upon receipt by Equiniti of a valid Exchange Instruction submitted in accordance with the procedures described in this Section C Part 4.

1.6 ***Preference Shares and Perpetual Subordinated Bonds to be offered for exchange or sale in whole denominations; minimum offer amount for Preference Shares***

The Preference Shares have a nominal amount of £1 each. Accordingly, the Preference Shares may be offered for exchange or sale in any whole multiple of £1, subject to a minimum of £2 if the Holder elects the Final Repayment Notes option (which is the minimum amount required, based on the Late Consideration Amount, in order to receive the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if the Holder elects the Instalment Repayment Notes option.

The specified denomination of each Perpetual Subordinated Bond is £1,000. Accordingly, 13% Bonds and 5.5555% Bonds must be offered for exchange or sale in principal amounts equal to £1,000 or a whole multiple of £1,000.

1.7 ***Instructions irrevocable except in limited circumstances***

It is a term of the Exchange Offers that Exchange Instructions are irrevocable except upon the publication of any supplements to the Prospectuses. Upon the publication of any such supplement, investors will have at least two Business Days to withdraw their Exchange Instructions – see further Section E of this Offer Memorandum.

1.8 ***Immobilisation of Preference Shares, 13% Bonds and 5.5555% Bonds***

The submission of a valid Exchange Instruction by or on behalf of a Holder will result in the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which are the subject of that Exchange Instruction being immobilised from the time of such submission such that no transfers may be effected in relation to such Preference Shares, 13% Bonds or 5.5555% Bonds until settlement or termination of the relevant Exchange Offer (or if such instruction is revoked, in the limited circumstances in which such revocation is permitted). The manner in which such immobilisation is effected will depend upon how the relevant securities are held and offered for exchange or sale:

(a) *Preference Shares and Perpetual Subordinated Bonds held in CREST*

In the case of Preference Shares and Perpetual Subordinated Bonds held in CREST, immobilisation will be effected by the mandatory transfer of the relevant Preference Shares or Perpetual Subordinated Bonds to one or more escrow accounts in CREST set up by Computershare (in respect of the Preference Shares) or Equiniti (in respect of the Perpetual Subordinated Bonds) in connection with the Exchange Offers and the Proposals.

(b) *Preference Shares and Perpetual Subordinated Bonds held in certificated form*

In the case of Preference Shares and Perpetual Subordinated Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg, immobilisation will be effected by the surrender of such Holder's certificate(s) evidencing the holding of those securities to Computershare (in the case of the Preference Shares) or Equiniti (in the case of Perpetual Subordinated Bonds), and Computershare or Equiniti (as applicable) will not register the transfer of such Preference Shares or Perpetual Subordinated Bonds in the register it maintains in respect of the securities represented by such Exchange Instruction.

(c) *Preference Shares and Perpetual Subordinated Bonds held in Euroclear and Clearstream, Luxembourg*

In the case of Preference Shares and Perpetual Subordinated Bonds held in Euroclear or Clearstream, Luxembourg, immobilisation will be effected by the blocking of the relevant Perpetual Subordinated Bonds in the Holder's account in accordance with the usual procedures of the relevant Clearing System (which will result in the underlying Preference Shares or Perpetual Subordinated Bonds, as the case may be, being transferred to escrow in CREST).

(d) *Holders to take reasonable steps to ensure no transfer of immobilised securities*

Holders and (if applicable) Direct Participants and CREST Participants who submit Exchange Instructions on their behalf must take the appropriate steps to ensure that no transfers may be effected in relation to such immobilised Preference Shares and Perpetual Subordinated Bonds.

1.9 ***Representations, warranties, acknowledgements, agreements and undertakings***

Holders submitting (or having submitted on their behalf) Exchange Instructions will be required to make and give, and will be deemed to have made and given, the representations, warranties, acknowledgements, agreements and undertakings set out in Part 5 of this Section C of this Offer Memorandum. Holders who have concerns about making or giving any such representations, warranties, acknowledgements, agreements and/or undertakings should contact Computershare (in the case of Holders of Preference Shares) or Equiniti (in the case of Holders of Perpetual Subordinated Bonds) immediately.

1.10 ***Authorisation to disclose information***

By submitting (or arranging to have submitted on its behalf) an Exchange Instruction, each Holder will be deemed to consent to CREST, Euroclear, Clearstream, Luxembourg, Computershare and/or Equiniti (as appropriate) providing details of the Holder and (if applicable) the Direct Participant or CREST Participant who submits an Exchange Instruction on its behalf to Computershare, Equiniti and the Exchange Agent (as appropriate) and for such information to be shared with the Bank, the Group, the Dealer Managers and their respective legal advisers.

1.11 ***Acceptance of offer results in binding contract***

By submitting (or arranging to have submitted on its behalf) a valid Exchange Instruction, a Holder will, if such offer to exchange or sell is accepted by the Bank, have entered into a binding agreement between such Holder and the Bank upon the terms and subject to the conditions of the relevant Exchange Offer.

1.12 ***Specific procedures***

Eligible Holders who hold their Preference Shares or Perpetual Subordinated Bonds held in CREST should follow the procedures set out in paragraph 2 below.

Eligible Holders who hold their Preference Shares or Perpetual Subordinated Bonds in certificated form outside CREST, Euroclear and Clearstream, Luxembourg should follow the procedures set out in paragraph 3 below.

Eligible Holders who hold their Preference Shares or Perpetual Subordinated Bonds in Euroclear or Clearstream, Luxembourg should follow the procedures set out in paragraph 4 below.

2. SPECIFIC PROCEDURES FOR HOLDERS OF PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS HELD IN CREST

The procedures contained under this paragraph 2 apply only to Preference Shares and Perpetual Subordinated Bonds held in CREST.

Procedures for offering Preference Shares or Perpetual Subordinated Bonds for exchange or sale (or otherwise for voting in favour of the relevant Proposals)

2.1 Only CREST Participants may submit Exchange Instructions in CREST. Each Holder that is not itself a CREST Participant must arrange for the CREST Participant through which such Holder holds its Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) to submit a valid Exchange Instruction on its behalf before the relevant deadlines specified by CREST.

2.2 To offer to exchange or sell Preference Shares or Perpetual Subordinated Bonds held in CREST, a Holder must send (or, for a CREST sponsored member, procure that its CREST sponsor sends) a TTE Instruction (which must comply with paragraph 2.3 below in the case of an offer to exchange or sell Preference Shares or paragraph 2.4 below in the case of an offer to exchange or sell 13% Bonds or 5.5555% Bonds) in respect of the Preference Shares or Perpetual Subordinated Bonds to be offered for exchange or sale, which transfer to escrow must settle:

(a) if such Holder wishes to offer to exchange or sell its Preference Shares or Perpetual Subordinated Bonds by the Early Participation Deadline, by the Early Participation Deadline; or

(b) otherwise, by the Expiration Deadline.

2.3 Each TTE Instruction relating to Preference Shares should specify Computershare (in its capacity as a CREST Participant under its participant ID referred to below) as the escrow agent to whom the relevant Preference Shares should be transferred. A TTE Instruction will not be valid unless and until it has settled and Computershare will not take any action in respect of any TTE Instruction until such time. The TTE Instruction must be properly authenticated in accordance with EUI's specifications and must contain, in addition to the other information which is required for a TTE Instruction to settle in CREST, the following details:

(a) the number of Preference Shares to be transferred to an escrow balance;

(b) the Holder's member account ID;

(c) the Holder's participant ID;

(d) the relevant corporate action ISIN number (being GB0002224516);

(e) Computershare's participant ID, being: 3RA13;

(f) the relevant CREST member account ID of Computershare (in its capacity as a CREST receiving agent) from the table set out after sub-paragraph (j) below, corresponding to the option which the Holder wishes to select;

(g) the intended settlement date (which should be as soon as possible and in any event not later than the relevant deadline specified in paragraph 2.2 above);

(h) the corporate action number for the Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(i) the standard TTE instruction of priority 80; and

(j) a contact number, to be inserted in the shared note field.

For the purposes of sub-paragraph (f) above, the relevant CREST member IDs of Computershare relevant to a Holder of Preference Shares are set out in the table below. **A Holder should elect the ID which corresponds to such Holder's preferred option**:

Option	CREST Member ID
Option 1: (Not available to U.S. Holders) Offer to exchange some or all of your Preference Shares for **Final Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the Preference Shareholders Meeting and the chairman of the General Meeting as your proxies to vote those Preference Shares IN FAVOUR of the resolutions to be proposed at those meetings).	**OPT0001A**
Option 2: (Not available to U.S. Holders) Offer to sell some or all of your Preference Shares to the Group for cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the Preference Shareholders Meeting and the chairman of the General Meeting as your proxies to vote those Preference Shares IN FAVOUR of the resolutions to be proposed at those meetings)	**OPT0001B**
Option 3: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002A**
Option 4: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002B**
Option 5: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002C**

Option	CREST Member ID
Option 6: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002D**
NB: to vote AGAINST the resolutions proposed at the Preference Shareholders Meeting and the General Meeting, please use the paper voting instruction available from Computershare.	**–**

2.4 Each TTE Instruction relating to 13% Bonds or 5.5555% Bonds should specify Equiniti (in its capacity as a CREST Participant under its participant ID referred to below) as the escrow agent to whom the relevant Perpetual Subordinated Bonds should be transferred. A TTE Instruction will not be valid unless and until it has settled and Equiniti will not take any action in respect of any TTE Instruction until such time. The TTE Instruction must be properly authenticated in accordance with EUI's specifications and must contain, in addition to the other information which is required for a TTE Instruction to settle in CREST, the following details:

13% Bonds

(a) the principal amount of 13% Bonds to be transferred to an escrow balance;

(b) the Holder's member account ID;

(c) the Holder's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VH4201;

(e) Equiniti's participant ID, being: 2RA35;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out after sub-paragraph (j) below, corresponding to the option which the Holder wishes to select;

(g) the intended settlement date (which should be as soon as possible and in any event not later than the relevant deadline specified in paragraph 2.2 above);

(h) the corporate action number for the relevant Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(i) the standard TTE instruction of priority 80; and

(j) a contact number, to be inserted in the shared note field.

For the purposes of sub-paragraph (f) above, the relevant CREST member IDs of Equiniti relevant to a Holder of 13% Bonds are set out in the table below. **A Holder should elect the ID which corresponds to such Holder's preferred option:**

Option	CREST Member ID
Option 1: (Not available to U.S. Holders) Offer to exchange some or all of your 13% Bonds for **Final Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the 13% Bondholders Meeting as your proxy to vote those 13% Bonds IN FAVOUR of the resolution to be proposed at that meeting).	**OPT0001A**
Option 2: (Not available to U.S. Holders) Offer to sell some or all of your 13% Bonds to the Group for cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the 13% Bondholders Meeting as your proxy to vote those 13% Bonds IN FAVOUR of the resolution to be proposed at that meeting)	**OPT0001B**
Option 3: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution **AND** if the 13% Bonds Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002A**
Option 4: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution **AND** if the 13% Bonds Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002B**
Option 5: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution **AND** if the 13% Bonds Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002C**
Option 6: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution AND if the 13% Bonds Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002D**
NB: to vote AGAINST the resolution proposed at the 13% Bondholders Meeting, please use the paper voting instruction available from Equiniti.	**–**

5.5555% Bonds

(a) the principal amount of 5.5555% Bonds to be transferred to an escrow balance;

(b) the Holder's member account ID;

(c) the Holder's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VMBW45;

(e) Equiniti's participant ID, being: 6RA99;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out after sub-paragraph (j) below, corresponding to the option which the Holder wishes to select;

(g) the intended settlement date (which should be as soon as possible and in any event not later than the relevant deadline specified in paragraph 2.2 above);

(h) the corporate action number for the relevant Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(i) the standard TTE instruction of priority 80; and

(j) a contact number, to be inserted in the shared note field.

For the purposes of sub-paragraph (f) above, the relevant CREST member IDs of Equiniti relevant to a Holder of 5.5555% Bonds are set out in the table below. **A Holder should elect the ID which corresponds to such Holder's preferred option:**

Option	**CREST Member ID**
Option 1: (Not available to U.S. Holders) Offer to exchange some or all of your 5.5555% Bonds for **Bank T2 Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the 5.5555% Bondholders Meeting as your proxy to vote those 5.5555% Bonds IN FAVOUR of the resolution to be proposed at that meeting).	**OPT55001**
Option 2: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolution at the 5.5555% Bondholders Meeting (without offering to exchange your 5.5555% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 5.5555% Bonds in favour of such resolution. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT5502A**
Option 3: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolution at the 5.5555% Bondholders Meeting (without offering to exchange your 5.5555% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 5.5555% Bonds in favour of such resolution. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT5502B**
NB: to vote AGAINST the resolution proposed at the 5.5555% Bondholders Meeting, please use the paper voting instruction available from Equiniti.	**–**

2.5 After settlement of the TTE Instruction, Holders will not be able to access the Preference Shares or Perpetual Subordinated Bonds concerned in CREST for any transaction or charging purposes (subject to the revocation rights of Holders described in Section E of this Offer Memorandum). If such

Preference Shares and/or Perpetual Subordinated Bonds are accepted pursuant to the relevant Exchange Offer, Computershare (in its capacity as escrow agent for the Preference Shares) will transfer such Preference Shares to the Group and Equiniti (in its capacity as escrow agent for the Perpetual Subordinated Bonds) will transfer the 13% Bonds to the Group and will cancel the 5.5555% Bonds.

2.6 Holders are recommended to refer to the CREST Manual for further information on the CREST procedures outlined above.

2.7 Holders of Preference Shares and Perpetual Subordinated Bonds in CREST should note that normal system timings and limitations will apply in connection with a TTE Instruction. Holders are referred to the sections of the CREST Manual concerning practical limitations of the CREST system and timings.

Procedures for revoking Exchange Instructions

2.8 In the limited circumstances where Holders are permitted to revoke their Exchange Instructions (as described in Section E of this Offer Memorandum), TTE Instructions may be withdrawn by a Holder by sending (or, for a CREST sponsored member, procuring that its CREST sponsor sends) an ESA Instruction to settle in CREST (prior to the relevant deadline) in relation to each Exchange Instruction submitted. Such ESA Instruction must comply with paragraph 2.9 below in the case of Preference Shares or paragraph 2.10 below in the case of Perpetual Subordinated Bonds.

2.9 Each ESA Instruction relating to Preference Shares must, in order for it to be valid and settle, include the following details:

(a) the number of Preference Shares to be withdrawn;

(b) the Holder's member account ID;

(c) the Holder's participant ID;

(d) the relevant corporate action ISIN number (being GB0002224516);

(e) Computershare's participant ID, being: 3RA13;

(f) the relevant CREST member account ID of Computershare (in its capacity as a CREST receiving agent) from the table set out in paragraph 2.3 above;

(g) the intended settlement date for the withdrawal;

(h) the transaction reference number of the Exchange Instruction to be withdrawn;

(i) the corporate action number for the Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(j) the standard TTE instruction of priority 80; and

(k) a contact number, to be inserted in the shared note field.

2.10 Each ESA Instruction relating to Perpetual Subordinated Bonds must, in order for it to be valid and settle, include the following details:

13% Bonds

(a) the principal amount of 13% Bonds to be withdrawn;

(b) the Holder's member account ID;

(c) the Holder's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VH4201;

(e) Equiniti's participant ID, being: 2RA35;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out in paragraph 2.4 above and relating to the 13% Bonds;

(g) the intended settlement date for the withdrawal;

(h) the transaction reference number of the Exchange Instruction to be withdrawn;

(i) the corporate action number for the relevant Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(j) the standard TTE instruction of priority 80; and

(k) a contact number, to be inserted in the shared note field.

5.5555% Bonds

(a) the principal amount of 5.5555% Bonds to be withdrawn;

(b) the Holder's member account ID;

(c) the Holder's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VMBW45;

(e) Equiniti's participant ID, being: 6RA99;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out in paragraph 2.4 above and relating to the 5.5555% Bonds;

(g) the intended settlement date for the withdrawal;

(h) the transaction reference number of the Exchange Instruction to be withdrawn;

(i) the corporate action number for the relevant Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(j) the standard TTE instruction of priority 80; and

(k) a contact number, to be inserted in the shared note field.

2.11 Any such withdrawal of Exchange Instructions will be conditional upon Computershare (in the case of a withdrawal of Preference Shares) or Equiniti (in the case of a withdrawal of Perpetual Subordinated Bonds) verifying that the withdrawal request is validly made. Accordingly, Computershare or, as the case may be, Equiniti will, on behalf of the Bank, reject or accept the withdrawal by transmitting in CREST a receiving agent reject (AEAD) or receiving agent accept (AEAN) message.

2.12 Upon a valid revocation of an Exchange Instruction, or in the event that the relevant Exchange Offer is terminated (including if the relevant offer to exchange or sell Preference Shares, 13% Bonds or 5.5555% Bonds is not accepted), the relevant Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) will be returned to the relevant CREST account of the Holder (or its sponsor).

2.13 Any Holder who does not, within the applicable timeframe, exercise its right of revocation in the manner specified above, shall be deemed to have waived such right of revocation and its original Exchange Instruction will remain effective.

3. SPECIFIC PROCEDURES FOR HOLDERS OF PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS HELD IN CERTIFICATED FORM OUTSIDE CREST, EUROCLEAR AND CLEARSTREAM, LUXEMBOURG

The procedures contained under this paragraph 3 apply only to Preference Shares and Perpetual Subordinated Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg.

Procedures for offering Preference Shares or Perpetual Subordinated Bonds for exchange or sale

3.1 In this paragraph 3, references to the "**relevant Registrar**" mean:

(a) for holders of Preference Shares, Computershare; or

(b) for holders of 13% Bonds or 5.5555% Bonds, Equiniti.

3.2 To offer to exchange or sell Preference Shares, 13% Bonds or 5.5555% Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg, a Holder must deliver to the relevant Registrar, not later than:

(a) if such Holder wishes to offer to exchange or sell its Preference Shares or Perpetual Subordinated Bonds by the Early Participation Deadline, the Early Participation Deadline; or

(b) otherwise, the Expiration Deadline,

a duly completed Certificated Holding Exchange Instruction, together with the certificate or certificates evidencing ownership of the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which are the subject of such Certificated Holding Exchange Instruction.

3.3 The form of Certificated Holding Exchange Instruction for the Preference Shares and the 13% Bonds will contain appropriate boxes for a Holder to specify whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option.

3.4 The appropriate form of Certificated Holding Exchange Instruction will be mailed on or around 4 November 2013 to the relevant Holders of Preference Shares, 13% Bonds and 5.5555% Bonds at the address of each such Holder appearing in the register of such securities as at 31 October 2013 (in the case of the Preference Shares) and 30 October 2013 (in the case of the 13% Bonds and the 5.5555% Bonds). If a Holder has not received a Certificated Holding Exchange Instruction within five working days of 4 November 2013, or if it requires an additional copy of a Certificated Holding Exchange Instruction, it should contact the relevant Registrar without delay.

3.5 Holders who have lost their certificate(s) should notify the relevant Registrar by telephone as soon as possible, and in any event at least two Business Days in advance of any relevant deadline for submission of Exchange Instructions, to obtain a declaration and indemnity for return to the relevant Registrar by not later than the relevant deadline. Indemnities will only be accepted in lieu of certificates at the discretion of the Bank.

3.6 An Exchange Instruction relating to Preference Shares, 13% Bonds or 5.5555% Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg will not be valid unless accompanied by either (i) the certificate(s) in respect of the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) to which such Exchange Instruction relates, or (ii) a duly completed declaration and indemnity accepted by the Bank.

3.7 Computershare's address for the delivery of Certified Holding Exchange Instructions in relation to Preference Shares and related certificates is:

Computershare Investor Services PLC
Corporate Actions Projects
Bristol BS99 6AH
United Kingdom

3.8 Equiniti's address for the delivery of Certificated Holding Exchange Instructions in relation to 13% Bonds and 5.5555% Bonds and related certificates is:

Equiniti Limited
Corporate Actions
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA
United Kingdom

3.9 Certificated Holding Exchange Instructions relating to Preference Shares will be required to specify, amongst other information:

(a) the name and address of the relevant Holder and a contact telephone number;

(b) confirmation that such Holder is an Eligible Holder;

(c) the number of Preference Shares which are being offered for exchange or sale;

(d) whether the Holder elects the Final Repayment Notes option or the Instalment Repayment Notes option; and

(e) the address to which (if the Exchange Offer is settled) the certificate evidencing such Holder's holding of Final Repayment Notes or Instalment Repayment Notes should be mailed (if different from the address currently on the register).

3.10 Certificated Holding Exchange Instructions relating to 13% Bonds will be required to specify, amongst other information:

(a) the name and address of the relevant Holder and a contact telephone number;

(b) confirmation that such Holder is an Eligible Holder;

(c) the principal amount of 13% Bonds which is being offered for exchange or sale;

(d) whether the Holder elects the Final Repayment Notes option or the Instalment Repayment Notes option; and

(e) the address to which (if the Exchange Offer is settled) the certificate evidencing such Holder's holding of Final Repayment Notes or Instalment Repayment Notes should be mailed (if different from the address currently on the register).

3.11 Certificated Holding Exchange Instructions relating to 5.5555% Bonds will be required to specify, amongst other information:

(a) the name and address of the relevant Holder and a contact telephone number;

(b) confirmation that such Holder is an Eligible Holder;

(c) the principal amount of 5.5555% Bonds which is being offered for exchange; and

(d) the address to which (if the Exchange Offer is settled) the certificates evidencing such Holder's holding of Bank T2 Notes should be mailed (if different from the address currently on the register).

Procedures for revoking Exchange Instructions

3.12 To revoke a Certificated Holding Exchange Instruction in the limited circumstances in which revocation is permitted, a Holder must deliver to the relevant Registrar, not later than the applicable

revocation deadline, a written revocation instruction in such form as the relevant Registrar deems appropriate and shall make available to Holders in the event that a revocation right arises.

3.13 The Holder will be required to specify in the revocation instruction, amongst other information:

(a) the name and address of the relevant Holder and a contact telephone number; and

(b) the number of Preference Shares or, as the case may be, the principal amount of 13% Bonds or 5.5555% Bonds, which are being revoked.

3.14 Upon a valid revocation of a Certificated Holding Exchange Instruction, or in the event that the relevant Exchange Offer is terminated (including if the relevant offer to exchange or sell Preference Shares or Perpetual Subordinated Bonds is not accepted), the certificate(s) relating to the Preference Shares, 13% Bonds and/or 5.5555% Bonds (as applicable) which have been delivered to the relevant Registrar (and, if applicable, which are being revoked) will be returned to the relevant Holder at the address specified on its Certificated Holding Exchange Instruction.

3.15 Any Holder who does not, within the applicable timeframe, exercise its right of revocation in the manner specified above, shall be deemed to have waived such right of revocation and its original Exchange Instruction will remain effective.

4. SPECIFIC PROCEDURES FOR HOLDERS OF PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS HELD IN EUROCLEAR AND CLEARSTREAM, LUXEMBOURG

The procedures contained under this paragraph 4 apply only to Preference Shares and Perpetual Subordinated Bonds held in Euroclear or Clearstream, Luxembourg.

Procedures for offering Preference Shares and Perpetual Subordinated Bonds for exchange or sale

4.1 Only Direct Participants in Euroclear and Clearstream, Luxembourg may submit Exchange Instructions through such Clearing Systems. Each Holder that is not such a Direct Participant must arrange for the Direct Participant through which such Holder holds its Preference Shares, 13% Bonds or, as the case may be, 5.5555% Bonds to submit a valid Exchange Instruction through Euroclear or Clearstream, Luxembourg (as applicable) before the relevant deadlines specified by the relevant Clearing System.

4.2 The receipt of such Exchange Instruction will be acknowledged in accordance with the standard practices of such Clearing System and will result in the blocking of the relevant Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) in the Holder's account with the relevant Clearing System so that no transfers may be effected in relation to such Preference Shares, 13% Bonds or 5.5555% Bonds.

Procedures for revoking Exchange Instructions

4.3 In the limited circumstances in which revocation is permitted, an Exchange Instruction may be revoked in accordance with the usual procedures of the relevant Clearing System by the submission of an electronic withdrawal instruction.

4.4 To be valid, any withdrawal instruction must specify the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) to which the original Exchange Instruction related, the securities account to which such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) are credited and any other information required by the relevant Clearing System.

5. RESPONSIBILITY FOR DELIVERY OF EXCHANGE INSTRUCTIONS

5.1 It is the responsibility of Holders wishing to participate in the Exchange Offers to validly submit (or arrange to have validly submitted on their behalf) Exchange Instructions in respect of their Preference Shares, 13% Bonds and/or 5.5555% Bonds. The Bank and the Group have the right to waive any

defects of such instructions submitted by Holders. However, they are not required to waive such defects and none of the Bank, the Group, the Exchange Agent or the relevant Registrar is required to notify a Holder of defects in their Exchange Instructions.

5.2 None of the Bank, the Group, the Dealer Managers, the Exchange Agent, Computershare or Equiniti will be responsible for the communication of Exchange Instructions by Holders or, where applicable, their custodian, broker, Direct Participant, CREST Participant or other intermediary.

5.3 If a beneficial owner holds its Preference Shares, 13% Bonds or 5.5555% Bonds through a custodian, broker or other intermediary, it should consult with that intermediary as to whether such intermediary will charge any service fees in connection with the services provided to such Holder in connection with the Exchange Offers and/or the Proposals.

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 5

REPRESENTATIONS, WARRANTIES, ACKNOWLEDGEMENTS, AGREEMENTS AND UNDERTAKINGS

By submitting (or arranging to have submitted on its behalf) an Exchange Instruction, each Holder and (if applicable) the relevant Direct Participant or CREST Participant on its behalf (as the case may be) represents, warrants, acknowledges, agrees and undertakes to the Bank, the Group, the Dealer Managers, the Exchange Agent and the relevant Registrar, at the time of submission of such Exchange Instruction, the Early Participation Deadline (if submitted before that deadline), the relevant Expiration Deadline and at the time of settlement on the relevant Settlement Date, as follows:

1.1 it has received, reviewed and understood this Offer Memorandum and accepts the terms of the relevant Exchange Offer;

1.2 it is assuming all the risks inherent in participating in the relevant Exchange Offer, and has undertaken all the appropriate analysis of the implications of the relevant Exchange Offer, without reliance on (i) the Group (except that Holders of Preference Shares and 13% Bonds may place reliance on information contained in the Group Notes Prospectus, for which the Group accepts responsibility); (ii) the Bank (except that Holders of the 5.5555% Bonds may place reliance on information contained in the Bank T2 Prospectus, for which the Bank accepts responsibility); or (iii) the Dealer Managers, the Exchange Agent or the relevant Registrar;

1.3 by arranging for the blocking or immobilisation of its Preference Shares, 13% Bonds or 5.5555% Bonds (as the case may be) in the manner described in paragraph 1.8 of Part 4 of this Section C of this Offer Memorandum, it will be deemed to consent to details concerning the identity of any Direct Participant or CREST Participant (if relevant) to be disclosed to the Bank, the Group, the Dealer Managers, the Exchange Agent, the relevant Registrar and their respective advisers;

1.4 upon the terms and subject to the conditions of the relevant Exchange Offer, it offers to exchange or sell (as the case may be) the nominal amount of Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which are so blocked or immobilised pursuant to the relevant Exchange Offer and, subject to and effective on the acceptance for exchange or sale by the Bank or the Group in respect of such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) pursuant to the relevant Exchange Offer, it irrevocably sells, assigns and transfers to the Group (in the case of any Preference Shares or 13% Bonds) or to the Bank (in the case of any 5.5555% Bonds) all right, title and interest in and to, and any and all claims in respect of or arising or having arisen as a result of its status as a Holder of, all such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) and renounces all right, title and interest in and to all such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) accepted for exchange or sale and waives and releases any rights or claims it may have against the Bank, the Group or any subsidiary of the Group with respect to any such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) or the relevant Exchange Offer;

1.5 that by delivering (or arranging for the delivery on its behalf of) a valid Exchange Instruction, it also (i) instructs the appointment of the chairman of the relevant Meeting (including, if such meeting is adjourned, the chairman of the adjourned meeting) as its proxy to vote in favour of the relevant Extraordinary Resolution in respect of all its Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which are the subject of such Exchange Instruction (and, if such Exchange Instruction is delivered in respect of Preference Shares on or before 28 November 2013, the corresponding Additional Preference Shares) and that, accordingly, such Holder will be unable to attend the relevant Meeting itself or appoint a different proxy to attend the Meeting on its behalf; and (ii) (in the case of a Holder of Preference Shares only) instructs the appointment of the chairman of the General Meeting

(including, if such meeting is adjourned, the chairman of the adjourned meeting) as its proxy to vote in favour of the relevant corresponding resolution in respect of all its Preference Shares which are the subject of such Exchange Instruction (and, if such Exchange Instruction is delivered on or before 28 November 2013, the corresponding Additional Preference Shares) and that, accordingly, such Holder will be unable to attend the General Meeting itself or appoint a different proxy to attend the General Meeting on its behalf;

1.6 (in the case of a Holder of Preference Shares) that by delivering (or arranging for the delivery on its behalf of) a valid Exchange Instruction in respect of Preference Shares on or prior to 28 November 2013, it irrevocably directs the Bank to allot any Additional Preference Shares which would otherwise be allotted to such Holder in lieu of a cash dividend on 29 November 2013 to Computershare Investor Services PLC as nominee for such Holder, and irrevocably directs such nominee (i) if the Exchange Offers are settled, to deliver such Additional Preference Shares on behalf of such Holder to the Group on the Settlement Date in consideration for the payment to it in cash of an amount equal to the cash dividend which would have been payable on 29 November had the terms of the Preference Shares permitted that dividend instalment to be paid in cash, or (ii) if the Exchange Offers are not settled, to promptly deliver such Additional Preference Shares to such Holder;

1.7 it will not sell, pledge, hypothecate or otherwise encumber or transfer any Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which are the subject of the Exchange Instruction from the date of its Exchange Instruction and it agrees that any purported sale, pledge, hypothecation or other encumbrance or transfer will be void and of no effect, and that the delivery of such Exchange Instruction shall constitute an undertaking to execute any further documents and give any further assurances that may be required in connection with any of the foregoing, in each case on and subject to the terms and conditions of the Exchange Offer;

1.8 with respect to any Bank T2 Notes or Group Notes (or interests therein) which are to be delivered to it in CREST, Euroclear or Clearstream, Luxembourg, it acknowledges and agrees that (a) the Bank and the Group (as applicable) will procure the issue of such Bank T2 Notes and Group Notes in CREST on the Settlement Date; (b) CREST (and, where applicable, Euroclear and Clearstream, Luxembourg) will thereafter arrange for such Bank T2 Notes and Group Notes (or, where applicable, interests therein) to be delivered to such Holder's account in CREST, Euroclear or Clearstream, Luxembourg (as applicable). It is possible that this process may not be completed on the Settlement Date, and accordingly the Holder may not receive its Bank T2 Notes and Group Notes (or, where applicable, interests therein) until after the Settlement Date; (c) the issue of the Bank T2 Notes and Group Notes in CREST on or before the Settlement Date will discharge the Bank's and the Group's respective obligations in respect of the delivery of such Bank T2 Notes and Group Notes. Thereafter, the Holder must look to CREST, Euroclear and/or Clearstream, Luxembourg (as applicable) for receipt of such Bank T2 Notes and Group Notes (or interests therein); and (d) provided that the Bank and the Group (as applicable) procure the issue the Bank T2 Notes and the Group Notes in CREST on or before the Settlement Date, neither the Bank nor the Group will be liable to pay any compensation or other additional amounts in the event that such Holder receives its entitlement to such Bank T2 Notes or Group Notes after the Settlement Date;

1.9 with respect to Bank T2 Notes and Group Notes which are to be held by it in certificated form outside CREST, Euroclear and Clearstream, Luxembourg, it acknowledges and agrees that (a) the Bank and the Group will, on the Settlement Date, instruct Computershare (as registrar for the Bank T2 Notes and Group Notes) to prepare and mail the certificate evidencing the holdings of such Bank T2 Notes or, as the case may be, Group Notes as soon as reasonably practicable; (b) Computershare will thereafter arrange for such certificate to be prepared and mailed to the relevant address of such Holder. Accordingly, such Holder will not receive its certificate until after the Settlement Date; (c) the instructions of the Bank and the Group to Computershare on or before the Settlement Date will discharge the Bank's and the Group's respective obligations in respect of the delivery of such certificate, and the Holder should look to Computershare for such certificate; and (d) provided that the Bank and the Group (as applicable), on or before the Settlement Date, instruct Computershare to prepare and mail the certificates, neither the Bank nor the Group will be liable to pay any

compensation or other additional amounts in the event that such Holder receives its certificate after the Settlement Date;

1.10 with respect to the payment to it of any Accrued Dividends, Accrued Interest and/or any other amounts (as applicable) under the terms of the Offers, it acknowledges and agrees that (a) the Bank will pay, or procure the payment of, (i) an amount equal to all Accrued Dividends (and cash amounts to be paid in exchange for Additional Preference Shares) to Computershare and (ii) an amount equal to all Accrued Interest (including deferred interest payments, where relevant) to Equiniti, in each case on or before the Settlement Date; (b) Computershare and/or Equiniti (as applicable) will thereafter arrange for the payment of such amounts to such Holder in accordance with their usual procedures for making payments of dividends and interest (as applicable) on such Preference Shares, 13% Bonds and 5.5555% Bonds (as applicable). Accordingly, the Holder may not receive its Accrued Dividends and/or Accrued Interest and/or other amounts (as applicable) until after the Settlement Date; (c) the payment by or on behalf of the Bank of (i) an amount equal to all Accrued Dividends (and cash amounts to be paid in exchange for Additional Preference Shares) to Computershare and (ii) an amount equal to all Accrued Interest (including deferred interest payments, where relevant) to Equiniti, in each case on or before the Settlement Date, will discharge the Bank's obligations in respect of the payment of such amounts, and such Holder should look to Computershare and/or Equiniti (as applicable) for its share of such amount(s); and (d) provided that the Bank pays, or procures the payment of such amounts to Computershare and Equiniti as mentioned above, in each case on or before the Settlement Date, neither the Bank nor the Group will be liable to pay any interest, compensation or other additional amounts in the event that such Holder receives its Accrued Dividends and/or Accrued Interest and/or other amounts after the Settlement Date;

1.11 in respect of its Existing Securities which it offers for exchange or sale and which are accepted on the terms of the relevant Exchange Offer, it (a) releases, to the fullest extent permitted by law, the Bank, the Group, the Dealer Managers, the Exchange Agent, the Registrars, the Trustee and their respective financial and legal advisers (together in each case with their respective directors, members, employees and representatives) from any liabilities in relation to or arising in connection with the preparation, negotiation or implementation of the Liability Management Exercise or any part thereof; (b) waives, to the fullest extent permitted by law, all rights and entitlement it may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against the Bank, the Group, the Dealer Managers, the Exchange Agent, the Registrars, the Trustee and/or their respective financial and legal advisers (together in each case with their respective directors, members and representatives) in connection with the Liability Management Exercise and/or its Existing Securities; and (c) (if its Existing Securities are exchanged or sold in the Liability Management Exercise) waives, to the fullest extent permitted by law, all its rights, title and interest to and claims in respect of such Existing Securities (provided that such Holder does not release the Bank or the Group from their respective obligations or liabilities in their capacity as the persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively);

1.12 it (by the delivery of its Exchange Instruction) irrevocably appoints each of the Exchange Agent and the relevant Registrar as its true and lawful agents and attorneys-in-fact (with full knowledge that each of the Exchange Agent and relevant Registrar also acts as agent of the Bank) with respect to the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which are the subject of its Exchange Instruction, with full powers of substitution (such power of attorney being deemed to be an irrevocable power of attorney coupled with an interest) to: (i) transfer ownership of such Preference Shares or 13% Bonds to the Group or 5.5555% Bonds to the Bank (as applicable) upon the terms of the relevant Exchange Offer; (ii) present such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) for transfer of ownership on the relevant security register; and (iii) receive all benefits and otherwise exercise all rights of beneficial ownership of such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable), except that the Exchange Agent and relevant Registrar will have no rights to or control over (except as agent of the Bank) the Bank T2 Notes, Group Notes, Accrued Dividends, Accrued Interest and/or other cash amounts which are deliverable to the Holder in exchange for its Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) under the terms of

the Exchange Offers, all in accordance with the terms and conditions of the relevant Exchange Offer as described in this Offer Memorandum;

1.13 it agrees to ratify and confirm each and every act or thing that may be done or effected by the Bank, the Group, the Dealer Managers, the Exchange Agent, the relevant Registrar or any of their respective directors or any person nominated by any of them in the proper exercise of his or her powers and/or authority hereunder;

1.14 it agrees to do all such acts and things as shall be necessary and execute any additional documents deemed by the Bank to be desirable to (i) complete the transfer of the Preference Shares or 13% Bonds to the Group and the transfer to the Bank and/or cancellation of the 5.5555% Bonds (as applicable) against delivery and payment (as applicable) of the relevant Bank T2 Notes, Group Notes, Accrued Dividends, Accrued Interest and/or other cash amounts (as applicable), and/or (ii) perfect any of the authorities expressed to be given hereunder;

1.15 it has observed the laws of all relevant jurisdictions; obtained all requisite governmental, exchange control or other required consents; complied with all requisite formalities; and paid any issue, transfer or other taxes or requisite payments due from it in each respect in connection with any offer or acceptance in any jurisdiction and that it has not taken or omitted to take any action in breach of the terms of the relevant Exchange Offer, or which will or may result in the Bank, the Group, the Dealer Managers, the Exchange Agent, the relevant Registrar or any other person acting in breach of the legal or regulatory requirements of any such jurisdiction in connection with the Offers or any invitation for Holders to offer to exchange or sell their Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) in connection therewith;

1.16 all authority conferred or agreed to be conferred pursuant to its representations, warranties, undertakings and directions and all of its obligations shall be binding upon its successors, assigns, heirs, executors, trustees in bankruptcy, insolvency practitioners and legal representatives and shall not be affected by, and shall survive, its death, incapacity, bankruptcy, insolvency or any other similar proceedings;

1.17 except for the generic description of certain taxation considerations expressly set out in the relevant Prospectus(es), including the Offer Memorandum, (which the Holder acknowledges does not constitute advice and is not tailored to any particular investor), no information has been provided to it by the Bank, the Group, the Dealer Managers, the Exchange Agent or the relevant Registrar with regard to the tax consequences to Holders, beneficial owners or Direct Participants or CREST Participants arising from the exchange or sale of Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) in the Exchange Offers or the receipt, or transfer or payment of Bank T2 Notes, Group Notes, Accrued Dividends, Accrued Interest and/or other cash amounts (as applicable). It hereby acknowledges that it is solely liable for any taxes and similar or related payments imposed on it under the laws of any applicable jurisdiction as a result of its participation in the relevant Exchange Offer and agrees that it will not and does not have any right of recourse (whether by way of reimbursement, indemnity or otherwise) against the Bank, the Group, the Dealer Managers, the Exchange Agent, the relevant Registrar or any other person in respect of such taxes and payments;

1.18 it is not a person to whom it is unlawful to make an invitation pursuant to the relevant Exchange Offer under applicable laws, it has not distributed or forwarded this Offer Memorandum or any other document or material relating to the Exchange Offers to any such person and it has (before submitting, or arranging for the submission on its behalf, as the case may be, of the Exchange Instruction in respect of the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which it is offering for exchange or sale) complied with all laws and regulations applicable to it for the purposes of its participation in the relevant Exchange Offer;

1.19 it acknowledges that none of the Bank T2 Notes or Group Notes, nor any guarantee in respect thereof, have been or will be registered under the Securities Act or any other applicable U.S. State securities laws and agrees that it will not sell or otherwise transfer the New Securities during the 40 day period commencing on the Settlement Date for the Exchange Offers (i) except outside of the United States

in a transaction complying with Rule 903 or 904 of Regulation S, and (ii) it will send to each distributor, dealer or person receiving a selling concession, fee or other remuneration that purchases New Securities from it or through it a confirmation or notice setting forth the restrictions on offers and sales of the New Securities within the United States or to, or for the account or benefit of, U.S. persons;

1.20 it has full power and authority to submit for exchange or sale (as applicable) the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) hereby submitted for exchange or sale and if such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) are accepted for exchange or sale, such Preference Shares or 13% Bonds will be transferred to the Group (with full title free from all liens, charges and encumbrances, not subject to any adverse claim and together with all rights attached thereto) or, as the case may be, such 5.5555% Bonds will be cancelled;

1.21 it holds and will hold, until the time of settlement on the relevant Settlement Date, the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which are the subject of its Exchange Instruction, immobilised in the relevant manner and will ensure that, at any time pending the transfer of such Preference Shares or 13% Bonds to the Group or, as the case may be, the transfer to the Bank and/or cancellation of such 5.5555% Bonds (as applicable) on the relevant Settlement Date, no transfers of such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) may be effected;

1.22 the terms and conditions of the Exchange Offers shall be deemed to be incorporated in, and form a part of, the Exchange Instruction which shall be read and construed accordingly and that the information given by or on behalf of such Holder in the Exchange Instruction is true and will be true in all respects at the time of the exchange;

1.23 it accepts that, subject to applicable law or otherwise expressly provided in this Offer Memorandum, (i) its Exchange Instruction is irrevocable once submitted, and (ii) the Bank and the Group are under no obligation to Holders to accept Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) offered for exchange or sale and accordingly offers to exchange or sell Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) may be accepted or rejected by the Bank for any reason in the Bank's and/or the Group's sole discretion; and it accepts that the Bank and the Group may not be able to accept an offer to exchange or sell Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) for a variety of reasons;

1.24 the receipt from a Holder or from a Direct Participant or CREST Participant on behalf of a beneficial owner of an Exchange Instruction will (where applicable) constitute instructions to debit the securities in such Holder's or Direct Participant's account (or the account of the relevant Registrar in which such securities have been immobilised) on the relevant Settlement Date in respect of all of the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) that such Holder, Direct Participant or CREST Participant has so immobilised and which have been accepted, upon receipt by the relevant Clearing System of an instruction from the Exchange Agent, to receive those Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) for the account of the Bank or the Group, subject to the automatic withdrawal of those instructions in the event that the relevant Exchange Offer is terminated by the Bank or the Group or the withdrawal of such Exchange Instruction (in the limited circumstances in which such withdrawal is permitted) in accordance with the procedures set out in this Offer Memorandum;

1.25 it understands that acceptance for exchange or sale of its Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) offered for exchange or sale by it pursuant to the relevant Exchange Offer will constitute a binding agreement between it and the Bank or Group (as the case may be), in accordance with and subject to the terms and conditions of the relevant Exchange Offer;

1.26 it understands that the Bank and the Group may, at their sole discretion, extend, re-open, amend, waive any condition of (other than the Settlement Condition and the Acceptance Conditions) or terminate the Exchange Offers or any of them at any time, and that in the event of a termination of the relevant Exchange Offer, the Exchange Instructions with respect to the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) will be released (and the Preference Shares, 13% Bonds or

5.5555% Bonds (as applicable) returned to the Holder or, as the case may be, unblocked in the relevant Clearing System account or, if immobilised in an account of the relevant Registrar, released to such Holder);

1.27 none of the Bank, the Group, the Dealer Managers, the Exchange Agent, the relevant Registrar or any of their respective directors or employees, has given it any information with respect to the Exchange Offers save as expressly set out in the Bank T2 Prospectus and the Group Notes Prospectus (including, in each case, this Offer Memorandum) nor has any of them made any recommendation to it as to whether it should offer any of its Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) for exchange or sale in the Exchange Offers, and the Holder has made its own decision with regard to offering Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) for exchange or sale in the Exchange Offers based on any legal, tax or financial advice it has deemed necessary to seek;

1.28 it (or any account for which it is acting) is a person other than a "U.S. person" (as defined in Regulation S under the Securities Act) and is acquiring the Bank T2 Notes or (as applicable) Group Notes in an offshore transaction in accordance with Regulation S under the Securities Act;

1.29 it is not located or resident in the United Kingdom or, if it is located or resident in the United Kingdom, it is either (i) a holder of Preference Shares, 13% Bonds or 5.5555% Bonds, or (ii) any other person also falling within Article 43(2) or within Article 49(2)(a) to (d) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "**Order**") or falling within the definition of investment professionals (as defined in Article 19(5)) of the Order;

1.30 it is outside the Republic of France or, if it is located in the Republic of France, it is a (i) provider of investment services relating to portfolio management for the account of third parties ("*personnes fournissant le service d'investissement de gestion de portefeuille pour compte de tiers*"), and/or (ii) qualified investor acting for its own account (*Investisseur Qualifié*) other than an individual, (as defined in and in accordance with article L. 411-1, L.411-2, D.411-1 to D.411-3 of the French *Code Monétaire et Financier*);

1.31 it is not resident or located in the Kingdom of Belgium or, if it is located or resident in the Kingdom of Belgium, it is a "qualified investor" within the meaning of Article 6, paragraph 3 of the Public Takeover Law and Article 10 of the Prospectus Law, acting on its own account;

1.32 it is outside the European Economic Area or, if it is located in the European Economic Area (but outside the United Kingdom, France and Belgium), either (i) it is a 'qualified investor' as defined in the Prospectus Directive or (ii) it is able to participate in the Liability Management Exercise on the grounds that any other circumstances falling within Article 3(2) of the Prospectus Directive apply; and

1.33 it acknowledges that the Bank, the Group, the Dealer Managers, the Exchange Agent and the relevant Registrar will rely upon the truth and accuracy of the foregoing acknowledgments, agreements, representations, warranties, undertakings and directions.

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 6

COMPARISON OF CERTAIN KEY FEATURES OF THE PREFERENCE SHARES, THE FINAL REPAYMENT NOTES AND THE INSTALMENT REPAYMENT NOTES

AND

WORKED EXAMPLES

1. Comparison of Certain Features

The following table compares certain key features of the Preference Shares, the Final Repayment Notes and the Instalment Repayment Notes. This is a summary of certain features only, and Holders are recommended to read the Group Notes Prospectus carefully and take any financial or legal advice which they consider appropriate prior to making a decision with respect to the Offer.

	Preference Shares	Final Repayment Notes	Instalment Repayment Notes
Issuer	Bank	Group	Group
Guarantors	N/A	The Final Repayment Notes and the Instalment Repayment Notes are guaranteed (on a subordinated basis) by Funeral Services Limited, Somerfield Stores Limited, Co-operative Group Holdings (2011) Limited, Co-operative Group Food Limited, Co-operative Group Healthcare Limited, The Co-operative Pharmacy National Distribution Centre Limited and Rochpion Properties (4) LLP.	
Credit ratings	Not rated	The Final Repayment Notes and the Instalment Repayment Notes are expected to be rated CCC+ by Standard & Poor's Credit Market Services Europe Ltd., a division of The McGraw-Hill Companies Inc. which is established in the European Union and is registered under Regulation (EC) No 1060/2009 (as amended) (the CRA Regulation). *A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.*	
Nominal amount	The Preference Shares have a nominal amount of £1 each.	The Final Repayment Notes will have a principal amount of £1 each.	The Instalment Repayment Notes will have a principal amount of £0.12 (12 pence) each.
Dividends / Interest rate	The Preference Shares accrue dividends at a rate of 9.25% per year.	The Final Repayment Notes will accrue interest at a rate of 11% per year.	The Instalment Repayment Notes will not bear interest.
Frequency of payment	Dividends are payable in half-year instalments every six months.	Interest will be payable in yearly instalments every twelve months. Principal will be repaid in one payment on the twelfth anniversary of the issue date.	Payments of principal will be made in yearly instalments every twelve months.

	Preference Shares	Final Repayment Notes	Instalment Repayment Notes
Deferral of Dividend / Interest / Payments	The Bank must not pay dividends in cash if either (i) it has insufficient profits and reserves or (ii) in the judgement of the Directors, payment would breach capital adequacy requirements imposed by the Prudential Regulation Authority. If the Bank does not pay dividends in cash due to the reasons above, then (provided it has sufficient reserves available for capitalisation) it is required to allot additional Preference Shares to each holder in lieu of the cash payment. The number of Preference Shares to be delivered is calculated by multiplying the cash dividend which would otherwise be payable by four-thirds, and rounding the resulting figure down to the nearest £1.	The Group will not have any right or discretion to defer or cancel an interest payment. Accordingly, payments of interest on the Final Repayment Notes will be mandatory, and failure to pay will constitute an event of default under the terms of the Final Repayment Notes.	The Group will not have any right or discretion to defer or cancel any scheduled instalment payment. Accordingly, the amounts of principal of the Instalment Repayment Notes payable each year will be mandatory, and failure to pay will constitute an event of default under the terms of the Instalment Repayment Notes.
Scheduled repayment of principal	The Preference Shares do not have a maturity date. Accordingly, there is no date on which the Bank is required to repay the Preference Shares.	The Final Repayment Notes will mature on the twelfth anniversary of their issue date. At that time, the Group will be required to repay the Final Repayment Notes at par and the Final Repayment Notes will then be cancelled.	The principal amount of the Instalment Repayment Notes will be repaid in twelve equal annual instalments. The final instalment will be payable on the twelfth anniversary of the date of issue of the Instalment Repayment Notes, and the Instalment Repayment Notes will then be cancelled.

	Preference Shares	Final Repayment Notes	Instalment Repayment Notes
Repayment of principal in other circumstances	The terms of the Preference Shares do not give the Bank any right or obligation to repay the Preference Shares.	Holders of the Final Repayment Notes and the Instalment Repayment Notes will, following a change of control of the Group which results in one or more ratings of the Group falling below investment grade, have the option (for a limited period) to require the Group to redeem the Final Repayment Notes and the Instalment Repayment Notes. If 80% or more of the Final Repayment Notes or the Instalment Repayment Notes are redeemed in such circumstances, the Group will have the option to redeem the remaining Final Repayment Notes and/or Instalment Repayment Notes (as applicable). The Group will be entitled to redeem the Final Repayment Notes and the Instalment Repayment Notes in the event of certain changes in tax law which result in more onerous obligations on the Group with respect to the Final Repayment Notes and the Instalment Repayment Notes, respectively.	
Ranking	On a winding up of the Bank, the Preference Shares would rank above the ordinary shares and below any Dated Notes and Perpetual Subordinated Bonds which remain outstanding. In the event of insolvency of the Bank, or if the UK authorities were to consider the Bank to be in severe financial difficulty and take action under UK law to resolve the Bank, a Preference Share holder may lose some or the entire amount of its investment.	The Final Repayment Notes and Instalment Repayment Notes will rank alongside each other in a winding-up of the Group. The Final Repayment Notes and the Instalment Repayment Notes are subordinated obligations of the Group. On a winding up of the Bank but not of the Group, the Final Repayment Notes and the Instalment Repayment Notes will remain outstanding and will continue to be subordinated obligations of the Group. On a winding up of the Group, the Final Repayment Notes and the Instalment Repayment Notes will rank alongside each other and with other subordinated obligations of the Group. Each guarantor's obligations under the guarantee will rank alongside other subordinated obligations of such guarantor. In the event of insolvency of the Group, a holder of Final Repayment Notes and/or Instalment Repayment Notes may lose some or the entire amount of its investment.	
Manner in which securities can be held	The Preference Shares may currently be held electronically in CREST, Euroclear or Clearstream, Luxembourg or in certificated (physical) form outside those clearing systems.	The Final Repayment Notes and the Instalment Repayment Notes will be available to hold in CREST, Euroclear and Clearstream, Luxembourg and in certificated (physical) form outside those clearing systems.	

2. Worked Examples

The following examples are intended to assist Holders to understand the difference in income they will be eligible to receive if their Preference Shares are exchanged or sold in the Liability Management Exercise. The examples are calculated on the theoretical assumption that the Bank continues to pay dividends on its Preference Shares in cash, (although this may not necessarily be the case under the terms of the Preference Shares).

The examples, in each case, assume the following fact pattern:

- the Holder holds £1,000 in nominal amount of Preference Shares, which he has held since 28 November 2013 (the record date for determining eligibility for Additional Preference Shares) or earlier;
- the Liability Management Exercise settles on 18 December 2013 (if the Liability Management Exercise settles after this date, the Holder will be entitled to receive a slightly higher amount in respect of Accrued Dividends than is shown in the examples below);
- the Holder will be eligible to receive £61 in nominal amount of Additional Preference Shares (in lieu of a cash dividend of £46.25) on 29 November 2013; and
- the Holder holds its Final Repayment Notes or Instalment Repayment Notes for the full term of such securities (i.e. twelve years).

Example 1 – Exchange for Final Repayment Notes on the basis of the Early Consideration Amount

- Before the Liability Management Exercise, Holder "**H1**" holds £1,000 in nominal amount of Preference Shares.
    - H1 receives annual income on its Preference Shares of £92.50 (£1,000 x 9.25%). This income is paid in two half-yearly instalments of £46.25.
    - The Bank has no obligation to repay the Preference Shares.
- H1's Preference Shares are exchanged for Final Repayment Notes. Upon settlement of the Liability Management Exercise, H1 will receive:
    - £601 in principal amount of Final Repayment Notes;
    - a cash payment of £4.56 equal to the Accrued Dividends on his Preference Shares since 30 November 2013; and
    - a cash payment of £46.25 equal to the cash dividend which the Bank would have paid H1 on 29 November 2013 if permitted by the terms of the Preference Shares.
- Following the Liability Management Exercise, H1 holds £601 in principal amount of Final Repayment Notes:
    - H1 receives annual income on its Final Repayment Notes of £66.11 (£601 x 11%). This income is paid in one annual instalment.
    - On the twelfth anniversary of the issue date of the Final Repayment Notes, the Group will (provided it remains solvent), in addition to the final interest payment then due, repay the principal amount of the Final Repayment Notes at par, and H1 will receive £601 (excluding interest).

Example 2 – Exchange for <u>Final Repayment Notes</u> on the basis of the <u>Late Consideration Amount</u>

- Before the Liability Management Exercise, Holder "**H2**" holds £1,000 in nominal amount of Preference Shares.
    - H2 receives annual income on its Preference Shares of £92.50 (£1,000 x 9.25%). This income is paid in two half-yearly instalments of £46.25.
    - The Bank has no obligation to repay the Preference Shares.
- H2's Preference Shares are exchanged for Final Repayment Notes. Upon settlement of the Liability Management Exercise, H2 will receive:
    - £551 in principal amount of Final Repayment Notes;
    - a cash payment of £4.56 equal to the Accrued Dividends on his Preference Shares since 30 November 2013; and
    - a cash payment of £46.25 equal to the cash dividend which the Bank would have paid H2 on 29 November 2013 if permitted by the terms of the Preference Shares.
- Following the Liability Management Exercise, H2 holds £551 in principal amount of Final Repayment Notes:
    - H2 receives annual income on its Final Repayment Notes of £60.61 (£551 x 11%). This income is paid in one annual instalment.
    - On the twelfth anniversary of the issue date of the Final Repayment Notes, the Group will (provided it remains solvent), in addition to the final interest payment then due, repay the principal amount of the Final Repayment Notes at par, and H2 will receive £551 (excluding interest).

Example 3 – Sale for consideration payable in instalments represented by <u>Instalment Repayment Notes</u> on the basis of the <u>Early Consideration Amount</u>

- Before the Liability Management Exercise, Holder "**H3**" holds £1,000 in nominal amount of Preference Shares.
    - H3 receives annual income on its Preference Shares of £92.50 (£1,000 x 9.25%). This income is paid in two half-yearly instalments of £46.25.
    - The Bank has no obligation to repay the Preference Shares.
- H3's Preference Shares are sold to the Group and H3 receives Instalment Repayment Notes. Upon settlement of the Liability Management Exercise, H3 will receive:
    - £1,110 in principal amount of Instalment Repayment Notes;
    - a cash payment of £4.56 equal to the Accrued Dividends on his Preference Shares since 30 November 2013; and
    - a cash payment of £46.25 equal to the cash dividend which the Bank would have paid H3 on 29 November 2013 if permitted by the terms of the Preference Shares.
- Following the Liability Management Exercise, H3 holds £1,110 in principal amount of Instalment Repayment Notes:
    - H3 receives an amount each year of £92.50 (being the repayment of an instalment of principal of its Instalment Repayment Notes).

- ◦ On the twelfth anniversary of the issue date of the Instalment Repayment Notes, the Group will (provided it remains solvent), make a final payment of £92.50 (being an amount equal to the final instalment of principal).

Example 4 – Sale for consideration payable in instalments represented by <u>Instalment Repayment Notes</u> on the basis of the <u>Late Consideration Amount</u>

- Before the Liability Management Exercise, Holder "**H4**" holds £1,000 in nominal amount of Preference Shares.
  - ◦ H4 receives annual income on its Preference Shares of £92.50 (£1,000 x 9.25%). This income is paid in two half-yearly instalments of £46.25.
  - ◦ The Bank has no obligation to repay the Preference Shares.
- H4's Preference Shares are sold to the Group and H4 receives Instalment Repayment Notes. Upon settlement of the Liability Management Exercise, H4 will receive:
  - ◦ £1,060 in principal amount of Instalment Repayment Notes;
  - ◦ a cash payment of £4.56 equal to the Accrued Dividends on his Preference Shares since 30 November 2013; and
  - ◦ a cash payment of £46.25 equal to the cash dividend which the Bank would have paid H4 on 29 November 2013 if permitted by the terms of the Preference Shares.
- Following the Liability Management Exercise, H4 holds £1,060 in principal amount of Instalment Repayment Notes:
  - ◦ H4 receives an amount each year of £88.33 (being the repayment of an instalment of principal of its Instalment Repayment Notes).
  - ◦ On the twelfth anniversary of the issue date of the Instalment Repayment Notes, the Group will (provided it remains solvent), make a final payment of £88.33 (being an amount equal to the final instalment of principal).

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 7

COMPARISON OF CERTAIN KEY FEATURES OF THE 13% BONDS, THE FINAL REPAYMENT NOTES AND THE INSTALMENT REPAYMENT NOTES

AND

WORKED EXAMPLES

1. Comparison of Certain Features

The following table compares certain key features of the 13% Bonds, the Final Repayment Notes and the Instalment Repayment Notes. This is a summary of certain features only, and Holders are recommended to read the Group Notes Prospectus carefully and take any financial or legal advice which they consider appropriate prior to making a decision with respect to the Offer.

	13% Bonds	Final Repayment Notes	Instalment Repayment Notes
Issuer	Bank	Group	Group
Guarantors	N/A	The Final Repayment Notes and the Instalment Repayment Notes are guaranteed (on a subordinated basis) by Funeral Services Limited, Somerfield Stores Limited, Co-operative Group Holdings (2011) Limited, Co-operative Group Food Limited, Co-operative Group Healthcare Limited, The Co-operative Pharmacy National Distribution Centre Limited and Rochpion Properties (4) LLP.	
Credit ratings	The 13% Bonds are currently rated Ca by Moody's Investors Service Limited and CC by Fitch Ratings Limited, which are in each case established in the European Union and registered under Regulation (EC) No 1060/2009 (as amended) (the CRA Regulation). *A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.*	The Final Repayment Notes and the Instalment Repayment Notes are expected to be rated CCC+ by Standard & Poor's Credit Market Services Europe Ltd., a division of The McGraw-Hill Companies Inc. which is established in the European Union and is registered under Regulation (EC) No 1060/2009 (as amended) (the CRA Regulation). *A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.*	
Nominal amount	The 13% Bonds have a principal amount of £1,000 each.	The Final Repayment Notes will have a principal amount of £1 each.	The Instalment Repayment Notes will have a principal amount of £0.12 (12 pence) each.

	13% Bonds	Final Repayment Notes	Instalment Repayment Notes
Interest rate	The 13% Bonds accrue interest at a rate of 13% per year.	The Final Repayment Notes will accrue interest at a rate of 11% per year.	The Instalment Repayment Notes will not bear interest.
Frequency of payment	Interest is payable in half-yearly instalments every six months.	Interest will be payable in yearly instalments every twelve months. Principal will be repaid in one payment on the twelfth anniversary of the issue date.	Payments of principal will be made in yearly instalments every twelve months.
Deferral of Interest / Payments	The Bank currently may elect to defer any interest payment. The Bank may (subject to regulatory consent) pay deferred interest at any time, and in any event all deferred interest will become payable upon any redemption or purchase of 13% Bonds or in the event of a winding up of the Bank. Whilst any deferred interest remains unpaid, the Bank is not permitted to make discretionary payments on instruments which rank alongside, or junior to, the 13% Bonds (but is able to make mandatory payments on such instruments).	The Group will not have any right or discretion to defer or cancel an interest payment. Accordingly, payments of interest on the Final Repayment Notes will be mandatory, and failure to pay will constitute an event of default under the terms of the Final Repayment Notes.	The Group will not have any right or discretion to defer or cancel any scheduled instalment payment. Accordingly, the amounts of instalments of principal of the Instalment Repayment Notes payable each year will be mandatory, and failure to pay will constitute an event of default under the terms of the Instalment Repayment Notes.
Scheduled repayment of principal	The 13% Bonds do not have a maturity date. Accordingly, there is no date on which the Bank is required to repay the 13% Bonds.	The Final Repayment Notes will mature on the twelfth anniversary of their issue date. At that time, the Group will be required to repay the Final Repayment Notes at par and the Final Repayment Notes will then be cancelled.	The principal amount of the Instalment Repayment Notes will be repaid in twelve annual instalments. The final instalment will be payable on the twelfth anniversary of the date of issue of the Instalment Repayment Notes, and the Instalment Repayment Notes will then be cancelled.

	13% Bonds	Final Repayment Notes	Instalment Repayment Notes
Repayment of principal in other circumstances	The Bank may (subject to obtaining PRA consent) repay and cancel the 13% Bonds if, due to a change in law or regulation, it becomes subject to certain more onerous tax obligations.	Holders of the Final Repayment Notes and the Instalment Repayment Notes will, following a change of control of the Group which results in one or more ratings of the Group falling below investment grade, have the option (for a limited period) to require the Group to redeem the Final Repayment Notes and the Instalment Repayment Notes. If 80% or more of the Final Repayment Notes or the Instalment Repayment Notes are redeemed in such circumstances, the Group will have the option to redeem the remaining Final Repayment Notes and/or Instalment Repayment Notes (as applicable). The Group will be entitled to redeem the Final Repayment Notes and the Instalment Repayment Notes in the event of certain changes in tax law which result in more onerous obligations on the Group with respect to the Final Repayment Notes and the Instalment Repayment Notes, respectively.	
Ranking	On a winding up of the Bank, the 13% Bonds would rank above the Preference Shares and ordinary shares of the Bank and below the Dated Notes. In the event of insolvency of the Bank, or if the UK authorities were to consider the Bank to be in severe financial difficulty and take action under UK law to resolve the Bank, a 13% Bonds holder may lose some or the entire amount of its investment.	The Final Repayment Notes and Instalment Repayment Notes will rank alongside each other in a winding-up of the Group. The Final Repayment Notes and the Instalment Repayment Notes are subordinated obligations of the Group. On a winding up of the Bank but not of the Group, the Final Repayment Notes and the Instalment Repayment Notes will remain outstanding and will continue to be subordinated obligations of the Group. On a winding up of the Group, the Final Repayment Notes and the Instalment Repayment Notes will rank alongside each other and with other subordinated obligations of the Group. Each guarantor's obligations under the guarantee will rank alongside other subordinated obligations of such guarantor. In the event of insolvency of the Group, a holder of Final Repayment Notes and/or Instalment Repayment Notes may lose some or the entire amount of its investment.	
Manner in which securities can be held	The 13% Bonds may currently be held electronically in CREST, Euroclear or Clearstream, Luxembourg or in certificated (physical) form outside those clearing systems.	The Final Repayment Notes and the Instalment Repayment Notes will be available to hold in CREST, Euroclear and Clearstream, Luxembourg and in certificated (physical) form outside those clearing systems.	

2. Worked Examples

The following examples are intended to assist Holders to understand the difference in income they will be eligible to receive if their 13% Bonds are exchanged or sold in the Liability Management Exercise. The examples are calculated on the theoretical assumption that the Bank continues to pay (and not defer) interest on its 13% Bonds, (although this may not necessarily be the case under the terms of the 13% Bonds).

The examples, in each case, assume the following fact pattern:

- the Holder holds, and offers for exchange or sale, £1,000 in nominal amount of 13% Bonds;
- the Liability Management Exercise settles on 18 December 2013 (if the Liability Management Exercise settles after this date, the Holder will be entitled to receive a slightly higher amount in respect of Accrued Interest than is shown in the examples below); and
- the Holder holds its Final Repayment Notes or Instalment Repayment Notes for the full term of such securities (i.e. twelve years).

Example 1 – Exchange for Final Repayment Notes on the basis of the Early Consideration Amount

- Before the Liability Management Exercise, Holder "**H1**" holds £1,000 in nominal amount of 13% Bonds.
    - H1 receives annual income on its 13% Bonds of £130 (£1,000 x 13%). This income is paid in two half-yearly instalments of £65.
    - The Bank has no obligation to repay the 13% Bonds.
- H1's 13% Bonds are exchanged for Final Repayment Notes. Upon settlement of the Liability Management Exercise, H1 will receive:
    - £844 in principal amount of Final Repayment Notes;
    - a cash payment of £49.46 equal to the Accrued Interest on his 13% Bonds since 31 July 2013; and
    - a cash payment of £65 equal to the deferred interest payment on his 13% Bonds originally scheduled for 31 July 2013.
- Following the Liability Management Exercise, H1 holds £844 in principal amount of Final Repayment Notes:
    - H1 receives annual income on its Final Repayment Notes of £92.84 (£844 x 11%). This income is paid in one annual instalment.
    - On the twelfth anniversary of the issue date of the Final Repayment Notes, the Group will (provided it remains solvent), in addition to the final interest payment then due, repay the principal amount of the Final Repayment Notes at par, and H1 will receive £844 (excluding interest).

Example 2 – Exchange for Final Repayment Notes on the basis of the Late Consideration Amount

- Before the Liability Management Exercise, Holder "**H2**" holds £1,000 in nominal amount of 13% Bonds.
    - H2 receives annual income on its 13% Bonds of £130 (£1,000 x 13%). This income is paid in two half-yearly instalments of £65.
    - The Bank has no obligation to repay the 13% Bonds.
- H2's 13% Bonds are exchanged for Final Repayment Notes. Upon settlement of the Liability Management Exercise, H2 will receive:

- £794 in principal amount of Final Repayment Notes;
- a cash payment of £49.46 equal to the Accrued Interest on his 13% Bonds since 31 July 2013; and
- a cash payment of £65 equal to the deferred interest payment on his 13% Bonds originally scheduled for 31 July 2013.

- Following the Liability Management Exercise, H2 holds £794 in principal amount of Final Repayment Notes:
  - H2 receives annual income on its Final Repayment Notes of £87.34 (£794 x 11%). This income is paid in one annual instalment.
  - On the twelfth anniversary of the issue date of the Final Repayment Notes, the Group will (provided it remains solvent), in addition to the final interest payment then due, repay the principal amount of the Final Repayment Notes at par, and H2 will receive £794 (excluding interest).

Example 3 – Sale for consideration payable in instalments represented by Instalment Repayment Notes on the basis of the Early Consideration Amount

- Before the Liability Management Exercise, Holder "**H3**" holds £1,000 in nominal amount of 13% Bonds.
  - H3 receives annual income on its 13% Bonds of £130 (£1,000 x 13%). This income is paid in two half-yearly instalments of £65.
  - The Bank has no obligation to repay the 13% Bonds.
- H3's 13% Bonds are sold to the Group and H3 receives Instalment Repayment Notes. Upon settlement of the Liability Management Exercise, H3 will receive:
  - £1,560 in principal amount of Instalment Repayment Notes;
  - a cash payment of £49.46 equal to the Accrued Interest on his 13% Bonds since 31 July 2013; and
  - a cash payment of £65 equal to the deferred interest payment on his 13% Bonds originally scheduled for 31 July 2013.
- Following the Liability Management Exercise, H3 holds £1,560 in principal amount of Instalment Repayment Notes:
  - H3 receives an amount each year of £130 (being the repayment of an instalment of principal of its Instalment Repayment Notes).
  - On the twelfth anniversary of the issue date of the Instalment Repayment Notes, the Group will (provided it remains solvent), make a final payment of £130 (being an amount equal to the final instalment of principal).

Example 4 – Sale for consideration payable in instalments represented by Instalment Repayment Notes on the basis of the Late Consideration Amount

- Before the Liability Management Exercise, Holder "**H4**" holds £1,000 in nominal amount of 13% Bonds.
  - H4 receives annual income on its 13% Bonds of £130 (£1,000 x 13%). This income is paid in two half-yearly instalments of £65.
  - The Bank has no obligation to repay the 13% Bonds.

- H4's 13% Bonds are sold to the Group and H4 receives Instalment Repayment Notes. Upon settlement of the Liability Management Exercise, H4 will receive:
    - £1,510 in principal amount of Instalment Repayment Notes;
    - a cash payment of £49.46 equal to the Accrued Interest on his 13% Bonds since 31 July 2013; and
    - a cash payment of £65 equal to the deferred interest payment on his 13% Bonds originally scheduled for 31 July 2013.
- Following the Liability Management Exercise, H4 holds £1,510 in principal amount of Instalment Repayment Notes:
    - H4 receives an amount each year of £125.83 (being the repayment of an instalment of principal of its Instalment Repayment Notes).
    - On the twelfth anniversary of the issue date of the Instalment Repayment Notes, the Group will (provided it remains solvent), make a final payment of £125.83 (being an amount equal to the final instalment of principal).

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 8

COMPARISON OF CERTAIN KEY FEATURES OF THE 5.5555% BONDS AND THE BANK T2 NOTES

AND

WORKED EXAMPLES

1. Comparison of Certain Features

The following table compares certain key features of the 5.5555% Bonds and the Bank T2 Notes. This is a summary of certain features only, and Holders are recommended to read the Bank T2 Prospectus carefully and take any financial or legal advice which they consider appropriate prior to making a decision with respect to the Offer.

	5.5555% Bonds	**Bank T2 Notes**
Issuer	Bank	Bank.
Guarantors	None.	None.
Credit ratings	The 5.5555% Bonds are currently rated Ca by Moody's Investors Service Limited and CC by Fitch Ratings Limited, which are in each case established in the European Union and registered under Regulation (EC) No 1060/2009 (as amended) (the CRA Regulation). *A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.*	The Bank T2 Notes will not be rated upon issue.
Principal amount	The 5.5555% Bonds have a principal amount of £1,000 each.	The Bank T2 Notes will have a principal amount of £10 each.
Dividends / Interest rate	The 5.5555% Bonds accrue interest at a fixed rate of 5.5555% per year up to 14 December 2015, and thereafter at a floating rate of interest equal to 3-month LIBOR plus 2.05 per cent.	The Bank T2 Notes will accrue interest at a rate of 11% per year.
Frequency of payment	Interest is payable in half-yearly instalments every six months up to (and including) 14 December 2015, and thereafter in quarterly instalments every three months.	Interest will be payable in quarterly instalments every three months.

	5.5555% Bonds	Bank T2 Notes
Deferral of interest	The Bank currently may elect to defer any interest payment. The Bank currently expects that, if it does not redeem the 5.5555% Bonds on the interest payment date scheduled for 14 December 2015, the 5.5555% Bonds may cease to qualify as regulatory capital from that date. If the 5.5555% Bonds cease to qualify as regulatory capital, the Bank will lose its option to defer interest payments. The Bank may (subject to regulatory consent) pay deferred interest at any time, and in any event all deferred interest will become payable upon any redemption or purchase of 5.5555% Bonds or in the event of a winding up of the Bank. Whilst any deferred interest remains unpaid, the Bank is not permitted to make discretionary payments on instruments which rank alongside, or junior to, the 5.5555% Bonds (but is able to make mandatory payments on such instruments).	The Bank will not have any right or discretion to defer or cancel an interest payment. Accordingly, payments of interest on the Bank T2 Notes will be mandatory, and failure to pay will constitute an event of default under the terms of the Bank T2 Notes.
Repayment of principal at maturity	The 5.5555% Bonds do not have a maturity date. Accordingly, there is no date on which the Bank is required to repay the 5.5555% Bonds.	The Bank T2 Notes will mature on the tenth anniversary of their issue date. At that time, the Bank will be required to repay the Bank T2 Notes at par (i.e. their face amount) and the Bank T2 Notes will then be cancelled.
Repayment of principal in other circumstances	The Bank may (subject to obtaining PRA consent) repay and cancel the 5.5555% Bonds at its option on 14 December 2015 or any quarterly interest payment date thereafter. In addition, the Bank may (subject to obtaining PRA consent) repay and cancel the 5.5555% Bonds if, due to a change in law or regulation, it becomes subject to certain more onerous tax obligations.	The Bank may (subject to obtaining PRA consent) repay and cancel the Bank T2 Notes early at 101% of their face amount if, due to a change in law or regulation after the issue date, it becomes subject to certain more onerous tax obligations or all of the Bank T2 Notes cease to be eligible for recognition as regulatory capital of the Bank (and such changes must not have been foreseeable at the time of issue).

	5.5555% Bonds	Bank T2 Notes
Ranking	On a winding up of the Bank, the 5.5555% Bonds would rank above the Preference Shares and ordinary shares of the Bank and below the Dated Notes. In the event of insolvency of the Bank, or if the UK authorities were to consider the Bank to be in severe financial difficulty and take action under UK law to resolve the Bank, a 5.5555% Bonds holder may lose some or the entire amount of its investment.	On a winding up of the Bank, the Bank T2 Notes would rank above the 5.5555% Bonds (had they remained outstanding) and below depositors and other senior creditors of the Bank. In the event of insolvency of the Bank, or if the UK authorities were to consider the Bank to be in severe financial difficulty and take action under UK law to resolve the Bank, a Bank T2 Notes holder may lose some or the entire amount of its investment.
Manner in which securities can be held	The 5.5555% Bonds may currently be held electronically in CREST, Euroclear or Clearstream, Luxembourg or in certificated (physical) form outside those clearing systems.	The Bank T2 Notes will be available to hold in CREST, Euroclear and Clearstream, Luxembourg and in certificated (physical) form outside those clearing systems.

2. Worked Examples

The following examples are intended to assist Holders to understand the difference in income they will be eligible to receive if their 5.5555% Bonds are exchanged in the Liability Management Exercise. The examples are calculated on the theoretical assumption that the Bank continues to pay (rather than defer) interest on its 5.5555% Bonds, (although that may not necessarily be the case under the terms of the 5.5555% Bonds).

The examples, in each case, assume the following fact pattern:

- the Holder holds, and offers to exchange, £1,000 in nominal amount of 5.5555% Bonds;
- the Liability Management Exercise settles on 18 December 2013 (if the Liability Management Exercise settles after this date, the Holder will be entitled to receive a slightly higher amount in respect of Accrued Interest than is shown in the examples below); and
- the Holder holds its Bank T2 Notes for the full term of such securities (i.e. ten years).

Example 1 – 5.5555% Bonds exchanged on the basis of the Early Consideration Amount

- Before the Liability Management Exercise, Holder "**H1**" holds £1,000 in nominal amount of 5.5555% Bonds.
    - H1 receives annual income on its 5.5555% Bonds of £55.54 (£1,000 x 5.5555%, adjusted for semi-annual rounding). This income is paid in two half-yearly instalments of £27.77.
    - The Bank has no obligation to repay the 5.5555% Bonds.
- H1's 5.5555% Bonds are exchanged for Bank T2 Notes. Upon settlement of the Liability Management Exercise, H1 will receive:
    - £530 in principal amount of Bank T2 Notes;
    - a cash payment of £0.61 equal to the Accrued Interest on his 5.5555% Bonds since 14 December 2013; and
    - a cash payment of £27.77 equal to the deferred interest payment on his 5.5555% Bonds originally scheduled for 14 December 2013.
- Following the Liability Management Exercise, H1 holds £530 in principal amount of Bank T2 Notes.
    - H1 receives annual income on its Bank T2 Notes of £58.28 (£530 x 11%, adjusted for quarterly rounding). This income is paid in four instalments of £14.57 every three months.
    - On the tenth anniversary of the issue date of the Bank T2 Notes, the Bank will (provided it remains solvent), in addition to the final interest payment then due, repay the principal amount of the Bank T2 Notes at par, and H1 will receive £530 (excluding interest).

Example 2 – 5.5555% Bonds exchanged on the basis of the Late Consideration Amount

- Before the Liability Management Exercise, Holder "**H2**" holds £1,000 in nominal amount of 5.5555% Bonds.
    - H2 receives annual income on its 5.5555% Bonds of £55.54 (£1,000 x 5.5555%, adjusted for semi-annual rounding). This income is paid in two half-yearly instalments of £27.77.
    - The Bank has no obligation to repay the 5.5555% Bonds.
- H2's 5.5555% Bonds are exchanged for Bank T2 Notes. Upon settlement of the Liability Management Exercise, H2 will receive:
    - £480 in principal amount of Bank T2 Notes;

- a cash payment of £0.61 equal to the Accrued Interest on his 5.5555% Bonds since 14 December 2013; and
- a cash payment of £27.77 equal to the deferred interest payment on his 5.5555% Bonds originally scheduled for 14 December 2013.

- Following the Liability Management Exercise, H2 holds £480 in principal amount of Bank T2 Notes.
  - H2 receives annual income on its Bank T2 Notes of £52.80 (£480 x 11%, adjusted for quarterly rounding). This income is paid in four instalments of £13.20 every three months.
  - On the tenth anniversary of the issue date of the Bank T2 Notes, the Bank will (provided it remains solvent), in addition to the final interest payment then due, repay the principal amount of the Bank T2 Notes at par, and H2 will receive £480 (excluding interest).

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 9

FORM OF NOTICE CONVENING THE MEETING IN RESPECT OF THE PREFERENCE SHARES

THIS NOTICE IS IMPORTANT AND REQUIRES THE IMMEDIATE ATTENTION OF HOLDERS. IF HOLDERS ARE IN ANY DOUBT AS TO THE ACTION THEY SHOULD TAKE, THEY SHOULD CONSULT THEIR OWN PROFESSIONAL ADVISERS AUTHORISED UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000 IMMEDIATELY.

THE CO-OPERATIVE BANK p.l.c.

(incorporated in England and Wales with registered number 990937)

(the "**Bank**")

NOTICE OF A MEETING

of the holders of those of the

£75,000,000
9.25 PER CENT. NON-CUMULATIVE IRREDEEMABLE PREFERENCE SHARES OF £1 EACH
(ISIN: GB0002224516)

of the Bank presently outstanding
(the "**Holders**" and the "**Preference Shares**" respectively).

As at the date of this notice, £60,000,000 of the Preference Shares are presently outstanding.

NOTICE IS HEREBY GIVEN that a Meeting of the Holders convened by the Bank will be held at Holiday Inn London (Bloomsbury), Coram Street, London WC1N 1HT on Wednesday, 11 December, 2013 at 1.00 p.m. (London time) for the purpose of considering and, if thought fit, passing the following resolution (the "**Resolution**") which will be proposed as an Extraordinary Resolution in accordance with the provisions of the Bank's Articles of Association (the "**Articles of Association**") (the "**Proposal**").

EXTRAORDINARY RESOLUTION

"THAT this Meeting of the holders (the "**Holders**" or "**holders**") of those of the £75,000,000 9.25 per cent. Non-Cumulative Irredeemable Preference Shares of £1 each of The Co-operative Bank p.l.c. presently outstanding (the "**Preference Shares**" and the "**Bank**" respectively) issued under the Articles of Association of the Bank (the "**Articles of Association**") hereby:

1. assents to and sanctions the modification of the terms of the Preference Shares (as currently set out in Article 4.(B) of the Articles of Association) to the following extent:

   Notwithstanding Article 4.(B)(d) or any other provision of the Articles of Association of the Bank, the Bank may, at its option and without the need for the consent or approval of the holders of the Preference Shares, purchase (or repurchase) and cancel any share capital of the Bank from time to time, in any manner and at any price, and any such purchase (or repurchase) and cancellation shall not be treated as a modification or variation of the rights of the holders of the Preference Share within the meaning of Article 4.(B)(d).

2. assents to and sanctions the modification of the terms of the Preference Shares (as currently set out in Article 4.(B) of the Articles of Association) conferring on the Bank a mandatory exchange option on the following terms:

(1) The Bank may, upon giving not less than one day's prior notice to the holders of the Preference Shares in accordance with paragraph (8) below, at its option and without the consent or approval of the holders of the Preference Shares, require and effect the mandatory transfer of the legal and beneficial title to, and all interests in, all outstanding Preference Shares (other than Excluded Preference Shares) to Co-operative Group, on the terms set out in the following paragraphs (2) to (10) (the "**Mandatory Exchange Option**").

(2) The mandatory transfer of a holder's Preference Shares (other than Excluded Preference Shares and Additional Preference Shares) to Co-operative Group will be effected (having regard to paragraphs (3) and (4) below) on the date specified in the notice referred to in paragraph (1) above (the "**Settlement Date**") either:

(a) by way of exchange of such holder's Preference Shares for a principal amount of Final Repayment Notes equal to the principal amount of Final Repayment Notes which such holder would have received had those Preference Shares been exchanged for Final Repayment Notes in the Exchange Offer (on the same terms as those on which Preference Shares are exchanged for Final Repayment Notes in the Exchange Offer); or

(b) by way of sale of such holder's Preference Shares to Co-operative Group in consideration for a cash consideration which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by a principal amount of Instalment Repayment Notes equal to the principal amount of Instalment Repayment Notes which such holder would have received had those Preference Shares been sold to Co-operative Group in the Exchange Offer (on the same terms as those on which Preference Shares are sold to Co-operative Group in the Exchange Offer).

(3) Where any such holder of Preference Shares (other than Excluded Preference Shares and Additional Preference Shares) has, in accordance with the procedures of the Liability Management Exercise, validly elected which Group Notes it would prefer to receive upon the transfer of its Preference Shares to Co-operative Group, such holder shall be entitled to receive such Group Notes.

(4) Where a holder of Preference Shares (other than Excluded Preference Shares and Additional Preference Shares) has not validly elected (in accordance with the procedures provided under the Liability Management Exercise) which Group Notes it would prefer to receive upon the transfer of Preference Shares to Co-operative Group, then (i) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes, such holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes, such holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the holder will receive Final Repayment Notes.

(5) The mandatory exchange of the Additional Preference Shares will be effected on the Settlement Date by:

(a) the mandatory transfer to Co-operative Group of such Additional Preference Shares; and

(b) the payment by or on behalf of the Bank to the holders of a cash amount (in pounds sterling) equal to the cash dividend which the Bank would have paid on or around 30 November 2013 had it been able to do so under the terms of the Preference Shares.

(6) In addition, holders of the Preference Shares which are transferred to Co-operative Group pursuant to the Mandatory Exchange Option will be entitled to receive a cash amount equal to the accrued dividends on their Preference Shares (other than Additional Preference Shares) for the period from (and including) 30 November 2013 to (but excluding) the Settlement Date (calculated on the assumption that dividends accrue from day-to-day on a non-compounding basis).

(7) The Bank shall procure the issue of the Group Notes by Co-operative Group on the Settlement Date.

(8) Notwithstanding any other provision of the Bank's Articles of Association as regards the giving of notices, the notice referred to in paragraph (1) above shall be validly given upon the publication of such notice on the Regulatory News Service (RNS) operated by the London Stock Exchange plc, and shall be deemed to have been given on the date of such publication. The Bank will, in addition, procure that the notice be mailed to the holders of Preference Shares at their respective addresses in the register maintained by the Bank (or by a registrar on its behalf) in respect of the Preference Shares.

(9) The Mandatory Exchange Option, including the provisions of these paragraphs (1) to (10), shall apply notwithstanding any other provision of the Articles of Association. In the event of any inconsistency between the provisions of these paragraphs (1) to (10) and any other provision of the Articles of Association, the provisions of these paragraphs (1) to (10) shall prevail.

(10) For the purposes of the Mandatory Exchange Option:

"**Additional Preference Shares**" means any additional Preference Shares (other than Additional Preference Shares which are also Excluded Preference Shares) which were (or are deemed to have been) allotted on or around 29 November 2013 in lieu of a cash dividend scheduled for 30 November 2013 (and for these purposes, 6¼ per cent. of the aggregate nominal amount of the Preference Shares (excluding Excluded Preference Shares) outstanding will be deemed to have been so allotted and to so constitute such amount of Additional Preference Shares);

"**Co-operative Group**" means Co-operative Group Limited;

"**Exchange Offer**" means the invitation to holders of Preference Shares to offer to exchange or sell their Preference Shares in the Liability Management Exercise;

"**Excluded Preference Shares**" means those Preference Shares and Additional Preference Shares which are being exchanged or sold pursuant to the Exchange Offer on or around the Settlement Date;

"**Final Repayment Notes**" means sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain of its subsidiaries;

"**Group Notes**" means the Final Repayment Notes and the Instalment Repayment Notes;

"**Instalment Repayment Notes**" means sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) having their last payment date in 2025, to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain of its subsidiaries; and

"**Liability Management Exercise**" means the liability management exercise (in respect of, amongst other securities, the Preference Shares) described in the announcement made by the Bank and/or Co-operative Group on or around 4 November 2013;

3. assents to and sanctions, to the fullest extent permitted by law and under the Articles of Association, in respect of all holders of Preference Shares:

   (a) the release, to the fullest extent permitted by law, of all Relevant Persons (as defined below) and each of them from any liabilities in relation to or arising in connection with the preparation, negotiation or implementation of the Liability Management Exercise or any part thereof;

   (b) the waiver, to the fullest extent permitted by law, of all rights and entitlement that the holders or any of them may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against the Relevant Persons or any of them in connection with the Liability Management Exercise and/or their Preference Shares;

   (c) (following the transfer of the holders' Preference Shares to Co-operative Group and upon delivery of the relevant Group Notes to such holders in accordance with the terms of the Liability Management Exercise) the waiver, to the fullest extent permitted by law, of all the rights, title and interest of the holders to and claims in respect of such Preference Shares; and

   (d) the modification, abrogation, compromise or arrangement in respect of the rights of all holders necessary to give effect to the foregoing provisions of this paragraph 3.

   provided, however, that nothing in this paragraph 3 shall constitute a release of the Bank or Co-operative Group from, or a waiver of the rights and entitlements of Holders in respect of, their respective obligations or liabilities in their capacity as persons responsible for the respective prospectuses published by them in connection with the Liability Management Exercise.

   For these purposes, "**Relevant Persons**" means each of the Bank, Co-operative Group, Co-operative Banking Group Limited, HSBC Bank plc and UBS Limited (in their capacity as dealer managers in connection with the Liability Management Exercise), Lucid Issuer Services Limited (in its capacity as exchange agent in connection with the Liability Management Exercise), the Registrar (as defined below) and, in each case, their respective financial and legal advisers (together in each case with their respective directors, members, employees and representatives);

4. sanctions every abrogation, modification, compromise or arrangement in respect of the rights of the holders appertaining to the Preference Shares against the Bank, whether or not such rights arise under the Articles of Association, involved in or resulting from or to be effected by, the modifications and other arrangements referred to in paragraphs 1, 2 and 3 of this Resolution and their implementation;

5. authorises, empowers and directs the Bank and the registrar in respect of the Preference Shares (the "**Registrar**") (i) to execute, including on behalf of the holders of the Preference Shares, all such deeds, instruments, forms of transfer and other documents of any nature, (ii) to make any such entries in the register maintained in respect of the Preference Shares and (iii) to do any and all acts and things, which in each case may be necessary or appropriate to carry out and give effect to (A) this Resolution, (B) the implementation of the modifications and other arrangements referred to in paragraphs 1, 2 and 3 of this Resolution and/or (C) the Mandatory Exchange Option referred to above;

6. discharges and exonerates the Bank and the Registrar from all liability for which it may have become or may become responsible with respect to the Preference Shares in respect of any act or omission in connection with the modifications and other arrangements referred to in paragraphs 1, 2 and 3 of this Resolution, their implementation, or this Resolution or the giving effect to the Mandatory Exchange Option referred to above; and

7. agrees that if any paragraph of this Resolution is or becomes illegal, invalid or unenforceable that will not affect the legality, validity or enforceability of any other paragraph of this Resolution and accordingly the remainder of this Resolution shall be effective."

The Directors of the Bank have no interests in the Preference Shares described in this Notice.

Set out below are the market values (as a percentage of their nominal amount) of the Preference Shares on or around the first dealing day in each of the six months prior to the date of this Notice (and 21 October 2013, which is the latest date for which information was available prior to publication of this Notice):

Date	**Market Value* (%)**
3 June 2013	62.000
1 July 2013	52.000
1 August 2013	50.250
2 September 2013	44.500
1 October 2013	43.250
21 October 2013	49.750

* Source: Bloomberg (composite prices where available; otherwise, prices sourced to the extent available)

Background to the Proposal

The Proposal forms part of a wider liability management exercise (the "**Liability Management Exercise**") being conducted by the Bank as part of its capital actions plan, originally announced by the Bank on 17 June 2013, to raise £1.5 billion of common equity tier 1 capital.

As part of the Liability Management Exercise, holders of the Preference Shares are being invited to offer to exchange or sell their Preference Shares to Co-operative Group and receive new Group Notes (as defined in the Resolution) to be issued by Co-operative Group (the "**Exchange Offer**"). Detailed information regarding the Liability Management Exercise (including the Exchange Offer), Co-operative Group and the Group Notes is contained in a prospectus dated 4 November 2013 published by Co-operative Group in connection with the Liability Management Exercise and the offer and issue of the Group Notes (the "**Prospectus**"). The Prospectus can be accessed via the Regulatory News Service (RNS) operated by the London Stock Exchange plc, which can be accessed at the following web link: *www.lseg.com/areas-expertise/market-information/regulatory-news-service*; and at: *http://www.co-operative.coop/bondholders*. Holders who are unable to access the Prospectus at that web link should contact the Registrar at the details below.

Holders are urged to read the Prospectus carefully. Holders should note that a Holder who offers to exchange or sell its Preference Shares in the Exchange Offer will also appoint a proxy to vote in favour of the Resolution. If the Resolution is passed and implemented, the Bank will have the right to effect the mandatory transfer of any Preference Shares (which are not exchanged or sold in the Exchange Offer) to Co-operative Group on the same economic terms as those upon which Preference Shares are exchanged or sold (as the case may be) in the Exchange Offer.

Other important information

The attention of Holders is drawn to the quorum required for the Meeting and for an adjourned Meeting which is set out in paragraph 2 of "*Voting and Quorum*" below.

Copies of the current Articles of Association of the Bank and of certain other relevant documents will be available for inspection by Holders at the specified offices of the Registrar set out below.

Any Holders who are in any doubt as to the impact of the implementation of the Proposal are urged to seek their own financial, legal and other advice as they consider appropriate.

Holders who wish to make arrangements to attend (in person or by proxy) and vote at the Meeting may do so in any manner provided for in the Articles of Association and described below under "*Voting and Quorum*". However, Holders who are eligible and wish to participate in the Exchange Offer should make arrangements to participate in the Exchange Offer in the manner specified in the Prospectus, rather than making arrangements as described below.

VOTING AND QUORUM

1. The provisions governing the convening and holding of a Meeting are set out in the Articles of Association, a copy of which is available for inspection by the Holders during normal business hours at the specified office of the Registrar set out below.

Terms used herein but not defined have the meaning given to them in the Consent and Exchange Offer Memorandum (the "**CEOM**") scheduled to the Prospectus.

IMPORTANT: The Preference Shares are either in certificated form or uncertificated form in CREST. A registered holding of Preference Shares in certificated form will be represented by a certificate (each a "**Holder Certificate**"). The only Holders for the purposes of Preference Shares held through CREST, Euroclear or Clearstream, Luxembourg (each a "**Clearing System**") are CREST Participants appearing on the register of shares (each such participant, together with each other registered holder of the Preference Shares appearing on such register, a "**Registered Holder**"). Each person (a "**Beneficial Owner**") who is the owner of a particular nominal amount of the Preference Shares through a Clearing System or its respective Direct Participant (in the case of Euroclear or Clearstream, Luxembourg) should note that such person is not considered to be a Holder for the purposes of Preference Shares and will only be entitled to attend and vote at the Meeting or to appoint a proxy to do so in accordance with the procedures set out below.

Any reference herein to a Beneficial Owner sending voting instructions to the relevant CREST participant or arranging for a Corporate Letter of Representation to be issued to it by the relevant CREST Participant (together the "**Corporate Actions**") shall mean:

(i) where the Beneficial Owner holds through a broker, dealer, commercial bank, trust company, custodian, nominee or intermediary in CREST, procuring that such party carries out such Corporate Actions on its behalf; and

(ii) where the Beneficial Owner holds through a Direct Participant or other broker, dealer, commercial bank, trust company, custodian, nominee or intermediary in Euroclear or Clearstream, Luxembourg, procuring that such Direct Participant or other party carries out such Corporation Actions (by issuing instructions in a form acceptable to such clearing Systems) through such Clearing Systems and before any deadlines specified by such Clearing Systems.

Where Corporate Actions are provided by a Direct Participant on behalf of a Beneficial Owner, the Preference Shares held by that Beneficial Owner shall be blocked in accordance with the usual procedures of Euroclear and Clearstream, Luxembourg which, in the case of instructions to vote in favour of the Resolution as provided in 1.2.1 below, will result in the underlying Preference Shares being transferred to escrow in CREST pursuant to a corresponding TTE Instruction.

1.1 Preference Shares in certificated form

A Registered Holder wishing to attend and vote at the relevant Meeting in person must produce at such Meeting either, in the case of an individual holder, a Holder Certificate or, in the case of a corporate holder, a certificate evidencing such corporate holder's entitlement to the Preference Shares and a duly approved resolution of the directors or other governing body of such corporation authorising such person to act as the corporation's representative (a "**representative**") at the relevant Meeting together, in each case, with satisfactory evidence of identity.

A Registered Holder not wishing to attend and vote at the relevant Meeting in person may by instrument in writing in the English language (a "**form of proxy**") in the form available from the Registrar, signed by the Registered Holder or, in the case of a corporation, executed under its common seal or signed on its behalf by an attorney or a duly authorised officer of the corporation and delivered to the specified office of the Registrar not less than 48 hours before the time fixed for the meeting, appoint any person (a "**proxy**") to act on his or its behalf in

connection with the Meeting (or any adjourned such Meeting). A proxy need not be a member of the Bank.

A proxy or representative so appointed shall so long as such appointment remains in force be deemed, for all purposes in connection with the Meeting (or any adjourned such Meeting) to be the holder of the Preference Shares to which such appointment relates and the holder of the Preference Shares shall be deemed for such purposes not to be the holder.

The CREST electronic proxy appointment service is not available for this event. CREST members should carefully read the relevant sections of the consent and exchange offer memorandum which is appended to, and forms part of, the Prospectus for relevant voting procedures.

1.2 **Preference Shares in uncertificated form in CREST**

Each CREST Participant that is a Registered Holder should, if it is not the Beneficial Owner of the Preference Shares, seek instructions from the Beneficial Owner(s) in accordance with its usual procedures. A CREST sponsored member wishing to vote in favour of the Resolution or revoke any such vote should instruct its CREST sponsor to issue a TTE Instruction to the Registrar (or if a revocation, an ESA Instruction) with the details set out below.

Each CREST Participant that is a Registered Holder, if it is the beneficial owner of the Preference Shares, can vote in favour of the Resolution by issuing a TTE Instruction with the details set out in paragraph 1.2.1, revoke by issuing an ESA Instruction with the details set out in paragraph 1.2.2, vote against the Resolution by filling out the paper voting instruction referred to in paragraph 1.2.3, and attend the Meeting by bringing a Corporate Letter of Representation containing the details referred to in paragraph 1.2.4.

1.2.1 A Beneficial Owner wishing to vote IN FAVOUR of the Resolution must send the voting instructions to its CREST Participant in accordance with such participant's usual procedures requesting that such participant issues a TTE Instruction and making an election as to which Group Notes it would like to receive by specifying which of the six options set out below is applicable. Any voting instruction must be received by the CREST Participant (i) in the case of an instruction under OPT0001A or OPT0001B below, prior to 4.30 p.m. (London time) on 6 December 2013, or (ii) in the case of an instruction under OPT0002A, OPT0002B, OPT0002C or OPT0002D below, not less than 48 hours before the time of the meeting (the "**Voting Deadline**"). **However Beneficial Owners are strongly encouraged to ensure that their CREST Participant submits all instructions by 4.30 p.m. (London time) on 29 November 2013**, since the terms of the Liability Management Exercise are more favourable for holders of Preference Shares if certain levels of participation in the Liability Management Exercise are achieved by this earlier deadline. A TTE Instruction must comply with the paragraph below.

Each TTE Instruction should specify Computershare (in its capacity as a CREST Participant under its participant ID referred to below) as the escrow agent to whom the Preference Shares should be transferred. A TTE Instruction will not be valid unless and until it has settled and Computershare will not take any action in respect of any TTE Instruction until such time. The TTE Instruction must be properly authenticated in accordance with EUI's specifications and must contain, in addition to the other information which is required for a TTE Instruction to settle in CREST, the following details:

(a) the principal amount of Preference Shares to be transferred to an escrow balance;

(b) the CREST Participant's member account ID;

(c) the CREST Participant's participant ID;

(d) the relevant corporate action ISIN number (being GB0002224516);

(e) Computershare's participant ID, being: 3RA13;

(f) the relevant CREST member account ID of Computershare (in its capacity as a CREST receiving agent) from the table set out after sub-paragraph (j) below, corresponding to the option which the CREST Participant wishes to select and in accordance with any voting instructions provided by any Beneficial Owner;

(g) the intended settlement date;

(h) the corporate action number for the Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(i) the standard TTE instruction of priority 80; and

(j) a contact number, to be inserted in the shared note field.

For the purposes of sub-paragraph (f) above, the relevant CREST member IDs of Computershare relevant to a Holder of Preference Shares are set out in the table below. **A Beneficial Owner should elect the ID which corresponds to such Beneficial Owner's preferred option**:

Option	**CREST Member ID**
Option 1: (Not available to U.S. Holders) Offer to exchange some or all of your Preference Shares for **Final Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the Preference Shareholders Meeting and the chairman of the General Meeting as your proxies to vote those Preference Shares IN FAVOUR of the resolutions to be proposed at those meetings). **NB: electing this Option automatically results in offering to exchange some or all of the Beneficial Owner's Preference Shares for Final Repayment Notes in the Exchange Offer. The Beneficial Owner should read the terms of the CEOM carefully before electing this Option.**	**OPT0001A**
Option 2: (Not available to U.S. Holders) Offer to sell some or all of your Preference Shares to the Group for cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the Preference Shareholders Meeting and the chairman of the General Meeting as your proxies to vote those Preference Shares IN FAVOUR of the resolutions to be proposed at those meetings). **NB: electing this Option automatically results in offering to sell some or all of the Beneficial Owner's Preference Shares to the Group for cash consideration payable in instalments over twelve years and represented by Instalment Repayment Notes in the Exchange Offer. The Beneficial Owner should read the terms of the CEOM carefully before electing this Option.**	**OPT0001B**

Option	CREST Member ID
Option 3: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE.	**OPT0002A**
Option 4: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE.	**OPT0002B**
Option 5: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE.	**OPT0002C**
Option 6: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002D**
NB: to vote AGAINST the resolutions proposed at the Preference Shareholders Meeting and the General Meeting, please use the paper voting instruction available from Computershare.	–

Any vote in favour of the resolution pursuant to a TTE Instruction as provided herein will automatically appoint the chairman of the Meeting as the relevant CREST Participant's proxy to vote the Preference Shares referred in such TTE Instruction in such way.

1.2.2 A Beneficial Owner wishing to REVOKE a voting instruction given under 1.2.1 above and the corresponding TTE Instruction may do so at any time prior to the Voting Deadline by sending voting instructions to its CREST Participant in accordance with such participant's usual procedures requesting that such participant issues an ESA Instruction to settle in CREST. Any such ESA Instruction must contain the following details:

(a) the number of Preference Shares to be withdrawn;

(b) the CREST Participant's member account ID;

(c) the CREST Participant's participant ID;

(d) the relevant corporate action ISIN number (being GB0002224516);

(e) Computershare's participant ID, being: 3RA13;

(f) the relevant CREST member account ID of Computershare (in its capacity as a CREST receiving agent) from the table set out above;

(g) the intended settlement date for the withdrawal;

(h) the transaction reference number of the voting instruction to be withdrawn;

(i) the corporate action number for the Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(j) the standard TTE instruction of priority 80; and

(k) a contact number, to be inserted in the shared note field.

Any such revocation of a TTE Instruction will be conditional upon Computershare verifying that the revocation is validly made. Accordingly, Computershare will, on behalf of the Bank, reject or accept the revocation by transmitting in CREST a receiving agent reject (AEAD) or receiving agent accept (AEAN) message.

1.2.3 A Beneficial Owner wishing to vote AGAINST the Resolution must send voting instructions to its CREST Participant in accordance with such participant's usual procedures requesting that such participant issues a no vote in respect of the nominal amount of Preference Shares the subject of such voting instructions by filling out the paper voting instruction which was provided with this Notice to each Registered Holder. A Beneficial Owner should also specify in its voting instruction whether it elects to receive either Final Repayment Notes or Instalment Repayment Notes if the Preference Shares Mandatory Exchange Option is exercised. Copies of the paper voting instruction are also available from Computershare.

1.2.4 A Beneficial Owner wishing to ATTEND the Meeting must arrange for its CREST Participant to issue a Corporate Letter of Representation to it. Any such Letter of Representation should be on the headed paper of such participant, should detail the person attending and the nominal amount of Preference Shares held by such person, and be signed by the CREST Participant.

2. The quorum required at the Meeting is two or more persons present being proxies or representatives or holding Preference Shares and representing or holding in the aggregate not less than one third in nominal amount of the Preference Shares for the time being outstanding. If a quorum is not present at the Meeting, the Meeting will be adjourned and the Resolution will be considered at an adjourned

Meeting (notice of which will be given to the Holders). The quorum at such an adjourned Meeting will be those persons present being proxies or representatives or holding Preference Shares, whatever the nominal amount of Preference Shares held or represented by them.

Holders should note this quorum requirement and should be aware that if the Holders either present or appropriately represented at the Meeting are insufficient to form a quorum the Resolution, and consequently the Proposal, cannot be formally considered thereat. Holders are therefore encouraged either to attend the Meeting in person or to arrange to be represented at the Meeting as soon as possible.

3. Every question submitted to the Meeting shall be decided in the first instance by a show of hands and in case of equality of votes the chairman of the Meeting shall both on a show of hands and on a poll have a casting vote in addition to the vote or votes (if any) to which he may be entitled as a proxy or as representative or as a Holder.

   Unless a poll is (before or on the declaration of the result of the show of hands) demanded by the chairman of the Meeting or by not less than five Holders having the right to vote on the Resolution or by a Holder or Holders representing not less than 10 per cent. of the total voting rights of all the Holders having the right to vote on the Resolution, a declaration by the chairman of the relevant Meeting that a resolution has been carried or carried by a particular majority or lost or not carried by a particular majority, and an entry to that effect in the book containing the minutes of the proceedings of the Meeting shall be conclusive evidence of the fact without proof of the number or proportion of the votes recorded in favour or against such resolution.

   On a show of hands every person who is present and is a proxy or representative or a Holder who produces a Holder Certificate shall have one vote and on a poll every person who is so present shall have one vote in respect of each £1 nominal amount of the Preference Shares in respect of which he is a proxy or representative or in respect of each £1 nominal amount of the Preference Shares represented by the Holder Certificate so produced.

4. To be passed, the Resolution requires a majority in favour consisting of not less than three-quarters of the votes cast. If passed, the Resolution will be binding upon all the Holders, whether or not present at such Meeting and whether or not voting.

REGISTRAR

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ
United Kingdom

This Notice is given by:

The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

Dated 4 November 2013.

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 10

FORM OF NOTICE CONVENING THE MEETING IN RESPECT OF THE 13% BONDS

THIS NOTICE IS IMPORTANT AND REQUIRES THE IMMEDIATE ATTENTION OF HOLDERS. IF HOLDERS ARE IN ANY DOUBT AS TO THE ACTION THEY SHOULD TAKE, THEY SHOULD CONSULT THEIR OWN PROFESSIONAL ADVISERS AUTHORISED UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000 IMMEDIATELY.

THE CO-OPERATIVE BANK p.l.c.

(incorporated in England and Wales with registered number 990937)

(the "**Bank**")

NOTICE OF A MEETING

of the holders of those of the

£110,000,000
13 PER CENT. PERPETUAL SUBORDINATED BONDS

(ISIN: GB00B3VH4201)

of the Bank presently outstanding
(the "**Holders**" and the "**13% Bonds**" respectively).

NOTICE IS HEREBY GIVEN that a Meeting of the Holders convened by the Bank will be held at Holiday Inn London (Bloomsbury), Coram Street, London WC1N 1HT on Wednesday, 11 December, 2013 at 2.00 p.m. (London time) for the purpose of considering and, if thought fit, passing the following resolution (the "**Resolution**") which will be proposed as an Extraordinary Resolution in accordance with the provisions of the Trust Deed dated 1 August 2009 (the "**Trust Deed**") made between the Bank and The Law Debenture Trust Corporation p.l.c. (the "**Trustee**") as trustee for the Holders and constituting the 13% Bonds (the "**Proposal**").

EXTRAORDINARY RESOLUTION

"THAT this Meeting of the holders of the £110,000,000 13 per cent. Perpetual Subordinated Bonds of The Co-operative Bank p.l.c. presently outstanding (the "**13% Bonds**" and the "**Bank**" respectively) constituted by the Trust Deed dated 1 August 2009 (the "**Trust Deed**") made between the Bank and The Law Debenture Trust Corporation p.l.c. (the "**Trustee**") as trustee for the holders of the 13% Bonds (the "**Holders**" or "**holders**") hereby:

1. assents to and sanctions the modification of the Terms and Conditions of the 13% Bonds as set out in Schedule 1 to the Trust Deed by the insertion of the following new Condition 19:

"19. MANDATORY EXCHANGE OPTION

19.1 The Issuer may, upon giving not less than one day's prior notice to the Bondholders and the Trustee in accordance with Condition 19.7 below, at its option and without the consent or approval of the Bondholders or the Trustee, require and effect (having regard to Conditions 19.3 and 19.4 below) the mandatory transfer of the legal and beneficial title to, and all interests in, all outstanding Bonds (other than Excluded Bonds) to Co-operative Group, on the terms set out in this Condition 19 (the "**Mandatory Exchange Option**").

19.2 The mandatory transfer of a holder's Bonds (other than Excluded Bonds) to Co-operative Group will be effected on the date specified in the notice referred to in Condition 19.1 (the "**Settlement Date**") either:

(a) by way of exchange of such holder's Bonds for a principal amount of Final Repayment Notes equal to the principal amount of Final Repayment Notes which such holder would have received had those Bonds been exchanged for Final Repayment Notes in the Exchange Offer (on the same terms as those on which Bonds are exchanged for Final Repayment Notes in the Exchange Offer); or

(b) by way of sale to Co-operative Group in consideration for a cash consideration which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by a principal amount of Instalment Repayment Notes equal to the principal amount of Instalment Repayment Notes which such holder would have received had those Bonds been sold to Co-operative Group in the Exchange Offer (on the same terms as those on which Bonds are sold to Co-operative Group in the Exchange Offer).

19.3 Where any such holder of Bonds (other than Excluded Bonds) has, in accordance with the procedures of the Liability Management Exercise, validly elected which Group Notes it would prefer to receive upon the transfer of its Bonds to Co-operative Group, such holder shall be entitled to receive such Group Notes.

19.4 Where a holder of Bonds (other than Excluded Bonds) has not validly elected (in accordance with the procedures provided under the Liability Management Exercise) which Group Notes it would prefer to receive upon the transfer of its Bonds to Co-operative Group, then (i) if (in the Liability Management Exercise) the nominal amount of Bonds which are the subject of elections to receive Final Repayment Notes is greater than the nominal amount of Bonds which are the subject of elections to receive Instalment Repayment Notes, such holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the nominal amount of Bonds which are the subject of elections to receive Instalment Repayment Notes is greater than the nominal amount of Bonds which are the subject of elections to receive Final Repayment Notes, such holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the holder will receive Final Repayment Notes.

19.5 In addition, holders of the Bonds which are transferred to Co-operative Group pursuant to this Condition 19 will be entitled to receive accrued interest on their Bonds for the period from (and including) 31 July 2013 to (but excluding) the Settlement Date.

Holders of Bonds will also separately be entitled to receive the deferred interest payment originally scheduled for 31 July 2013 upon settlement of the Liability Management Exercise. This italicised text is for information only and does not form part of these Conditions.

19.6 The Issuer shall procure the issue of the Group Notes by Co-operative Group on the Settlement Date.

19.7 Notwithstanding Condition 12 and any other provision in these Conditions as regards the giving of notices, the notice referred to in Condition 19.1 shall be validly given upon the publication of such notice on the Regulatory News Service (RNS) operated by the London Stock Exchange plc, and shall be deemed to have been given on the date of such publication. The Issuer will, in addition, procure that the notice be mailed to the Bondholders at their respective addresses in the register of Bondholders maintained by the Registrar.

19.8 This Condition 19 shall apply notwithstanding any other provision of these Conditions. In the event of any inconsistency between this Condition 19 and any other provision of these Conditions, this Condition 19 shall prevail.

19.9 In this Condition 19:

"**Co-operative Group**" means Co-operative Group Limited;

"**Exchange Offer**" means the invitation to holders of Bonds to offer to exchange or sell their Bonds in the Liability Management Exercise;

"**Excluded Bonds**" means those Bonds which are being exchanged or sold pursuant to the Exchange Offer on or around the Settlement Date.

"**Final Repayment Notes**" means sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain of its subsidiaries;

"**Group Notes**" means the Final Repayment Notes and the Instalment Repayment Notes;

"**Instalment Repayment Notes**" means sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) having their last payment date in 2025, to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain of its subsidiaries; and

"**Liability Management Exercise**" means the liability management exercise (in respect of, amongst other securities, the Bonds) described in the announcement made by the Issuer and/or Co-operative Group on or around 4 November 2013."

2. assents to and sanctions, to the fullest extent permitted by law and under the Trust Deed, in respect of all holders of 13% Bonds:

(a) the release, to the fullest extent permitted by law, of all Relevant Persons (as defined below) and each of them from any liabilities in relation to or arising in connection with the preparation, negotiation or implementation of the Liability Management Exercise (as defined above) or any part thereof;

(b) the waiver, to the fullest extent permitted by law, of all rights and entitlement that the holders or any of them may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against the Relevant Persons or any of them in connection with the Liability Management Exercise and/or their 13% Bonds;

(c) (following the transfer of the holders' 13% Bonds to Co-operative Group (as defined above) and upon delivery of the relevant Group Notes (as defined above) to such holders in accordance with the terms of the Liability Management Exercise) the waiver, to the fullest extent permitted by law, of all the rights, title and interest of the holders to and claims in respect of such 13% Bonds; and

(d) the modification, abrogation, compromise or arrangement in respect of the rights of all holders necessary to give effect to the foregoing provisions of this paragraph 2.

provided, however, that nothing in this paragraph 2 shall constitute a release of the Bank or Co-operative Group from, or a waiver of the rights and entitlements of Holders in respect of, their respective obligations or liabilities in their capacity as persons responsible for the respective prospectuses published by them in connection with the Liability Management Exercise.

For these purposes, "**Relevant Persons**" means each of the Bank, Co-operative Group, Co-operative Banking Group Limited, HSBC Bank plc and UBS Limited (in their capacity as dealer managers in connection with the Liability Management Exercise), Lucid Issuer Services Limited (in its capacity as exchange agent in connection with the Liability Management Exercise), the Registrar (as defined below), the Trustee and, in each case, their respective financial and legal advisers (together in each case with their respective directors, members, employees and representatives);

3. sanctions every abrogation, modification, compromise or arrangement in respect of the rights of the Holders appertaining to the 13% Bonds against the Bank, whether or not such rights arise under the Trust Deed, involved in or resulting from or to be effected by, the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution and their implementation;

4. authorises, empowers and directs the Trustee to concur in the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution and, in order to give effect to and to implement the modifications referred to in paragraph 1, forthwith to execute a Supplemental Trust Deed in the form of the draft produced to this Meeting and for the purpose of identification signed by the Chairman thereof with such amendments (if any) thereto as the Trustee shall require and to concur in, and to execute and do, all such other deeds, instruments, acts and things as may be necessary or appropriate to carry out and give effect to this Resolution and the implementation of the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution;

5. authorises, empowers and directs the Bank and the registrar in respect of the 13% Bonds (the "**Registrar**") (i) to execute, including on behalf of the holders of the 13% Bonds, all such deeds, instruments, forms of transfer and other documents of any nature, (ii) to make any such entries in the register maintained in respect of the 13% Bonds and (iii) to do any and all acts and things, which in each case may be necessary or appropriate to give effect to (A) this Resolution and/or (B) the Mandatory Exchange Option referred to above; and

6. discharges and exonerates the Trustee and the Registrar from all liability for which either of them may have become or may become responsible under the 13% Bonds, the Trust Deed or the registrar's agreement relating to the 13% Bonds in respect of any act or omission in connection with the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution, their implementation, or this Resolution or the giving effect to the Mandatory Exchange Option referred to above; and

7. agrees that if any paragraph of this Resolution is or becomes illegal, invalid or unenforceable that will not affect the legality, validity or enforceability of any other paragraph of this Resolution and accordingly the remainder of this Resolution shall be effective."

The Directors of the Bank have no interests in the 13% Bonds described in this Notice.

Set out below are the market values (as a percentage of their nominal amount) of the 13% Bonds on or around the first dealing day in each of the six months prior to the date of this Notice (including 1 November 2013, which is the latest practicable date for which information was available prior to publication of this Notice):

Date	**Market Value* (%)**
3 June 2013	80.937
1 July 2013	Information not available
1 August 2013	56.501
2 September 2013	54.356
1 October 2013	52.537
1 November 2013	72.349

*Source: Bloomberg (composite prices where available; otherwise, prices sourced to the extent available)

Background to the Proposal

The Proposal forms part of a wider liability management exercise (the "**Liability Management Exercise**") being conducted by the Bank as part of its capital actions plan, originally announced by the Bank on 17 June 2013, to raise £1.5 billion of common equity tier 1 capital.

As part of the Liability Management Exercise, holders of the 13% Bonds are being invited to offer to exchange or sell their 13% Bonds to Co-operative Group and to receive Group Notes (as defined in the Resolution above) to be issued by Co-operative Group (the "**Exchange Offer**"). Detailed information

regarding the Liability Management Exercise (including the Exchange Offer), Co-operative Group and the Group Notes is contained in a prospectus dated 4 November 2013 published by Co-operative Group in connection with the Liability Management Exercise and the offer and issue of the Group Notes (the "**Prospectus**"). The Prospectus can be accessed via the Regulatory News Service (RNS) operated by the London Stock Exchange plc, which can be accessed at the following web link: *www.lseg.com/areas-expertise/market-information/regulatory-news-service*; and at: *http://www.co-operative.coop/bondholders*. Holders who are unable to access the Prospectus at that web link should contact the Registrar at the details below.

Holders are urged to read the Prospectus carefully. Holders should note that a Holder who offers to exchange or sell its 13% Bonds in the Exchange Offer will also appoint a proxy to vote in favour of the Resolution. If the Resolution is passed and implemented, the Bank will have the right to effect the mandatory transfer of any 13% Bonds (which are not exchanged or sold in the Exchange Offer) to Co-operative Group on the same economic terms as those upon which 13% Bonds are exchanged or sold (as the case may be) in the Exchange Offer.

Other important information

The attention of Holders is drawn to the quorum required for the Meeting and for an adjourned Meeting which is set out in paragraph 2 of "*Voting and Quorum*" below.

Copies of the Trust Deed (including the Terms and Conditions of the 13% Bonds) and the draft Supplemental Trust Deed referred to in the Resolution set out above and of certain other relevant documents will be available for inspection by Holders at the specified offices of the Registrar set out below.

In accordance with normal practice, the Trustee expresses no opinion as to the merits of the Proposal (which it was not involved in negotiating). It has, however, authorised it to be stated that, on the basis of the information set out in this Notice, (which it recommends Holders to read carefully), it has no objection to the Resolution being submitted to the Holders for their consideration. The Trustee has, however, not been involved in formulating the Proposal and makes no representation that all relevant information has been disclosed to Holders in this Notice. Accordingly, the Trustee urges Holders who are in any doubt as to the impact of the implementation of the Proposal to seek their own financial, legal and other advice as they consider appropriate.

Holders who wish to make arrangements to attend (in person or by proxy) and vote at the Meeting may do so in any manner set out in the Trust Deed and described below under "*Voting and Quorum*". However, Holders who are eligible and wish to participate in the Exchange Offer should make arrangements to participate in the Exchange Offer in the manner specified in the Prospectus, rather than making arrangements as described below.

VOTING AND QUORUM

1. The provisions governing the convening and holding of a Meeting are set out in Schedule 3 to the Trust Deed, a copy of which is available for inspection by the Holders during normal business hours at the specified office of the Registrar set out below.

   Terms used herein but not defined have the meaning given to them in the Consent and Exchange Offer Memorandum (the "**CEOM**") scheduled to the Prospectus.

   IMPORTANT: The 13% Bonds are either in certificated form or uncertificated form in CREST. A registered holding of 13% Bonds in certificated form will be represented by a certificate (each a "**Bond Certificate**"). The only Holders for the purposes of 13% Bonds held through CREST, Euroclear or Clearstream, Luxembourg (each a "**Clearing System**") are CREST Participants appearing on the register of 13% Bonds (each such participant, together with each other registered holder of the 13% Bonds appearing on such register, a "**Registered Holder**"). Each person (a "**Beneficial Owner**") who is the owner of a particular principal amount of the 13% Bonds through a Clearing System or its respective Direct Participant (in the case of Euroclear or Clearstream,

Luxembourg) should note that such person is not considered to be a Holder for the purposes of 13% Bonds and will only be entitled to attend and vote at the Meeting or to appoint a proxy to do so in accordance with the procedures set out below.

Any reference herein to a Beneficial Owner sending voting instructions to the relevant CREST participant or arranging for a Corporate Letter of Representation to be issued to it by the relevant CREST Participant (together the "**Corporate Actions**") shall mean:

(i) where the Beneficial Owner holds through a broker, dealer, commercial bank, trust company, custodian, nominee or intermediary in CREST, procuring that such party carries out such Corporate Actions on its behalf; and

(ii) where the Beneficial Owner holds through a Direct Participant or other broker, dealer, commercial bank, trust company, custodian, nominee or intermediary in Euroclear or Clearstream, Luxembourg, procuring that such Direct Participant or other party carries out such Corporation Actions (by issuing instructions in a form acceptable to such clearing Systems) through such Clearing Systems and before any deadlines specified by such Clearing Systems.

Where Corporate Actions are provided by a Direct Participant on behalf of a Beneficial Owner, the 13% Bonds held by that Beneficial Owner shall be blocked in accordance with the usual procedures of Euroclear and Clearstream, Luxembourg which, in the case of instructions to vote in favour of the Resolution as provided in 1.2.1 below, will result in the underlying 13% Bonds being transferred to escrow in CREST pursuant to a corresponding TTE Instruction.

1.1 ***Bonds in certificated form***

A Registered Holder wishing to attend and vote at the relevant Meeting in person must produce at such Meeting either, in the case of an individual holder, a Bond Certificate or, in the case of a corporate holder, a duly approved resolution of the directors or other governing body of such corporation authorising such person to act as the corporation's representative (a "**representative**") at the relevant Meeting together, in each case, with satisfactory evidence of identity.

A Registered Holder not wishing to attend and vote at the relevant Meeting in person may by instrument in writing in the English language (a "**form of proxy**") in the form available from the Registrar, signed by the Registered Holder or, in the case of a corporation, executed under its common seal or signed on its behalf by an attorney or a duly authorised officer of the corporation and delivered to the specified office of the Registrar not less than 48 hours before the time fixed for the meeting, appoint any person (a "**proxy**") to act on his or its behalf in connection with the Meeting (or any adjourned such Meeting).

A proxy or representative so appointed shall so long as such appointment remains in force be deemed, for all purposes in connection with the Meeting (or any adjourned such Meeting) to be the holder of the 13% Bonds to which such appointment relates and the holder of the 13% Bonds shall be deemed for such purposes not to be the holder.

1.2 ***Bonds in uncertificated form in CREST***

Each CREST Participant that is a Registered Holder should, if it is not the Beneficial Owner of the 13% Bonds, seek instructions from the Beneficial Owner(s) in accordance with its usual procedures. A CREST sponsored member wishing to vote in favour of the Resolution or revoke any such vote should instruct its CREST sponsor to issue a TTE Instruction to the Registrar (or if a revocation, an ESA Instruction) with the details set out below.

Each CREST Participant that is a Registered Holder, if it is the beneficial owner of the 13% Bonds, can vote in favour of the Resolution by issuing a TTE Instruction with the details set out in paragraph 1.2.1, revoke by issuing an ESA Instruction with the details set out in paragraph 1.2.2, vote against the Resolution by filling out the paper voting instruction referred

to in paragraph 1.2.3, and attend the Meeting by bringing a Corporate Letter of Representation containing the details referred to in paragraph 1.2.4.

1.2.1 A Beneficial Owner wishing to vote IN FAVOUR of the Resolution must send the voting instructions to its CREST Participant in accordance with such participant's usual procedures requesting that such participant issues a TTE Instruction and making an election as to which Group Notes it would like to receive by specifying which of the six options set out below is applicable. Any voting instruction must be received by the CREST Participant (i) in the case of an instruction under OPT0001A or OPT0001B below, prior to 4.30 p.m. (London time) on 6 December 2013, or (ii) in the case of an instruction under OPT0002A, OPT0002B, OPT0002C or OPT0002D below, not less than 48 hours before the time of the meeting (the "**Voting Deadline**"). **However Beneficial Owners are strongly encouraged to ensure that their CREST Participant submits all instructions by 4.30 p.m. (London time) on 29 November 2013**, since the terms of the Liability Management Exercise are more favourable for holders of 13% Bonds if certain levels of participation in the Liability Management Exercise are achieved by this earlier deadline. A TTE Instruction must comply with the paragraph below.

Each TTE Instruction should specify Equiniti (in its capacity as a CREST Participant under its participant ID referred to below) as the escrow agent to whom the 13% Bonds should be transferred. A TTE Instruction will not be valid unless and until it has settled and Equiniti will not take any action in respect of any TTE Instruction until such time. The TTE Instruction must be properly authenticated in accordance with EUI's specifications and must contain, in addition to the other information which is required for a TTE Instruction to settle in CREST, the following details:

(a) the principal amount of 13% Bonds to be transferred to an escrow balance;

(b) the CREST Participant's member account ID;

(c) the CREST Participant's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VH4201;

(e) Equiniti's participant ID, being: 2RA35;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out after sub-paragraph (j) below, corresponding to the option which the CREST Participant wishes to select and in accordance with any voting instructions provided by any Beneficial Owner;

(g) the intended settlement date;

(h) the corporate action number for the Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(i) the standard TTE instruction of priority 80; and

(j) a contact number, to be inserted in the shared note field.

For the purposes of sub-paragraph (f) above, the relevant CREST member IDs of Equiniti relevant to a Holder of 13% Bonds are set out in the table below. **A Beneficial Owner should elect the ID which corresponds to such Beneficial Owner's preferred option:**

Option	CREST Member ID
Option 1: (Not available to U.S. Holders) Offer to exchange some or all of your 13% Bonds for **Final Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the 13% Bondholders Meeting as your proxy to vote those 13% Bonds IN FAVOUR of the resolution to be proposed at that meeting). **NB: electing this Option automatically results in offering to exchange some or all of the Beneficial Owner's 13% Bonds for Final Repayment Notes in the Exchange Offer. The Beneficial Owner should read the terms of the CEOM carefully before electing this Option.**	**OPT0001A**
Option 2: (Not available to U.S. Holders) Offer to sell some or all of your 13% Bonds to the Group for cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the 13% Bondholders Meeting as your proxy to vote those 13% Bonds IN FAVOUR of the resolution to be proposed at that meeting). **NB: electing this Option automatically results in offering to sell some or all of the Beneficial Owner's 13% Bonds to the Group for cash consideration payable in instalments over twelve years and represented by Instalment Repayment Notes in the Exchange Offer. The Beneficial Owner should read the terms of the CEOM carefully before electing this Option.**	**OPT0001B**
Option 3: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution **AND** if the 13% Bonds Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE.	**OPT0002A**
Option 4: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution **AND** if the 13% Bonds Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE.	**OPT0002B**

Option 5: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution **AND** if the 13% Bonds Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE.	**OPT0002C**
Option 6: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution **AND** if the 13% Bonds Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE.	**OPT0002D**
NB: to vote AGAINST the resolution proposed at the 13% Bondholders Meeting, please use the paper voting instruction available from Equiniti.	**–**

Any vote in favour of the resolution pursuant to a TTE Instruction as provided herein will automatically appoint the chairman of the Meeting as the relevant CREST Participant's proxy to vote the 13% Bonds referred in such TTE Instruction in such way.

1.2.2 A Beneficial Owner wishing to REVOKE a voting instruction given under 1.2.1 above and the corresponding TTE Instruction may do so at any time prior to the Voting Deadline by sending voting instructions to its CREST Participant in accordance with such participants usual procedures requesting that such participant issues an ESA Instruction to settle in CREST. Any such ESA Instruction must contain the following details:

(a) the principal amount of 13% Bonds to be withdrawn;

(b) the CREST Participant's member account ID;

(c) the CREST Participant's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VH4201;

(e) Equiniti's participant ID, being: 2RA35;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out above;

(g) the intended settlement date for the withdrawal;

(h) the transaction reference number of the Exchange Instruction to be withdrawn;

(i) the corporate action number for the Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(j) the standard TTE instruction of priority 80; and

(k) a contact number, to be inserted in the shared note field.

Any such revocation of a TTE Instruction will be conditional upon Equiniti verifying that the revocation is validly made. Accordingly, Equiniti will, on behalf of the Bank, reject or accept the revocation by transmitting in CREST a receiving agent reject (AEAD) or receiving agent accept (AEAN) message.

1.2.3 A Beneficial Owner wishing to vote AGAINST the Resolution must send voting instructions to its CREST Participant in accordance with such participants usual procedures requesting that such participant issues a no vote in respect of the principal amount of 13% Bonds the subject of such voting instructions by filling out the paper voting instruction which was provided with this Notice to each Registered Holder. A Beneficial Owner should also specify in its voting instruction whether it elects to receive either Final Repayment Notes or Instalment Repayment Notes if the 13% Bonds Mandatory Exchange Option is exercised. Copies of the paper voting instruction are also available from Equiniti.

1.2.4 A Beneficial Owner wishing to ATTEND the Meeting must arrange for its CREST Participant to issue a Corporate Letter of Representation to it. Any such Letter of Representation should be on the headed paper of such participant, should detail the person attending and the principal amount of 13% Bonds held by such person, and be signed by the CREST Participant.

2. The quorum required at the Meeting is one or more persons present being proxies or representatives or holding 13% Bonds and representing or holding in the aggregate not less than two thirds in principal amount of the 13% Bonds for the time being outstanding. If a quorum is not present at the Meeting, the Meeting will be adjourned and the Resolution will be considered at an adjourned Meeting (notice of which will be given to the Holders). The quorum at such an adjourned Meeting will be one or more persons present being proxies or representatives or holding 13% Bonds and representing or holding in the aggregate not less than one-third of the principal amount of the 13% Bonds for the time being outstanding.

Holders should note this quorum requirement and should be aware that if the Holders either present or appropriately represented at the Meeting are insufficient to form a quorum the Resolution, and consequently the Proposal, cannot be formally considered thereat. Holders are therefore encouraged either to attend the Meeting in person or to arrange to be represented at the Meeting as soon as possible.

3. Every question submitted to the Meeting shall be decided in the first instance by a show of hands and in case of equality of votes the chairman of the Meeting shall both on a show of hands and on a poll have a casting vote in addition to the vote or votes (if any) to which he may be entitled as a proxy or as representative or as a Holder.

Unless a poll is (before or on the declaration of the result of the show of hands) demanded by the chairman of the Meeting, the Bank, the Trustee or one or more persons holding one or more of the 13% Bonds or being proxies or representatives or holding 13% Bonds and representing or holding in the aggregate not less than one-fiftieth in principal amount of such 13% Bonds for the time being outstanding, a declaration by the chairman of the relevant Meeting that a resolution has been carried or carried by a particular majority or lost or not carried by a particular majority shall be conclusive evidence of the fact without proof of the number or proportion of the votes recorded in favour or against such resolution.

On a show of hands every person who is present and is a proxy or representative or a Holder who produces a Bond Certificate shall have one vote and on a poll every person who is so present shall have one vote in respect of each £1,000 principal amount of the 13% Bonds in respect of which he is

a proxy or representative or in respect of each £1,000 principal amount of the 13% Bonds represented by the Bond Certificate so produced.

4. To be passed, the Resolution requires a majority in favour consisting of not less than three-quarters of the votes cast. If passed, the Resolution will be binding upon all the Holders, whether or not present at such Meeting and whether or not voting.

REGISTRAR

Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA
United Kingdom

TRUSTEE

The Law Debenture Trust Corporation p.l.c.
Fifth Floor
100 Wood Street
London EC2V 7EX
United Kingdom

This Notice is given by:

The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

Dated 4 November 2013.

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 11

FORM OF NOTICE CONVENING THE MEETING IN RESPECT OF THE 5.5555% BONDS

THIS NOTICE IS IMPORTANT AND REQUIRES THE IMMEDIATE ATTENTION OF HOLDERS. IF HOLDERS ARE IN ANY DOUBT AS TO THE ACTION THEY SHOULD TAKE, THEY SHOULD CONSULT THEIR OWN PROFESSIONAL ADVISERS AUTHORISED UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000 IMMEDIATELY.

THE CO-OPERATIVE BANK p.l.c.

(incorporated in England and Wales with registered number 990937)

(the "**Bank**")

NOTICE OF A MEETING

of the holders of those of the

£200,000,000
5.5555 PER CENT. PERPETUAL SUBORDINATED BONDS

(ISIN: GB00B3VMBW45)

of the Bank presently outstanding
(the "**Holders**" and the "**5.5555% Bonds**" respectively).

NOTICE IS HEREBY GIVEN that a Meeting of the Holders convened by the Bank will be held at Holiday Inn London (Bloomsbury), Coram Street, London WC1N 1HT on Wednesday, 11 December, 2013 at 3.00 p.m. (London time) for the purpose of considering and, if thought fit, passing the following resolution (the "**Resolution**") which will be proposed as an Extraordinary Resolution in accordance with the provisions of the Trust Deed dated 1 August 2009 (the "**Trust Deed**") made between the Bank and The Law Debenture Trust Corporation p.l.c. (the "**Trustee**") as trustee for the Holders and constituting the 5.5555% Bonds (the "**Proposal**").

EXTRAORDINARY RESOLUTION

"THAT this Meeting of the holders of the £200,000,000 5.5555 per cent. Perpetual Subordinated Bonds of The Co-operative Bank p.l.c. presently outstanding (the "**5.5555% Bonds**" and the "**Bank**" respectively) constituted by the Trust Deed dated 1 August 2009 (the "**Trust Deed**") made between the Bank and The Law Debenture Trust Corporation p.l.c. (the "**Trustee**") as trustee for the holders of the 5.5555% Bonds (the "**Holders**") hereby:

1. assents to and sanctions the modification of the Terms and Conditions of the 5.5555% Bonds as set out in Schedule 1 to the Trust Deed by the insertion of the following new Condition 19:

"19. MANDATORY EXCHANGE OPTION

19.1 The Issuer may, upon giving not less than one day's prior notice to the Bondholders and the Trustee in accordance with Condition 19.4 below, at its option and without the consent or approval of the Bondholders or the Trustee, require and effect the mandatory exchange of all outstanding Bonds (other than Excluded Bonds) for Bank T2 Notes, on the terms set out in this Condition 19 (the "**Mandatory Exchange Option**").

19.2 The mandatory exchange of the Bonds (other than Excluded Bonds) will be effected on the date specified in the notice referred to in Condition 19.1 (the "**Settlement Date**") by:

(a) the redemption and cancellation of such Bonds by the Issuer; and

(b) the issue by the Issuer, to each holder of such Bonds, of a principal amount of Bank T2 Notes equal to the principal amount of Bank T2 Notes which such holder would have received had those Bonds been exchanged for Bank T2 Notes in the Exchange Offer (on the same terms as those on which Bonds are exchanged for Bank T2 Notes in the Exchange Offer).

19.3 In addition, holders of the Bonds which are exchanged pursuant to this Condition 19 will be entitled to receive accrued interest on their Bonds for the period from (and including) 14 December 2013 to (but excluding) the Settlement Date.

Holders of Bonds will also separately be entitled to receive the deferred interest payment originally scheduled for 14 December 2013 upon settlement of the Liability Management Exercise. This italicised text is for information only and does not form part of these Conditions.

19.4 Notwithstanding Condition 12 and any other provision in these Conditions as regards the giving of notices, the notice referred to in Condition 19.1 shall be validly given upon the publication of such notice on the Regulatory News Service (RNS) operated by the London Stock Exchange plc, and shall be deemed to have been given on the date of such publication. The Issuer will, in addition, procure that the notice be mailed to the Bondholders at their respective addresses in the register of Bondholders maintained by the Registrar.

19.5 This Condition 19 shall apply notwithstanding any other provision of these Conditions. In the event of any inconsistency between this Condition 19 and any other provision of these Conditions, this Condition 19 shall prevail.

19.6 In this Condition 19:

"**Bank T2 Notes**" means sterling-denominated 11 per cent. subordinated notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Issuer;

"**Exchange Offer**" means the invitation to holders of the Bonds to offer to exchange their Bonds in the Liability Management Exercise;

"**Excluded Bonds**" means those Bonds which are being exchanged pursuant to the Exchange Offer on or around the Settlement Date; and

"**Liability Management Exercise**" means the liability management exercise (in respect of, amongst other securities, the Bonds) described in the announcement made by the Issuer and/or Co-operative Group Limited on or around 4 November 2013."

2. assents to and sanctions, to the fullest extent permitted by law and under the Trust Deed, in respect of all holders of 5.5555% Bonds:

(a) the release, to the fullest extent permitted by law, of all Relevant Persons (as defined below) and each of them from any liabilities in relation to or arising in connection with the preparation, negotiation or implementation of the Liability Management Exercise (as defined above) or any part thereof;

(b) the waiver, to the fullest extent permitted by law, of all rights and entitlement that the holders or any of them may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against the Relevant Persons or any of them in connection with the Liability Management Exercise and/or their 5.5555% Bonds;

(c) (following the exchange of the holders' 5.5555% Bonds for Bank T2 Notes (as defined above) in accordance with the terms of the Liability Management Exercise) the waiver, to the fullest

extent permitted by law, of all the rights, title and interest of the holders to and claims in respect of such 5.5555% Bonds; and

(d) the modification, abrogation, compromise or arrangement in respect of the rights of all holders necessary to give effect to the foregoing provisions of this paragraph 2.

provided, however, that nothing in this paragraph 2 shall constitute a release of the Bank or Co-operative Group from, or a waiver of the rights and entitlements of Holders in respect of, their respective obligations or liabilities in their capacity as persons responsible for the respective prospectuses published by them in connection with the Liability Management Exercise.

For these purposes, "**Relevant Persons**" means each of the Bank, Co-operative Group Limited, Co-operative Banking Group Limited, HSBC Bank plc and UBS Limited (in their capacity as dealer managers in connection with the Liability Management Exercise), Lucid Issuer Services Limited (in its capacity as exchange agent in connection with the Liability Management Exercise), the Registrar (as defined below), the Trustee and, in each case, their respective financial and legal advisers (together in each case with their respective directors, members, employees and representatives);

3. sanctions every abrogation, modification, compromise or arrangement in respect of the rights of the Holders appertaining to the 5.5555% Bonds against the Bank, whether or not such rights arise under the Trust Deed, involved in or resulting from or to be effected by, the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution and their implementation;

4. authorises, empowers and directs the Trustee to concur in the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution and, in order to give effect to and to implement the modifications referred to in paragraph 1, forthwith to execute a Supplemental Trust Deed in the form of the draft produced to this Meeting and for the purpose of identification signed by the Chairman thereof with such amendments (if any) thereto as the Trustee shall require and to concur in, and to execute and do, all such other deeds, instruments, acts and things as may be necessary or appropriate to carry out and give effect to this Resolution and the implementation of the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution;

5. authorises, empowers and directs the Bank and the registrar in respect of the 5.5555% Bonds (the "**Registrar**") (i) to execute, including on behalf of the holders of the 5.5555% Bonds, all such deeds, instruments, forms of transfer and other documents of any nature, (ii) to make any such entries in the register maintained in respect of the 5.5555% Bonds and (iii) to do any and all acts and things, which in each case may be necessary or appropriate to give effect to (A) this Resolution and/or the (B) Mandatory Exchange Option referred to above; and

6. discharges and exonerates the Trustee and the Registrar from all liability for which either of them may have become or may become responsible under the 5.5555% Bonds, the Trust Deed or the registrar's agreement relating to the 5.5555% Bonds in respect of any act or omission in connection with the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution, their implementation, or this Resolution or the giving effect to the Mandatory Exchange Option referred to above; and

7. agrees that if any paragraph of this Resolution is or becomes illegal, invalid or unenforceable that will not affect the legality, validity or enforceability of any other paragraph of this Resolution and accordingly the remainder of this Resolution shall be effective."

The Directors of the Bank have no interests in the 5.5555% Bonds described in this Notice.

Set out below are the market values (as a percentage of their nominal amount) of the 5.5555% Bonds on or around the first dealing day in each of the six months prior to the date of this Notice (including 1 November 2013, which is the latest practicable date for which information was available prior to publication of this Notice):

Date	Market Value* (%)
3 June 2013	51.609
1 July 2013	38.449
1 August 2013	38.872
2 September 2013	36.590
1 October 2013	34.280
1 November 2013	46.563

*Source: Bloomberg (composite prices where available; otherwise, prices sourced to the extent available)

Background to the Proposal

The Proposal forms part of a wider liability management exercise (the "**Liability Management Exercise**") being conducted by the Bank as part of its capital actions plan, originally announced by the Bank on 17 June 2013, to raise £1.5 billion of common equity tier 1 capital.

As part of the Liability Management Exercise, holders of the 5.5555% Bonds are being invited to offer to exchange their 5.5555% Bonds for new Bank T2 Notes (as defined in the Resolution above) to be issued by the Bank (the "**Exchange Offer**"). Detailed information regarding the Liability Management Exercise (including the Exchange Offer), the Bank and the Bank T2 Notes is contained in a prospectus dated 4 November 2013 published by the Bank in connection with the Liability Management Exercise and the offer and issue of the Bank T2 Notes (the "**Prospectus**"). The Prospectus can be accessed via the Regulatory News Service (RNS) operated by the London Stock Exchange plc, which can be accessed at the following web link: *www.lseg.com/areas-expertise/market-information/regulatory-news-service*; and at: *http://www.co-operative.coop/bondholders*. Holders who are unable to access the Prospectus at that web link should contact the Registrar at the details below.

Holders are urged to read the Prospectus carefully. Holders should note that a Holder who offers to exchange its 5.5555% Bonds in the Exchange Offer will also appoint a proxy to vote in favour of the Resolution. If the Resolution is passed and implemented, the Bank will have the right to effect the exchange of any 5.5555% Bonds (which are not exchanged in the Exchange Offer) for Bank T2 Notes on the same economic terms as those upon which 5.5555% Bonds are exchanged in the Exchange Offer.

Other important information

The attention of Holders is drawn to the quorum required for the Meeting and for an adjourned Meeting which is set out in paragraph 2 of "*Voting and Quorum*" below.

Copies of the Trust Deed (including the Terms and Conditions of the 5.5555% Bonds) and the draft Supplemental Trust Deed referred to in the Resolution set out above and of certain other relevant documents will be available for inspection by Holders at the specified offices of the Registrar set out below.

In accordance with normal practice, the Trustee expresses no opinion as to the merits of the Proposal (which it was not involved in negotiating). It has, however, authorised it to be stated that, on the basis of the information set out in this Notice, (which it recommends Holders to read carefully), it has no objection to the Resolution being submitted to the Holders for their consideration. The Trustee has, however, not been involved in formulating the Proposal and makes no representation that all relevant information has been disclosed to Holders in this Notice. Accordingly, the Trustee urges Holders who are in any doubt as to the impact of the implementation of the Proposal to seek their own financial, legal and other advice as they consider appropriate.

Holders who wish to make arrangements to attend (in person or by proxy) and vote at the Meeting may do so in any manner set out in the Trust Deed and described below under "*Voting and Quorum*". However, Holders who are eligible and wish to participate in the Exchange Offer should make arrangements to participate in the Exchange Offer in the manner specified in the Prospectus, rather than making arrangements as described below.

VOTING AND QUORUM

1. The provisions governing the convening and holding of a Meeting are set out in Schedule 3 to the Trust Deed, a copy of which is available for inspection by the Holders during normal business hours at the specified office of the Registrar set out below.

Terms used herein but not defined have the meaning given to them in the Consent and Exchange Offer Memorandum (the "**CEOM**") scheduled to the Prospectus.

IMPORTANT: The 5.5555% Bonds are either in certificated form or uncertificated form in CREST. A registered holding of 5.5555% Bonds in certificated form will be represented by a certificate (each a "**Bond Certificate**"). The only Holders for the purposes of Bonds held through CREST, Euroclear or Clearstream, Luxembourg (each a "**Clearing System**") are CREST Participants appearing on the register of 5.5555% Bonds (each such participant, together with each other registered holder of the 5.5555% Bonds appearing on such register, a "**Registered Holder**"). Each person (a "**Beneficial Owner**") who is the owner of a particular principal amount of the 5.5555% Bonds through a Clearing System or its respective Direct Participant (in the case of Euroclear or Clearstream, Luxembourg) should note that such person is not considered to be a Holder for the purposes of 5.5555% Bonds and will only be entitled to attend and vote at the Meeting or to appoint a proxy to do so in accordance with the procedures set out below.

Any reference herein to a Beneficial Owner sending voting instructions to the relevant CREST participant or arranging for a Corporate Letter of Representation to be issued to it by the relevant CREST Participant (together the "**Corporate Actions**") shall mean:

(i) where the Beneficial Owner holds through a broker, dealer, commercial bank, trust company, custodian, nominee or intermediary in CREST, procuring that such party carries out such Corporate Actions on its behalf; and

(ii) where the Beneficial Owner holds through a Direct Participant or other broker, dealer, commercial bank, trust company, custodian, nominee or intermediary in Euroclear or Clearstream, Luxembourg, procuring that such Direct Participant or other party carries out such Corporation Actions (by issuing instructions in a form acceptable to such clearing Systems) through such Clearing Systems and before any deadlines specified by such Clearing Systems.

Where Corporate Actions are provided by a Direct Participant on behalf of a Beneficial Owner, the 5.5555% Bonds held by that Beneficial Owner shall be blocked in accordance with the usual procedures of Euroclear and Clearstream, Luxembourg which, in the case of instructions to vote in favour of the Resolution as provided in 1.2.1 below, will result in the underlying 5.5555% Bonds being transferred to escrow in CREST pursuant to a corresponding TTE Instruction.

1.1 ***Bonds in certificated form***

A Registered Holder wishing to attend and vote at the relevant Meeting in person must produce at such Meeting either, in the case of an individual holder, a Bond Certificate or, in the case of a corporate holder, a duly approved resolution of the directors or other governing body of such corporation authorising such person to act as the corporation's representative (a "**representative**") at the relevant Meeting together, in each case, with satisfactory evidence of identity.

A Registered Holder not wishing to attend and vote at the relevant Meeting in person may by instrument in writing in the English language (a "**form of proxy**") in the form available from the Registrar, signed by the Registered Holder or, in the case of a corporation, executed under its common seal or signed on its behalf by an attorney or a duly authorised officer of the corporation and delivered to the specified office of the Registrar not less than 48 hours before the time fixed for the meeting, appoint any person (a "**proxy**") to act on his or its behalf in connection with the Meeting (or any adjourned such Meeting).

A proxy or representative so appointed shall so long as such appointment remains in force be deemed, for all purposes in connection with the Meeting (or any adjourned such Meeting) to be the holder of the 5.5555% Bonds to which such appointment relates and the holder of the 5.5555% Bonds shall be deemed for such purposes not to be the holder.

1.2 ***Bonds in uncertificated form in CREST***

Each CREST Participant that is a Registered Holder should, if it is not the Beneficial Owner of the 5.5555% Bonds, seek instructions from the Beneficial Owner(s) in accordance with its usual procedures. A CREST sponsored member wishing to vote in favour of the Resolution or revoke any such vote should instruct its CREST sponsor to issue a TTE Instruction to the Registrar (or if a revocation, an ESA Instruction) with the details set out below.

Each CREST Participant that is a Registered Holder, if it is the beneficial owner of the 5.5555% Bonds, can vote in favour of the Resolution by issuing a TTE Instruction with the details set out in paragraph 1.2.1, revoke by issuing an ESA Instruction with the details set out in paragraph 1.2.2, vote against the Resolution by filling out the paper voting instruction referred to in paragraph 1.2.3, and attend the Meeting by bringing a Corporate Letter of Representation containing the details referred to in paragraph 1.2.4.

1.2.1 A Beneficial Owner wishing to vote IN FAVOUR of the Resolution must send the voting instructions to its CREST Participant in accordance with such participant's usual procedures requesting that such participant issues a TTE Instruction by specifying which of the three options set out below is applicable. Any voting instruction must be received by the CREST Participant (i) in the case of an instruction under OPT55001 below, prior to 4.30 p.m. (London time) on 6 December 2013, or (ii) in the case of an instruction under OPT5502A or OPT5502B below, not less than 48 hours before the time of the meeting (the "**Voting Deadline**"). **However Beneficial Owners are strongly encouraged to ensure that their CREST Participant submits all instructions by 4.30 p.m. (London time) on 29 November 2013**, since the terms of the Liability Management Exercise are more favourable for holders of 5.5555% Bonds if certain levels of participation in the Liability Management Exercise are achieved by this earlier deadline. A TTE Instruction must comply with the paragraph below.

Each TTE Instruction should specify Equiniti (in its capacity as a CREST Participant under its participant ID referred to below) as the escrow agent to whom the 5.5555% Bonds should be transferred. A TTE Instruction will not be valid unless and until it has settled and Equiniti will not take any action in respect of any TTE Instruction until such time. The TTE Instruction must be properly authenticated in accordance with EUI's specifications and must contain, in addition to the other information which is required for a TTE Instruction to settle in CREST, the following details:

(a) the principal amount of 5.5555% Bonds to be transferred to an escrow balance;

(b) the CREST Participant's member account ID;

(c) the CREST Participant's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VMBW45;

(e) Equiniti's participant ID, being: 6RA99;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out after sub-paragraph (j) below, corresponding to the option which the CREST Participant wishes to select and in accordance with any voting instructions provided by any Beneficial Owner;

(g) the intended settlement date;

(h) the corporate action number for the Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(i) the standard TTE instruction of priority 80; and

(j) a contact number, to be inserted in the shared note field.

For the purposes of sub-paragraph (f) above, the relevant CREST member IDs of Equiniti relevant to a Holder of 5.5555% Bonds are set out in the table below. **A Beneficial Owner should elect the ID which corresponds to such Beneficial Owner's preferred option:**

Option	CREST Member ID
Option 1: (Not available to U.S. Holders) Offer to exchange some or all of your 5.5555% Bonds for **Bank T2 Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the 5.5555% Bondholders Meeting as your proxy to vote those 5.5555% Bonds IN FAVOUR of the resolution to be proposed at that meeting). **NB: electing this Option automatically results in offering to exchange some or all of the Beneficial Owner's 5.5555% Bonds for Bank T2 Notes in the Exchange Offer. The Beneficial Owner should read the terms of the CEOM carefully before electing this Option.**	**OPT55001**
Option 2: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolution at the 5.5555% Bondholders Meeting (without offering to exchange your 5.5555% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 5.5555% Bonds in favour of such resolution. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT5502A**
Option 3: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolution at the 5.5555% Bondholders Meeting (without offering to exchange your 5.5555% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 5.5555% Bonds in favour of such resolution. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT5502B**
NB: to vote AGAINST the resolution proposed at the 5.5555% Bondholders Meeting, please use the paper voting instruction available from Equiniti.	**–**

Any vote in favour of the resolution pursuant to a TTE Instruction as provided herein will automatically appoint the chairman of the Meeting as the relevant CREST Participant's proxy to vote the 5.5555% Bonds referred in such TTE Instruction in such way.

1.2.2 A Beneficial Owner wishing to REVOKE a voting instruction given under 1.2.1 above and the corresponding TTE Instruction may do so at any time prior to the Voting Deadline by sending voting instructions to its CREST Participant in accordance with such participant's usual procedures requesting that such participant issues an ESA Instruction to settle in CREST. Any such ESA Instruction must contain the following details:

(a) the principal amount of 5.5555% Bonds to be withdrawn;

(b) the CREST Participant's member account ID;

(c) the CREST Participant's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VMBW45;

(e) Equiniti's participant ID, being: 6RA99;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out above;

(g) the intended settlement date for the withdrawal;

(h) the transaction reference number of the voting instruction to be withdrawn;

(i) the corporate action number for the relevant Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(j) the standard TTE instruction of priority 80; and

(k) a contact number, to be inserted in the shared note field.

Any such revocation of a TTE Instruction will be conditional upon Equiniti verifying that the revocation is validly made. Accordingly, Equiniti will, on behalf of the Bank, reject or accept the revocation by transmitting in CREST a receiving agent reject (AEAD) or receiving agent accept (AEAN) message.

1.2.3 A Beneficial Owner wishing to vote AGAINST the Resolution must send voting instructions to its CREST Participant in accordance with such participant's usual procedures requesting that such participant issues a no vote in respect of the respect of the principal amount of 5.5555% Bonds the subject of such voting instructions by filling out the paper voting instruction which was provided with this Notice to each Registered Holder. Copies of the paper voting instruction are also available from Equiniti.

1.2.4 A Beneficial Owner wishing to ATTEND the Meeting must arrange for its CREST Participant to issue a Corporate Letter of Representation to it. Any such Letter of Representation should be on the headed paper of such participant, should detail the person attending and the principal amount of 5.5555% Bonds held by such person, and be signed by the CREST Participant.

2. The quorum required at the Meeting is one or more persons present being proxies or representatives or holding 5.5555% Bonds and representing or holding in the aggregate not less than two thirds in principal amount of the 5.5555% Bonds for the time being outstanding. If a quorum is not present at the Meeting, the Meeting will be adjourned and the Resolution will be considered at an adjourned Meeting (notice of which will be given to the Holders). The quorum at such an adjourned Meeting will be one or more persons present being proxies or representatives or holding 5.5555% Bonds and representing or holding in the aggregate not less than one-third of the principal amount of the 5.5555% Bonds for the time being outstanding

Holders should note this quorum requirement and should be aware that if the Holders either present or appropriately represented at the Meeting are insufficient to form a quorum the Resolution, and consequently the Proposal, cannot be formally considered thereat. Holders are therefore encouraged either to attend the Meeting in person or to arrange to be represented at the Meeting as soon as possible.

3. Every question submitted to the Meeting shall be decided in the first instance by a show of hands and in case of equality of votes the chairman of the Meeting shall both on a show of hands and on a poll

have a casting vote in addition to the vote or votes (if any) to which he may be entitled as a proxy or as representative or as a Holder.

Unless a poll is (before or on the declaration of the result of the show of hands) demanded by the chairman of the Meeting, the Bank, the Trustee or one or more persons holding one or more of the 5.5555% Bonds or being proxies or representatives or holding 5.5555% Bonds and representing or holding in the aggregate not less than one-fiftieth in principal amount of such 5.5555% Bonds for the time being outstanding, a declaration by the chairman of the relevant Meeting that a resolution has been carried or carried by a particular majority or lost or not carried by a particular majority shall be conclusive evidence of the fact without proof of the number or proportion of the votes recorded in favour or against such resolution.

On a show of hands every person who is present and is a proxy or representative or a Holder who produces a Bond Certificate shall have one vote and on a poll every person who is so present shall have one vote in respect of each £1,000 principal amount of the 5.5555% Bonds in respect of which he is a proxy or representative or in respect of each £1,000 principal amount of the 5.5555% Bonds represented by the Bond Certificate so produced.

4. To be passed, the Resolution requires a majority in favour consisting of not less than three-quarters of the votes cast. If passed, the Resolution will be binding upon all the Holders, whether or not present at such Meeting and whether or not voting.

REGISTRAR

Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA
United Kingdom

TRUSTEE

The Law Debenture Trust Corporation p.l.c.
Fifth Floor
100 Wood Street
London EC2V 7EX
United Kingdom

This Notice is given by:

The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

Dated 4 November 2013.

SECTION D

SCHEME OF ARRANGEMENT IN RESPECT OF THE DATED NOTES

Information in this Offer Memorandum relating to the Scheme is provided by way of a summary description only. Full details of the Scheme will be set out in the Explanatory Statement and Holders of Dated Notes should wait for the Explanatory Statement to be made available by the Bank before taking any action in connection with the Scheme. Any decision to be taken by a Holder of Dated Notes in respect of the Scheme should be made on the basis of the Explanatory Statement only.

Application of this Section D

This Section D applies to the following securities issued by the Bank:

Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998)
(the "**2016 Notes**")

5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942)
(the "**2019 Notes**")

9.25% Subordinated Notes due 28 April 2021 (ISIN: XS0620315902)
(the "**April 2021 Notes**")

Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984)
(the "**November 2021 Notes**")

7.875% Subordinated Notes due 19 December 2022 (ISIN: XS0864253868)
(the "**2022 Notes**")

5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183)
(the "**2024 Notes**")

5.875% Subordinated Notes due 2033 (ISIN: XS0145065602)
(the "**2033 Notes**")

(together, the "**Dated Notes**" and each a "**Series**" of Dated Notes)

Introduction to this Section D

The offers in respect of the Dated Notes are being conducted by way of the Scheme, which is a scheme of arrangement under Part 26 of the Companies Act 2006. The formal terms of the Scheme are set out in the Explanatory Statement. This Section D contains a brief description of certain features of the Scheme, and should be read in conjunction with the Explanatory Statement (which shall, in the event of any inconsistency, prevail over this Section D).

Capitalised terms used in this Section are defined in Section L of this Offer Memorandum.

This Section is split into the following parts:

Part 1: Details of the Scheme of Arrangement
Part 2: Indicative Timetable for the Scheme of Arrangement

Other relevant information

Holders of Dated Notes are recommended to read carefully the Scheme Documents (which incorporate the Bank T2 Prospectus).

Holders are also directed to the following Sections of this Offer Memorandum, which contain further information relevant to the Scheme in relation to the Dated Notes:

- Section A: Rationale for the Liability Management Exercise
- Section B: Offer Consideration – Overview Table
- Section E: Amendment and Termination and Revocation Rights
- Section G: Information on the Bank, the Group and the New Securities
- Section H: Risk Factors and Other Considerations
- Section I: Taxation Considerations
- Section J: Dealer Managers, Exchange Agent, Information Agent and Registrars
- Section K: General Notices and Important Information
- Section L: Definitions

SECTION D – DATED NOTES

PART 1

DETAILS OF THE SCHEME OF ARRANGEMENT

1. SUMMARY OFFERING TABLE

The following table summarises the consideration available to Holders of Dated Notes in the Scheme:

Existing Securities	ISIN	Consideration Amount[1, 5] (per £1,000 of Scheme Claim[4])		New Ordinary Shares Conversion Price[5]
		Bank T2 Notes[2]	New Ordinary Shares[3]	
2016 Notes	XS0254625998	£102.63	£897.37	£7.7718292 per share
2019 Notes	XS0189539942	£102.63	£897.37	
April 2021 Notes	XS0620315902	£102.63	£897.37	
November 2021 Notes	XS0274155984	£102.63	£897.37	
2022 Notes	XS0864253868	£102.63	£897.37	
2024 Notes	XS0188218183	£102.63	£897.37	
2033 Notes	XS0145065602	£102.63	£897.37	

Notes:

1 The number of New Ordinary Shares and principal amount of Bank T2 Notes which a holder of Dated Notes will be eligible to receive in respect of its Scheme Claim will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

2 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank.

3 New Ordinary Shares to be issued by the Bank. If the Liability Management Exercise is successfully completed, the Group's existing equity stake in the Bank will be converted into deferred shares and effectively reduced to nil and a total of 250,000,000 New Ordinary Shares will be issued at that time, of which:

(i) 75,000,000 (representing 30 per cent. of the total) will be issued to the Group in consideration for its fresh injection of capital into the Bank through the Liability Management Exercise and the 2014 Commitment (representing an effective subscription price of £6.16 per share);

(ii) 112,500,000 (representing 45 per cent. of the total) will be issued to holders of the Dated Notes in the Scheme in exchange for their Dated Notes, to be distributed in the Scheme *pro rata* amongst such holders based on their respective Scheme Claims (representing, based on the total value of Scheme Claims and the number of New Ordinary Shares issued in the Scheme to holders of Dated Notes, an implied subscription price equal to the New Ordinary Shares Conversion Price). The New Ordinary Shares referred to in the table above are these 112,500,000 New Ordinary Shares; and

(iii) 62,500,000 (representing the balance of 25 per cent. of the total) will be available for subscription by holders of Dated Notes pursuant to, and on the terms of, the Scheme for an aggregate consideration equal to £125 million (representing an effective subscription price of £2.00 per share).

4 A Holder's claim in the Scheme (its "**Scheme Claim**") will be equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date (expected to be 10 December 2013), provided that a Holder's Scheme Claim in respect of Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (which are denominated in euro) shall be the Sterling-Equivalent of such sum, calculated on the basis of an exchange rate of £0.85644 per €1.00.

5 Since Scheme Claims will include a component of accrued and unpaid interest on the Dated Notes and there is a finite amount of New Ordinary Shares and Bank T2 Notes available in the Scheme, the Consideration Amounts and the New Ordinary Shares Conversion Price in this table are indicative only, pending determination of the floating rate of interest applicable to the interest period commencing 18 November 2013 in respect of the Floating Rate Callable Step-up Dated Subordinated Notes due 2016. For the purpose of the indicative figures above, an assumed 3-month EURIBOR rate of 0.228 per cent. (the rate prevailing as at 30 October 2013) has been applied. The actual rate is expected to be determined on 14 November 2013 and, once determined, the Bank will announce the final Consideration Amounts and New Ordinary Shares Conversion Price via the Regulatory News Service (RNS) operated by the London Stock Exchange. The final Consideration Amounts and New Ordinary Shares Conversion Price are not expected to differ materially from the indicative Consideration Amounts and New Ordinary Shares Conversion Price specified above.

.....

The Scheme will also provide that 62,500,000 additional New Ordinary Shares will be made available to Holders of the Dated Notes for subscription for an aggregate consideration equal to £125 million, all pursuant to, and on the terms of, the Scheme.

2. DESCRIPTION OF THE SCHEME

This section contains a description of the Scheme and should be read in conjunction with the more detailed information which will be presented in the Explanatory Statement forming part of the Scheme Documents. The Explanatory Statement will be made available to Scheme Creditors immediately following the Scheme Convening Hearing. Scheme Creditors are also referred to the practice statement letter published by the Bank in connection with the Scheme.

The terms of the Scheme will be considered by the Court at the Scheme Convening Hearing and the Scheme Sanction Hearing. The Scheme Convening Hearing is expected to be held on 18 November 2013 and the Scheme Sanction Hearing is anticipated to be held on or about 16 December 2013.

The convening of the Scheme Meeting and the sanctioning of the Scheme by the Court are subject to the discretion of the Court. Leave to convene the Scheme Meeting will not necessarily be granted at the Scheme Convening Hearing and/or the Scheme Meeting may not be convened in the manner sought by the Bank and described herein. Holders of Dated Notes should read carefully the Explanatory Statement once it is made available (which is currently expected to be 19 November 2013) for definitive information with respect to the Scheme.

2.1 *Purpose of the Scheme*

The purpose of the Scheme, as part of the Liability Management Exercise, is to enable the Bank, with the approval of the requisite majorities of Scheme Creditors, to require and effect the exchange of the entire aggregate principal amount of Dated Notes outstanding, together with any accrued but unpaid interest on such Dated Notes up to (and including) the Scheme Record Date, for a combination of New Ordinary Shares and Bank T2 Notes.

If the requisite majorities of Scheme Creditors vote in favour of the Scheme at the Scheme Meeting and the Court sanctions the Scheme at the Scheme Sanction Hearing, the Bank will, subject to satisfaction of certain conditions to the implementation of the Scheme (which will be described in the Explanatory Statement), be able to require and effect the exchange of all Dated Notes in accordance with the terms of the Scheme, including Dated Notes held by Holders who do not vote in favour of the Scheme.

2.2 *Nature of the Scheme*

The Scheme is a scheme of arrangement under the laws of England and Wales. A scheme of arrangement is a formal procedure under Part 26 of the Companies Act 2006 which enables a company to agree a compromise or arrangement with its creditors or any class of its creditors in respect of its debts or obligations owed to those creditors. A scheme of arrangement requires the following to occur in order to become legally binding:

(a) the approval of a majority in number representing at least 75 per cent. in value of the creditors or class of creditors present in person or by proxy and voting at the meeting convened to approve the scheme of arrangement;

(b) the approval of the Court by the making of an order sanctioning the scheme of arrangement; and

(c) the delivery of the order sanctioning the scheme of arrangement to the Registrar of Companies.

If the scheme of arrangement is approved by the requisite majorities and sanctioned by the Court and the order sanctioning the scheme of arrangement is delivered as set out above, the scheme of arrangement will bind all the creditors subject to it, both those creditors who voted in favour of it and those creditors who voted against it or did not vote at all.

A scheme of arrangement cannot be sanctioned by the Court unless the Court is satisfied, among other things, that the relevant provisions of part 26 of the Companies Act 2006 have been complied with and an intelligent and honest person, a member of the class concerned and acting in respect of his own interest, might reasonably approve the scheme of arrangement.

2.3 ***Key Dates and Times***

An indicative timetable for the Scheme is set out in Part 2 of this Section D. Certain key dates relevant to the Scheme are set out below:

- the initial Court hearing, at which the Bank will seek leave to convene the Scheme Meeting (the "**Scheme Convening Hearing**") is expected to be held on 18 November 2013.
- the Voting Instruction Deadline is scheduled for 4.30 p.m. (London time) on 10 December 2013.
- the Scheme Record Date is expected to be 10 December 2013.
- the Scheme Meeting is expected to be convened on 11 December 2013.
- the second Court hearing, at which the Bank will request the sanction of the Scheme by the Court (the "**Scheme Sanction Hearing**"), is expected to be held on 16 December 2013.
- the Scheme Settlement Date is expected to be 18 December 2013.

The times and dates given above are indicative only, and may be changed by the Bank if so required or permitted by the Court.

2.4 ***Identity of Scheme Creditors***

The Scheme will be proposed by the Bank in respect of the Dated Notes. The creditors in respect of which the Scheme will be proposed (the "**Scheme Creditors**") will consist of:

(a) the direct creditors in respect of the Dated Notes - the common depositary for each Series of Dated Notes as holder of the global note or global notes representing the relevant Series of Dated Notes and the trustee for each Series of Dated Notes solely as the beneficiary of the covenant to pay principal and interest on the relevant Series of Dated Notes; and

(b) the contingent creditors in respect of the Dated Notes - the Holders as the beneficial owners of and/or the persons with the ultimate economic interest in the Dated Notes.

The Holders, as the beneficial owners of and/or the persons with the ultimate economic interest in the Dated Notes, are the persons with the "real" interest in the Dated Notes and accordingly they will be entitled to vote in respect of the Scheme. To avoid double counting in respect of the Dated Notes, the trustee and common depositary in respect of each Series of Dated Notes will not exercise any voting rights to which they may be entitled as Scheme Creditors. References in this Offer Memorandum to "Scheme Creditors" should be construed accordingly.

2.5 ***Composition of class for the Scheme Meeting***

By their terms, the Dated Notes would rank *pari passu* amongst themselves on a winding up of the Bank. Further, if the Liability Management Exercise were to be unsuccessful and the relevant UK authorities were to exercise their powers under the Banking Act 2009 in order to resolve the Bank, the Bank believes that all of the Holders of the Dated Notes would be treated equally.

Accordingly, the rights of all of the Holders of Dated Notes are substantially the same (or are not so dissimilar as to make it impossible for them to consult together with a view to their common interest). The Bank therefore considers that it is appropriate for the Holders of the Dated Notes to vote together as one class at the Scheme Meeting.

2.6 ***Scheme Meeting***

The Scheme Meeting, for the purpose of considering and, if thought fit, approving the Scheme, will be convened in accordance with the order of the Court made at the Scheme Convening Hearing. The Bank will request the Court to order that the Scheme Meeting be convened on 11 December 2013.

For the avoidance of doubt and as the Scheme Meeting will be convened pursuant to an order of the Court, the procedures for the Scheme Meeting will be as set out in the Explanatory Statement (and not the procedures for the convening of noteholder meetings as set out in the trust deeds applicable to the Dated Notes).

2.7 ***Voting at the Scheme***

Detailed instructions in relation to voting at the Scheme Meeting will be set out in the Explanatory Statement.

In order to vote at the Scheme Meeting (either in person or by proxy), each Holder will be required to ensure that its Account Holder (or, if the Holder is an Account Holder, it) has completed and submitted to the Information Agent a valid Account Holder Letter before the Voting Instruction Deadline (being 4.30 p.m. (London time) on 10 December 2013).

If a Holder has not delivered a valid Account Holder Letter for the purpose of voting to the Information Agent before the Voting Instruction Deadline, then (subject to the following paragraph) that Holder will not be entitled to vote at the Scheme Meeting. Furthermore, as described below, if the Scheme is sanctioned and implemented, a Holder which has not delivered to the Information Agent a valid Account Holder Letter, with the relevant eligibility confirmations and details duly completed, on or before the date of the Scheme Sanction Hearing will not receive its New Ordinary Shares and Bank T2 Notes, which it is entitled to receive as Scheme Consideration in exchange for its Dated Notes, on the Scheme Settlement Date, but will need to take certain additional steps in order to demonstrate to the reasonable satisfaction of the Bank that it was a Scheme Creditor as at the Scheme Record Date and/or is eligible (or has nominated a Designated Recipient) to receive such Scheme Consideration.

Notwithstanding the foregoing paragraph, the chairman appointed in respect of the Scheme Meeting (the "**Scheme Chairman**") will be entitled, at his/her sole discretion, to permit a Holder in respect of which a completed Account Holder Letter has not been delivered prior to the Voting Instruction Deadline to vote at the Scheme Meeting if the Scheme Chairman considers that the relevant Holder has produced sufficient proof that it is a Scheme Creditor.

2.8 ***Scheme becoming effective***

Scheme Sanction Hearing

If the Scheme is approved by the Scheme Creditors at the Scheme Meeting, a date is then set for the Scheme Sanction Hearing for the Court to sanction the Scheme. Once the date of the Scheme Sanction Hearing is confirmed by the Court, the Bank will give notice to the Scheme Creditors via the Regulatory News Service (RNS) operated by the London Stock Exchange. The Bank currently expects that the Scheme Sanction Hearing will be held on or about 16 December 2013.

At the Scheme Sanction Hearing, the Bank will be entitled to consent on behalf of all Scheme Creditors to any modification of the Scheme or any term or condition which the Court may think fit to approve or impose and which would not directly or indirectly have a materially adverse effect on the interests of any Scheme Creditor under the Scheme.

The Scheme (if approved by the requisite majority of Scheme Creditors at the Scheme Meeting and sanctioned by the Court at the Scheme Sanction Hearing) will become effective in accordance with its terms, and will be binding on the Bank and the Scheme Creditors, when an office copy of the order of the Court sanctioning the Scheme is delivered to the Registrar of Companies.

Scheme Settlement Date

If the Scheme becomes effective, the Bank currently expects the exchange of the Dated Notes for a combination of New Ordinary Shares and Bank T2 Notes to be effected on 18 December 2013 (the "**Scheme Settlement Date**").

On and from the Scheme Settlement Date, the Scheme Creditors will have no further rights, title or benefit to the Dated Notes but shall be entitled to receive Scheme Consideration in accordance with the terms of the Scheme.

3. SCHEME CONSIDERATION

3.1 *Overview of Scheme Consideration*

If the Scheme is sanctioned and implemented, all the Dated Notes (together with accrued and unpaid interest thereon up to (and including) the Scheme Record Date) will be exchanged on the Scheme Settlement Date for:

(a) a number of New Ordinary Shares in the Bank; and

(b) a principal amount of Bank T2 Notes issued by the Bank.

The number of New Ordinary Shares and principal amount of Bank T2 Notes to which a Holder will become entitled will be determined in accordance with the terms of the Scheme which are described in the following provisions of this paragraph 3.

The consideration to which Holders will become entitled upon exchange of their Dated Notes (together with accrued and unpaid interest thereon up to (and including) the Scheme Record Date) pursuant to the Scheme (comprising the New Ordinary Shares and Bank T2 Notes) is referred to in this Offer Memorandum as "**Scheme Consideration**".

3.2 *Early Participation Threshold not relevant*

The number of New Ordinary Shares and principal amount of Bank T2 Notes which a Holder will receive in exchange for its Dated Notes (on the basis of its Scheme Claim as defined below) if the Liability Management Exercise is successfully completed will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

3.3 *Scheme Consideration: accrued interest and Scheme Claims*

The "**Scheme Record Date**" for the Scheme is currently expected to be 10 December 2013.

A Holder's claim in the Scheme (its "**Scheme Claim**") will be equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date; provided that a Holder's Scheme Claim in respect of 2016 Notes (which are denominated in euro) shall be the Sterling-Equivalent of such sum, calculated as provided in paragraph 3.6 below.

The amount of a Holder's Scheme Claim will be used to determine the number of New Ordinary Shares and principal amount of Bank T2 Notes which such Holder will be entitled to receive in exchange for its Dated Notes if the Scheme is settled, as further described in paragraphs 3.4 and 3.5 below. For the avoidance of doubt, no accrued interest will be paid in cash pursuant to the Scheme.

The Scheme will provide that any interest that accrues or falls due for payment after the Scheme Record Date will be irrevocably cancelled on the Scheme Settlement Date.

Note:

Since Scheme Claims will include a component of accrued and unpaid interest on the Dated Notes and there is a finite amount of New Ordinary Shares and Bank T2 Notes available in the Scheme, the percentages and Conversion Price given in paragraphs 3.4 and 3.5 below are indicative only, pending determination of the floating rate of interest applicable to the interest period commencing 18 November 2013 in respect of the 2016 Notes. For the purpose of the indicative figures below, an assumed 3-month EURIBOR rate of 0.228 per cent. (the rate prevailing as at 30 October 2013) has been applied. The actual

rate is expected to be determined on 14 November 2013 and, once determined, the Bank will announce the final percentages and Conversion Price via the Regulatory News Service (RNS) operated by the London Stock Exchange. The final percentages and Conversion Price are not expected to differ materially from the indicative percentages and Conversion Price specified in paragraphs 3.4 and 3.5 below.

3.4 ***Scheme Consideration: number of New Ordinary Shares***

The number of New Ordinary Shares to which a Holder will (if the Scheme is settled) be entitled based on its Scheme Claim will be calculated by:

(a) multiplying such Holder's Scheme Claim by 89.737* per cent.; and

(b) dividing the resulting figure by £7.7718292* (being the Conversion Price for the New Ordinary Shares) and, if necessary, rounding such figure down to the nearest whole number of New Ordinary Shares (any fractional amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof).

**Indicative only – see the Note in paragraph 3.3 above.*

3.5 ***Scheme Consideration: principal amount of Bank T2 Notes***

The principal amount of Bank T2 Notes to which a Holder will (if the Scheme is settled) be entitled based on its Scheme Claim will be calculated by multiplying such Holder's Scheme Claim by 10.263* per cent. and, if necessary, rounding the resulting figure down to the nearest whole multiple of £10 (being the minimum denomination of the Bank T2 Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof).

**Indicative only – see the Note in paragraph 3.3 above.*

3.6 ***Sterling-Equivalent amounts for the 2016 Notes***

The "**Sterling-Equivalent**" of any euro amount in respect of a 2016 Note will, for the purposes of determining the Scheme Claim of a Holder of 2016 Notes and for all other purposes under the Liability Management Exercise (including for determining the weighting of the votes of Holders of 2016 Notes at the Scheme Meeting) be the amount in sterling determined by the Bank to be equivalent to such euro amount by reference to the Scheme FX Rate of £0.85644 per €1.00.

4. OFFER OF ADDITIONAL NEW ORDINARY SHARES

62,500,000 additional New Ordinary Shares (the "**Additional New Ordinary Shares**") will be made available to Holders of the Dated Notes for subscription at an effective subscription price of £2 per Additional New Ordinary Share under the terms of the Scheme for an aggregate consideration equal to £125 million (the "**Additional New Ordinary Shares Offer**").

The Bank has entered into an agreement with certain Holders of the Dated Notes (the "**Purchasers**") on 4 November 2013 (the "**Purchase Agreement**"). The terms of the Purchase Agreement provide that the Purchasers will subscribe for any Additional New Ordinary Shares unallocated or not taken up under the Additional New Ordinary Shares Offer. The Bank will pay the Purchasers a fee equal to 4 per cent. of £125 million (the "**Purchaser Premium**").

All Holders of Dated Notes will be entitled to participate in a sub-purchase of the Additional New Ordinary Shares which are the subject of the Purchase Agreement (the "**Sub-purchase Offer**", and the sub-purchase of the Additional New Ordinary Shares the subject of the Purchase Agreement, the "**Sub-purchase**"). The Sub-purchase Offer will be available to all Holders of Dated Notes, including the Purchasers. To participate in the Sub-purchase Offer, a Holder of Dated Notes (the "**Sub-purchaser**") will be entitled to nominate the commitment which that Holder is prepared to sub-purchase, subject to a maximum commitment of £125 million and a minimum commitment of £100,000. The allocation of sub-purchasing commitments to a Holder of Dated Notes that wishes to participate in the Sub-purchase Offer will, in the case of aggregate nominations being less than £125 million, be the amount of Sub-purchasers' nominations and, in the case of nominations in aggregate

exceeding £125 million, be *pro rata* based on the proportion of its Scheme Claim (as at the Scheme Record Date) to the aggregate Scheme Claims of all Holders (as at the Record Date) who have elected to participate in the Sub-purchase Offer, subject to (i) a minimum commitment of £100,000 and (ii) a maximum commitment equal to the amount of the sub-purchasing commitment elected for by that Holder (the "**Sub-purchasing Commitment**"); provided always that the aggregate amount of all Sub-purchasing Commitments allocated to all Holders of Dated Notes that participate in the Sub-purchase Offer is no greater than £125 million.

The Sub-purchasers will be required to enter into an agreement with the Bank on or around the date of the Scheme Meeting (the "**Sub-purchase Agreement**"). The Bank will pay each Sub-purchaser a fee equal to 2 per cent. of their Sub-purchasing Commitment, provided that they comply with their obligations under the Sub-purchase Agreement (the "**Sub-purchaser Premium**"). The aggregate Purchaser Premium payable to the Purchasers will be reduced in an amount equal to the aggregate Sub-purchaser Premium paid to the Sub-purchasers, such reduction to be allocated among the Purchasers based on their subscription commitment as set out in the Purchase Agreement.

To the extent that the aggregate allocation of Additional New Ordinary Shares to all Holders of Dated Notes who elect to participate in the Additional New Ordinary Shares Offer is less than 62,500,000 Additional New Ordinary Shares, the Sub-purchasers pursuant to the Sub-purchase Agreement will be required to subscribe for such number of remaining Additional New Ordinary Shares up to their Sub-purchasing Commitments. If there are still Additional New Ordinary Shares to be issued, the Purchasers under the Purchase Agreement will be required to subscribe for the remaining Additional New Ordinary Shares in accordance with the terms of the Purchase Agreement. Furthermore, if a Holder of Dated Notes elects to participate in the Additional New Ordinary Shares Offer, or participates in the Sub-purchase Offer, but, in either case, fails to fund the purchase of its allocation of Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer, or the Sub-purchasing Commitment, as applicable, the Purchasers will also be required to subscribe for those New Ordinary Shares in accordance with the terms of the Purchase Agreement.

5. DESCRIPTION AND DELIVERY OF NEW ORDINARY SHARES AND BANK T2 NOTES

5.1 *Description of the New Ordinary Shares*

The New Ordinary Shares will comprise voting ordinary shares in the Bank (ISIN: GB00BDW0BX87; SEDOL: BDW0BX8) having a nominal value of £0.05 each.

The New Ordinary Shares will be in registered form and, subject to the provisions of the CREST Regulations, the Directors of the Bank may permit the holding of shares in any class of shares in uncertificated form and title to such shares may be transferred by means of a relevant system (as defined in the CREST Regulations).

Accordingly, it is expected that the New Ordinary Shares will be issued in CREST. With respect to New Ordinary Shares held in CREST, it will be possible to trade interests in such New Ordinary Shares indirectly in Euroclear and Clearstream, Luxembourg. In this case, the New Ordinary Shares themselves will be held in a CREST account by a nominee for Euroclear or Clearstream, Luxembourg (as applicable), and Euroclear and Clearstream, Luxembourg will enable interests representing the New Ordinary Shares held in those nominee accounts to be traded in Euroclear and Clearstream, Luxembourg.

The New Ordinary Shares will not be listed upon issue.

Further detailed information relating to the Bank and the New Ordinary Shares, including a description of certain risks relating to an investment in New Ordinary Shares, is set out in the Explanatory Statement.

5.2 *Description of the Bank T2 Notes*

The Bank T2 Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid quarterly in arrear on each three-month anniversary of the issue date of the

Bank T2 Notes up to (and including) the tenth anniversary of the issue date. The Bank will be obliged to repay the principal amount of the Bank T2 Notes on the tenth anniversary of their issue date.

The Bank T2 Notes will have denominations of £10 each.

Upon issue, the Bank T2 Notes will be capable of being held in dematerialised book-entry form in CREST or in certificated form outside CREST.

With respect to Bank T2 Notes held in certificated form outside CREST (if any), Computershare (in its capacity as registrar for the Bank T2 Notes) will arrange for certificates evidencing such holding to be mailed to the relevant holders.

With respect to Bank T2 Notes held in CREST, it will be possible to trade interests in such Bank T2 Notes indirectly in Euroclear and Clearstream, Luxembourg. In this case, the Bank T2 Notes themselves will be held in a CREST account by a nominee for Euroclear or Clearstream, Luxembourg (as applicable), and Euroclear and Clearstream, Luxembourg will enable interests representing the Bank T2 Notes held in those nominee accounts to be traded in Euroclear and Clearstream, Luxembourg.

Detailed information relating to the Bank and the Bank T2 Notes, including the full terms and conditions of the Bank T2 Notes and a description of certain risks relating to an investment in Bank T2 Notes, is set out in the Bank T2 Prospectus.

The Bank has, pursuant to the Bank T2 Prospectus, made an application to the Financial Conduct Authority for the Bank T2 Notes to be admitted to the Official List maintained by the Financial Conduct Authority and to the London Stock Exchange plc for such Bank T2 Notes to be admitted to trading on its regulated market. It is intended that admission to listing and trading will become effective on the Scheme Settlement Date.

5.3 ***Delivery of the New Ordinary Shares and Bank T2 Notes***

New Ordinary Shares and Bank T2 Notes to be delivered in exchange for Dated Notes will be delivered to each Holder which has delivered to the Information Agent a valid Account Holder Letter on or before the date of the Scheme Sanction Hearing in the Euroclear or Clearstream, Luxembourg account in which the relevant Dated Notes are blocked. The New Ordinary Shares and Bank T2 Notes will be delivered to the same account in Euroclear or Clearstream, Luxembourg in which such Holder holds its Dated Notes.

If a Holder has not delivered to the Information Agent a valid Account Holder Letter, with the relevant eligibility confirmations and details duly completed, on or before the date of the Scheme Sanction Hearing, the New Ordinary Shares and Bank T2 Notes to which such Holder becomes entitled upon exchange of its Dated Notes will be delivered to the Holding Period Trustee.

Such Bank T2 Notes and New Ordinary Shares will be held on trust by the Holding Period Trustee pending:

(i) confirmation for or on behalf of the relevant Holder that it or its Designated Recipient is eligible to receive the Bank T2 Notes and New Ordinary Shares, at which time the Holding Period Trustee will transfer the relevant Bank T2 Notes and New Ordinary Shares to that Holder or its Designated Recipient;

(ii) confirmation for or on behalf of the relevant Holder that it is not eligible to receive the Bank T2 Notes or New Ordinary Shares, at which time the relevant Bank T2 Notes and New Ordinary Shares will be sold by or on behalf of the Holding Period Trustee and the net proceeds of sale (after deduction of all applicable taxes and expenses) will be distributed to that Holder; or

(iii) the date falling 36 months following the Scheme Settlement Date, at which time the Holding Period Trustee will sell or procure the sale of the Bank T2 Notes and New Ordinary Shares not

already distributed or sold as described in (i) and (ii) above and the net proceeds of such sale (after deduction of all applicable taxes and expenses) will be distributed to the Bank.

Further detail with respect to the Holding Period arrangements are further described in the Explanatory Statement.

5.4 ***Delivery of the Dated Notes***

Upon exchange, the Dated Notes will be cancelled.

6. LOCK-UP ARRANGEMENTS

Each Holder of Dated Notes has the opportunity to enter into a lock-up arrangement (a "**Lock-up Arrangement**") with the Bank pursuant to which such Holder will agree, amongst other things and subject to certain conditions, to vote the full amount of its Scheme Claim in favour of the Scheme.

7. REPRESENTATIONS, WARRANTIES, ACKNOWLEDGEMENTS, AGREEMENTS AND UNDERTAKINGS

Each Holder which submits, delivers or procures the delivery of an Account Holder Letter will make a number of representations, warranties, acknowledgements, agreements and undertakings set out in the Account Holder Letter.

8. THE SETTLEMENT CONDITION

8.1 The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities is exchanged pursuant to the Liability Management Exercise.

8.2 In order for the entire principal amount of all Existing Securities to be exchanged pursuant to the Liability Management Exercise, all of the following must occur:

(a) the Proposal in respect of the Preference Shares must be (i) approved by the Holders of the Preference Shares at the Preference Shareholders Meeting (including, if such Meeting is adjourned, at the adjourned meeting) (and substantially the same resolution must be approved at the General Meeting also) and (ii) capable of being implemented in accordance with the terms of that Proposal as set out in this Offer Memorandum;

(b) the Proposal in respect of the 13% Bonds must be (i) approved by the Holders of the 13% Bonds at the 13% Bondholders Meeting (including, if such Meeting is adjourned, at the adjourned meeting) and (ii) capable of being implemented in accordance with the terms of that Proposal as set out in this Offer Memorandum;

(c) the Proposal in respect of the 5.5555% Bonds must be (i) approved by the Holders of the 5.5555% Bonds at the 5.5555% Bondholders Meeting (including, if such Meeting is adjourned, at the adjourned meeting) and (ii) capable of being implemented in accordance with the terms of that Proposal as set out in this Offer Memorandum; and

(d) (i) the Scheme must be approved by the requisite majority of the Holders of the Dated Notes at the Scheme Meeting and sanctioned by the Court; (ii) an office copy of the sanction order must be delivered to the Registrar of Companies at Companies House; and (iii) the Scheme must become unconditional in accordance with its terms (subject only to satisfaction of the Settlement Condition).

The requirements of sub-paragraphs (a) to (d) (inclusive) above are collectively referred to in this document as the "**Settlement Condition**".

8.3 The occurrence of the Scheme Settlement Date is conditional upon the Settlement Condition being satisfied. The last date on which the Liability Management Exercise may successfully complete is 31 December 2013.

8.4 **The Settlement Condition is not capable of being waived.** Accordingly, if the Settlement Condition is not satisfied, the Liability Management Exercise will not be implemented, and no Existing Securities will be exchanged or sold (and no New Securities will be issued) pursuant to the Liability Management Exercise.

9. RECEIPT OF NEW ORDINARY SHARES AND BANK T2 NOTES

9.1 If the Scheme is implemented, the Bank will deliver (or procure the delivery of) (i) the New Ordinary Shares and Bank T2 Notes to which Holders become entitled based on their Scheme Claims, and (ii) any Additional New Ordinary Shares to be delivered pursuant to the Additional New Ordinary Shares Offer, in each case on the Scheme Settlement Date.

9.2 If a Holder has delivered to the Information Agent a valid Account Holder Letter, with the relevant eligibility confirmations and details duly completed, on or before the date of the Scheme Sanction Hearing, the New Ordinary Shares and Bank T2 Notes which such Holder becomes entitled to receive will be delivered in the Euroclear or Clearstream, Luxembourg account in which such Holder held its Dated Notes.

9.3 Holders should note that the Bank will procure the delivery of such New Ordinary Shares and Bank T2 Notes to the relevant Clearing System(s) on the Scheme Settlement Date. Each Clearing System will subsequently arrange for the onward transmission of those New Ordinary Shares and Bank T2 Notes to the Holders entitled thereto in accordance with its usual procedures. It is possible that certain Holders may therefore not receive their New Ordinary Shares and/or Bank T2 Notes until after the Scheme Settlement Date.

9.4 The delivery of the New Ordinary Shares and the Bank T2 Notes to the relevant Clearing System(s) on or before the Scheme Settlement Date will discharge the Bank's obligations in respect of the delivery of such New Ordinary Shares and Bank T2 Notes. Thereafter, the Holders entitled to such New Ordinary Shares and Bank T2 Notes must look to the relevant Clearing System for receipt of such New Ordinary Shares and Bank T2 Notes.

9.5 Provided that the Bank delivers the New Ordinary Shares and the Bank T2 Notes to the relevant Clearing Systems on or before the Scheme Settlement Date, the Bank will not be liable to pay any compensation or other additional amounts in the event that a Holder receives its entitlement to such New Ordinary Shares and/or Bank T2 Notes after the Scheme Settlement Date.

9.6 If a Holder has not delivered to the Information Agent a valid Account Holder Letter, with the relevant eligibility confirmations and details duly completed, on or before the date of the Scheme Sanction Hearing, the New Ordinary Shares and Bank T2 Notes which such Holder becomes entitled to receive will be delivered to the Holding Period Trustee, and such Holder will need to take certain additional steps in order to demonstrate to the reasonable satisfaction of the Bank that it was a Holder as at the Scheme Record Date and/or is eligible (or has nominated an eligible Designated Recipient) to receive such New Ordinary Shares and Bank T2 Notes, as further described in the Explanatory Statement. Provided that the Bank delivers such New Ordinary Shares and Bank T2 Notes to or to the order of the Holding Period Trustee on or before the Scheme Settlement Date, the Bank will not be liable to pay any compensation or other additional amounts to such Holder.

10. ANNOUNCEMENTS

Unless stated otherwise or as required by order of the Court, announcements in relation to the Scheme will be made: (i) by the issue of a press release to a Notifying News Service; (ii) by the delivery of notices to Euroclear and Clearstream, Luxembourg for communication to Account Holders; (iii) via the Regulatory News Service (RNS) operated by the London Stock Exchange; and (iv) as otherwise required by the rules of the London Stock Exchange. Copies of all announcements, notices and press releases can also be obtained from the Information Agent, the contact details for which are at the end of this Offer Memorandum.

11. IRREGULARITIES

All questions as to the validity, form and eligibility (including the time of receipt) of any Account Holder Letter or any withdrawal, revocation or revision thereof or delivery of Dated Notes will be determined by the Bank in its sole and absolution discretion, which determination will be final and binding. The Bank reserves the absolute right to reject any and all Account Holder Letters not in proper form or for which any corresponding agreement by the Bank would, in the opinion of the Bank, be unlawful. The Bank also reserves the absolute right to waive any defects in any Account Holder Letter. None of the Bank, the Group, the Dealer Managers or the Information Agent shall be under any duty to give notice to Holders, Direct Participants or any intermediaries of any irregularities in Account Holder Letters.

12. SCHEME NOT IMPLEMENTED; OTHER PURCHASES

Notwithstanding any other provision of this Offer Memorandum, if the Scheme is not implemented, the Bank, the Group and/or any of their affiliates may (subject to applicable law and regulation and the terms of the Dated Notes) at any time after termination of the Scheme exchange, purchase or otherwise acquire Dated Notes pursuant to privately agreed market transactions or any other arrangement at a price or exchange ratio which may be more or less favourable than the terms of the Scheme.

13. CALCULATIONS AND DETERMINATIONS BY THE BANK

The terms of the Scheme will provide for the Bank to make certain determinations and perform certain calculations in respect of the Scheme. All such determinations and calculations by the Bank in good faith will, in the absence of manifest error, be conclusive and binding on the Bank, the Group and the Holders.

14. RELEASE

The terms of the Scheme will include a release of certain persons, including the Bank, the Group, the Dealer Managers, the Information Agent and their respective financial and legal advisers (together in each case with their respective directors, members and representatives) from any liabilities in relation to or arising in connection with the preparation, negotiation or implementation of the Scheme, to the fullest extent permitted by law, as will be more fully described in the Explanatory Statement.

15. THIRD PARTIES

As the Scheme will be an arrangement between the Bank and the Scheme Creditors, third parties which are required to take certain steps or perform certain functions pursuant to the terms of the Scheme will be requested to provide undertakings in favour of the Bank and the Court that they will take those steps and perform those functions in accordance with the terms of the Scheme.

16. GOVERNING LAW AND SUBMISSION TO JURISDICTION

The Scheme, any Account Holder Letters and any non-contractual obligations arising out of or in connection therewith shall be governed by, and construed in accordance with, English law.

SECTION D: DATED NOTES

PART 2

INDICATIVE TIMETABLE FOR THE SCHEME OF ARRANGEMENT

The times and dates referred to below are indicative only and are subject to the right of the Bank (if required or permitted by the Court) to amend and/or withdraw the Scheme at any time. Accordingly, the actual timetable may differ significantly from the expected timetable set out below.

If any of the below times and/or dates change, the revised time(s) and/or date(s) will be announced by the Bank as soon as reasonably practicable.

Events	*Dates and Times (all times are London time)*
Announcement of the Scheme Scheme announced. Practice statement letter sent to Scheme Creditors	4 November 2013
Announcement of Consideration Amounts in the Scheme Announcement of the final Consideration Amounts and New Ordinary Share Conversion Price in the Scheme.	On or around 14 November 2013
Scheme Convening Hearing Initial Court hearing for leave to convene the Scheme Meeting	18 November 2013
Explanatory Statement and Scheme Documents available Explanatory Statement and Scheme Documents available to Scheme Creditors	19 November 2013
Voting Instructions Deadline Deadline for receipt of all Account Holder Letters containing voting instructions in order for Holders to vote on the Scheme and elections to subscribe for Additional New Ordinary Shares pursuant to the Additional New Ordinary Shares Offer under the Scheme	4.30 p.m. on 10 December 2013
Scheme Record Date Only those Holders who are Scheme Creditors as at the Scheme Record Date are entitled to attend and vote at the Scheme Meeting (unless the Bank, in its sole discretion, elects to recognise, for the purposes of the Scheme, a transfer of Dated Notes after the Scheme Record Date such that the transferee becomes a Scheme Creditor)	10 December 2013
Scheme Meeting Meeting of the Scheme Creditors to vote on the Scheme. The Bank will request the Court to convene the Scheme Meeting on 11 December 2013	11 December 2013
Results Announcement Announcement of the results of the Scheme Meeting.	12 December 2013

Events	*Dates and Times (all times are London time)*
Scheme Sanction Hearing Second Court hearing for sanction of the Scheme by the Court. The Bank will announce as soon as reasonably practicable after the Scheme Sanction Hearing whether or not the Scheme is sanctioned.	16 December 2013
Filing of sanction order Sanction order (if granted) delivered to the Registrar of Companies. Scheme becomes effective in accordance with its terms	The date of the Scheme Sanction Hearing or the following business day
Scheme Settlement Date Expected settlement of the Scheme, including issue and delivery of New Ordinary Shares, Bank T2 Notes and Additional New Ordinary Shares.	18 December 2013

The above timetable may be impacted in certain respects if any of the Meetings in respect of the Preference Shares, the 13% Bonds and the 5.5555% Bonds are required to be adjourned. If any of the Meetings are required to be adjourned, the Bank currently expects that the settlement date for the Scheme will be postponed to on or around 31 December 2013.

If the timetable is changed for any reason, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

Unless stated otherwise or required by order of the Court, announcements in relation to the Scheme will be made: (i) by the issue of a press release to a Notifying News Service; (ii) by the delivery of notices to Euroclear and Clearstream, Luxembourg for communication to Direct Participants; (iii) via the Regulatory News Service (RNS) operated by the London Stock Exchange; and (iv) as otherwise required by the rules of the London Stock Exchange. Copies of all announcements, notices and press releases can also be obtained from the Information Agent, the contact details for which are at the end of this Offer Memorandum.

Holders are advised to check with any custodian, broker or other intermediary through which they hold their Dated Notes when such intermediary needs to receive instructions from a Holder in order for such Holder to participate in the Scheme.

SECTION E

AMENDMENT AND TERMINATION AND REVOCATION RIGHTS

1. AMENDMENT AND TERMINATION

Notwithstanding any other provision of the Liability Management Exercise, the Bank and/or the Group may, subject to applicable law and regulation, at their option (and, if and to the extent required in the case of the Scheme, at the direction or with the permission of the Court), at any time before settlement of the Exchange Offers or the Scheme:

1.1 extend the Early Participation Deadline, Expiration Deadline, Offer Record Date, Scheme Record Date, Voting Instruction Deadline, Settlement Date, Scheme Settlement Date and/or re-open the Exchange Offers or the Scheme, in respect of the Liability Management Exercise or any component part or parts thereof (in which case all references in this Offer Memorandum to the relevant date, time or deadline shall, unless the context otherwise requires, be to the latest date and/or time to which such date, time or deadline has been so extended);

1.2 otherwise amend the Offers or the Scheme or any one or more of them in any respect (including, but not limited to, any terms and conditions of the Offers or the Scheme, any terms and conditions of the New Securities or any of them and any scheduled date for any specified event);

1.3 delay acceptance or, subject to applicable law, exchange or sale of Existing Securities validly offered for exchange or sale or otherwise to be exchanged in the Liability Management Exercise until satisfaction or waiver (where waiver is permitted) of any conditions of the Liability Management Exercise; or

1.4 terminate the Liability Management Exercise or any component part of parts thereof, including (without limitation) in respect of any one or more Series of Existing Securities, and including with respect to Exchange Instructions and/or Account Holder Letters submitted before the time of such termination.

For the avoidance of doubt, the Bank and the Group may amend the Offers in respect of any one or more Series of Existing Securities without amending the Offers in respect of any other Series of Existing Securities, and may amend the Offers or any of them without amending or terminating the Scheme and *vice versa*.

If the Settlement Date or Scheme Settlement Date is postponed at the option of the Bank or the Group, Holders shall not be entitled to revoke their Exchange Instructions (or, as the case may be, if such postponement is effected after the Voting Instruction Deadline, their Account Holder Letters), or to any compensation or other amounts in respect of such postponement, provided that the Settlement Date and Scheme Settlement Date shall not be postponed for more than 45 calendar days from the currently scheduled date of 18 December 2013.

Neither the Bank nor the Group shall be liable under any provision contained in this Offer Memorandum to any Holder in respect of any costs incurred by such Holder in connection with the Liability Management Exercise, including if the Bank amends or terminates the Liability Management Exercise or any component part or parts of it.

Publication of Supplementary Prospectuses

In the event of any significant new factor, material mistake or inaccuracy relating to information included in the Bank T2 Prospectus or the Group Notes Prospectus (including, in each case, this Offer Memorandum) which is capable of affecting the assessment of the Exchange Offers, the Proposals or any of them, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate. For the avoidance of doubt, significant new

factors would include (but are not limited to) amendments to the terms and conditions of the Exchange Offers or the Proposals or any of them – see "*Revocation Rights*" below.

2. REVOCATION RIGHTS

2.1 Publication of Supplementary Prospectuses and Revocation of Exchange Instructions

Exchange Instructions shall be irrevocable except in the limited circumstances described in this sub-section.

If, at any time after commencement of the offer period and prior to the relevant Settlement Date:

(a) any material amendment to the terms and conditions of the Offers or any of them or the Scheme (including to the terms of the New Securities or any of them) is made by the Bank and/or the Group; or

(b) there arises or is noted a significant new factor, material mistake or inaccuracy relating to the information included in the Prospectuses or any of them which is capable of affecting an assessment of the Liability Management Exercise or any component part or parts thereof or an assessment of the New Securities or any of them,

the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

Upon the publication of any supplement to the Bank T2 Prospectus and/or the Group Notes Prospectus, Holders may elect to withdraw their Exchange Instructions during the period of two Business Days (or such longer period as the Bank and/or the Group may specify in the relevant supplement) commencing on (and including) the first Business Day after the date on which the relevant supplement is published.

Holders who hold their Existing Securities in Euroclear, Clearstream, Luxembourg or CREST are advised to check with such Clearing System and any broker, custodian or other intermediary through whom they hold their Existing Securities by what time such Clearing System and/or intermediary require instructions from the Holder in order for the Clearing System and/or intermediary to revoke such Holder's Exchange Instructions. The Clearing Systems and any such intermediary will require instructions in advance of the deadline for revocation specified above.

Holders wishing to exercise any such right of revocation should do so in accordance with the procedures set out in the relevant Section of this Offer Memorandum. For the avoidance of doubt, any Holder who does not exercise any such right of revocation in the circumstances and in the manner provided herein shall be deemed to have waived such right of revocation and its original Exchange Instruction will remain effective.

2.2 Revocation of Account Holder Letters

Account Holder Letters may be revoked before the Voting Instruction Deadline but are irrevocable thereafter, as will be further described in the Explanatory Statement.

SECTION F

OFFER RESTRICTIONS

RESTRICTIONS RELATING TO THE EXCHANGE OFFERS

This Offer Memorandum does not constitute an offer or an invitation to participate in the Exchange Offers in any jurisdiction in or from which, or to any person to whom, it is unlawful to make such offer or invitation under applicable laws. The distribution of this Offer Memorandum is permitted in the United Kingdom and the United States but may be restricted by law in other jurisdictions. Persons into whose possession this Offer Memorandum comes are required by each of the Bank, the Group, the Dealer Managers and the Exchange Agent to inform themselves about, and to observe, any such restrictions.

United States

The Exchange Offers are being made, and any New Securities to be issued pursuant to the Exchange Offers are being offered and will be issued, only to persons that are persons other than "U.S. persons", as that term is defined in Regulation S under the United States Securities Act of 1933 (as amended, the "**Securities Act**"), in offshore transactions in reliance upon Regulation S under the Securities Act, and only such persons are authorised to participate in the Exchange Offers.

None of the New Securities nor any guarantee in respect thereof have been or will be registered under the Securities Act, or any state securities laws. Accordingly, the New Securities will be subject to restrictions on transferability and resale and may not be transferred or resold except as permitted under the Securities Act and other applicable securities laws, pursuant to an exemption from registration. Registration rights will not be granted in favour of the New Securities. Holders who wish to participate in the Exchange Offers will be required to represent that they will not resell or otherwise transfer the New Securities during the 40 day period commencing on the Settlement Date for the Exchange Offers except outside of the United States in a transaction complying with Rule 903 or 904 of Regulation S.

None of the U.S. Securities and Exchange Commission, any state securities commission, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System nor any other regulatory body has approved or disapproved of any of the Exchange Offers or of the New Securities or determined if this Offer Memorandum is truthful or complete. Any representation to the contrary is a criminal offence.

United Kingdom

This Offer Memorandum may only be communicated to persons in the United Kingdom in circumstances where section 21(1) of the Financial Services and Markets Act 2000 does not apply. Accordingly, this Offer Memorandum is only for circulation to persons inside the United Kingdom who fall within one of the following categories:

(i) a person who is a holder of any Existing Securities; or

(ii) any other person also falling within Article 43(2) or within Article 49(2)(a) to (d) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "**Order**") or falling within the definition of "investment professionals" (as defined in Article 19(5) of the Order).

This Offer Memorandum is only available in the United Kingdom to such persons, and the transactions contemplated herein will be available only to, and may be engaged in only with, such persons.

This Offer Memorandum has been issued by The Co-operative Bank p.l.c. and the Co-operative Group Limited. The Bank, which has its registered address at 1 Balloon Street, Manchester M60 4EP, United Kingdom, is authorised by the Prudential Regulation Authority (the "**PRA**") and regulated by the Prudential Regulation Authority and the Financial Conduct Authority (the "**FCA**") in the United Kingdom. To the fullest extent permitted by applicable law and regulation, no person will become a client of the Bank (within

the meaning of the FCA's rules) by virtue of receipt of this Offer Memorandum or participation in the Liability Management Exercise or any component part thereof. The Bank is acting on its own account in relation to the Liability Management Exercise and, to the fullest extent permitted by applicable law and regulation, will not be responsible to any other person for providing the protections which would be afforded to clients of the Bank or for providing advice in relation to the Liability Management Exercise or any component part thereof.

Belgium

The Exchange Offers may not be made, and are not being made, in the Kingdom of Belgium (i) by way of an offer of securities to the public, as defined in Article 3 § 1 of the Belgian law of 16 June 2006 on the public offering of securities and the admission of securities to trading on a regulated market (*Loi relative aux offres publiques d'instruments de placement et aux admissions d'instruments de placement à la négociation sur des marchés réglementés / Wet op de openbare aanbieding van beleggingsinstrumenten en de toelating van beleggingsinstrumenten tot de verhandeling op een gereglementeerde markt*) (the "**Prospectus Law**") nor (ii) by way of a public takeover bid, as defined in Article 3 § 1 of the Belgian Law of 1 April 2007 on public takeover bids (*Loi relative aux offres publiques d'acquisition / Wet op de openbare overnamebiedingen*) (the "**Public Takeover Law**").

The Exchange Offers will be conducted in the Kingdom of Belgium under applicable private placement exemptions in accordance with the Prospectus Law and the Public Takeover Law and therefore neither the Exchange Offers nor this Offer Memorandum have been notified to the Belgian Financial Services and Markets Authority (*Autorité des services et marchés financiers / Autoriteit voor Financiële Diensten en Markten*) ("**Belgian FSMA**") nor has this Offer Memorandum or any other information circular, brochure or similar document relating to the Exchange Offers been, nor will it be, approved by the Belgian FSMA.

Accordingly the Exchange Offers are not being made, directly or indirectly, to, or for the account of, any person (individual or legal entity) other than "qualified investors" within the meaning of Article 6, paragraph 3 of the Public Takeover Law and Article 10 of the Prospectus Law.

France

The Exchange Offers are not being made, directly or indirectly, to the public in France and only (i) providers of investment services relating to portfolio management for the account of third parties ("*personnes fournissant le service d'investissement de gestion de portefeuille pour compte de tiers*"), and/or (ii) qualified investors acting for their own account ("*Investisseurs Qualifiés*") as defined in and in accordance with Articles L.411-1, L.411-2 and D.411-1 to D.411-3 of the French *Code Monétaire et Financier* are eligible to participate in the Exchange Offers described herein. Neither this Offer Memorandum nor any other offering material relating to the Exchange Offers has been submitted to the clearance of the *Autorité des marchés financiers*.

Public Offer Selling Restriction under the Prospectus Directive

This paragraph shall not apply in respect of the United Kingdom, France or Belgium, in which regard the more specific paragraphs above shall apply.

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a "**Relevant Member State**"), with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the "**Relevant Implementation Date**") no offer of any New Securities is being made to the public in that Relevant Member State under this Offer Memorandum, provided however that offers of New Securities may be made:

(i) to legal entities which are qualified investors as defined in the Prospectus Directive;

(ii) to fewer than 100 or, if the relevant Member State has implemented the relevant provision of Directive 2010/73/EU, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive); or

(iii) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of New Securities above shall require the Bank or the Group to publish a prospectus pursuant to Article 3 of the Prospectus Directive, or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, an offer of New Securities to the public in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the New Securities to be offered so as to enable an investor to decide to participate in the Liability Management Exercise, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State.

General

This Offer Memorandum is intended for the personal use of the recipient only. Under no circumstances should it be reproduced or distributed to any other persons (except that custodians or other intermediaries holding Existing Securities on behalf of a beneficial owner may forward this Offer Memorandum to such beneficial owner in accordance with applicable law and regulation). The distribution of this Offer Memorandum is permitted in the United Kingdom and the United States but may be restricted by law in certain other jurisdictions. Persons into whose possession this Offer Memorandum comes are required to inform themselves about and to observe any such restrictions. This Offer Memorandum does not constitute, and may not be used for the purpose of, an offer or solicitation to the public or to anyone in any jurisdiction in which such offer or solicitation is not authorised or to any person to whom it is unlawful to make such offer or solicitation.

Nothing contained in this Offer Memorandum is intended to constitute or should be construed as legal, financial, accounting or tax advice. This Offer Memorandum is for the information of Holders of Existing Securities only and nothing in this Offer Memorandum is intended to endorse or recommend a particular course of action. Holders of Existing Securities should consult with an appropriate professional for specific advice rendered on the basis of their particular situation.

RESTRICTIONS RELATING TO THE SCHEME

The Explanatory Statement will include details of the offer and distribution restrictions applicable in connection with the securities to be issued by the Bank pursuant to the Scheme. Holders of Dated Notes should carefully read the sections in the Explanatory Statement entitled "*Important Notice*" and "I*mportant Securities Law Notes*" once the Explanatory Statement has been made available.

SECTION G

INFORMATION ON THE BANK, THE GROUP AND THE NEW SECURITIES

Holders of the **Preference Shares** and the **13% Bonds** are directed to:

- the detailed information on the Group and the Group Notes set out in the Group Notes Prospectus

Holders of the **5.5555% Bonds** are directed to:

- the detailed information on the Bank and the Bank T2 Notes set out in the Bank T2 Prospectus

Holders of the **Dated Notes** are directed to:

- the detailed information on the Bank and the Bank T2 Notes set out in the Bank T2 Prospectus
- the detailed information on the Scheme and the New Ordinary Shares set out in the Explanatory Statement

SECTION H

RISK FACTORS AND OTHER CONSIDERATIONS

There are a number of risks and other considerations which may be relevant to a Holder's decision whether or not to participate in the Liability Management Exercise, including risks relating to the Liability Management Exercise, risks relating to an investment in the Bank and the Group and risks relating to the particular nature of the New Securities which such Holder may be eligible to receive through the Liability Management Exercise. Certain of these risks and other considerations have been described by the Bank and the Group (as applicable) in the Prospectuses they have prepared in connection with the Liability Management Exercise and the issue, offer and listing and admission to trading of the New Securities.

Holders of Existing Securities are urged to read carefully and consider those sections which are relevant to them. In particular:

Holders of the **Preference Shares** and the **13% Bonds** are directed to:

- the section headed "*Risk Factors*" in Section 2 of the Group Notes Prospectus

Holders of the **5.5555% Bonds** are directed to:

- the section headed "*Risk Factors*" in Section 2 of the Bank T2 Prospectus

Holders of the **Dated Notes** are directed to:

- Part C (*Risk Factors*) of the Explanatory Statement
- the section headed "*Risk Factors*" in Section 2 of the Bank T2 Prospectus

SECTION I

TAXATION CONSIDERATIONS

In view of the number of different jurisdictions where tax laws may apply to a Holder, this Offer Memorandum does not, save as set out below in respect of certain United Kingdom taxation matters, discuss the tax consequences for Holders arising from the exchange or sale of their Existing Securities pursuant to the Liability Management Exercise, the receipt or transfer of New Ordinary Shares, Group Notes and/or Bank T2 Notes or the receipt of Accrued Dividends or Accrued Interest.

The information regarding United Kingdom taxation set out below is intended as a general summary of certain United Kingdom tax considerations and does not purport to be a complete analysis of all potential UK tax consequences for Holders arising from the exchange or sale of their Existing Securities pursuant to the Liability Management Exercise. It is based on current UK tax law and what is understood to be the published practice of HM Revenue & Customs ("HMRC") as at the date of this Offer Memorandum, both of which are subject to change, possibly with retrospective effect. The information is intended to apply only to Holders who are resident in the UK for UK tax purposes, who hold their Existing Securities as investments (other than under an individual savings account) and who are the beneficial owners of their Existing Securities. The statements may not apply to certain classes of Holders such as dealers in securities. The information below is not exhaustive, nor is it tailored to any specific investor. Holders are also directed to the sections headed "*Taxation*" in each of the Bank T2 Prospectus and the Group Notes Prospectus and the section headed "*Taxation*" in the Explanatory Statement, which contain further information relevant to the potential UK tax consequences of holding Bank T2 Notes, New Ordinary Shares and Group Notes, respectively.

The information below does not constitute tax advice. Holders who are in any doubt as to their tax position regarding the exchange or sale of their Existing Securities in the Offers or pursuant to the Scheme are urged to consult their own professional advisers regarding the possible tax consequences under the laws of the jurisdictions that apply to them.

Holders are liable for their own taxes and have no recourse to the Bank, the Group, the Dealer Managers, the Exchange Agent, the Information Agent, the Registrars or any other entity or person named in this Offer Memorandum, with respect to taxes arising in connection with the Offers or the Scheme.

UNITED KINGDOM TAXATION CONSIDERATIONS

Preference Shares

Taxation of chargeable gains

For the purposes of UK taxation of chargeable gains, the disposal of Preference Shares pursuant to the relevant Exchange Offer or on exercise of the relevant Mandatory Exchange Option may, depending on the Holder's circumstances (including the availability of exemptions and reliefs) give rise to a chargeable gain or an allowable loss for the purposes of the United Kingdom taxation of chargeable gains.

For Holders who opt to sell their Preference Shares to the Group in consideration for a cash amount paid over twelve years (represented by Instalment Repayment Notes), as the consideration for the Preference Shares is payable in instalments it may be possible to pay any capital gains tax in instalments over a period not exceeding 8 years in accordance with section 280 of the Taxation of Chargeable Gains Act 1992.

Stamp duty and stamp duty reserve tax

No UK stamp duty or stamp duty reserve tax ("**SDRT**") should be payable by a Holder of Preference Shares as a result of that Holder participating in the Exchange Offers or being subject to the Mandatory Exchange Option.

Perpetual Subordinated Bonds

13% Bonds

United Kingdom Resident Individuals

On the basis that the 13% Bonds should constitute "qualifying corporate bonds" within the meaning of section 117 of the Taxation of Chargeable Gains Act 1992, the disposal of 13% Bonds by an individual pursuant to the relevant Exchange Offer or on exercise of the relevant Mandatory Exchange Option should not give rise to a chargeable gain or allowable loss for the purposes of the UK taxation of chargeable gains.

Accrued Interest may, subject to certain exemptions (including the exemption for "small holdings" not exceeding £5,000), be chargeable to tax as income under the rules of the accrued income scheme as set out in Part 12 of the Income Tax Act 2007.

United Kingdom Corporation Tax Payers

In general, Holders of 13% Bonds which are within the charge to corporation tax should be charged to tax as income on any returns, profits or gains (whether attributable to currency fluctuations or otherwise) arising from the disposal of the 13% Bonds pursuant to the relevant Exchange Offer or on exercise of the relevant Mandatory Exchange Option broadly in accordance with their statutory accounting treatment.

5.5555% Bonds

United Kingdom Resident Individuals

On the basis that the 5.5555% Bonds should constitute "qualifying corporate bonds" within the meaning of section 117 of the Taxation of Chargeable Gains Act 1992, the disposal of 5.5555% Bonds by an individual in exchange for Bank T2 Notes pursuant to the relevant Exchange Offer or on exercise of the relevant Mandatory Exchange Option should not give rise to a chargeable gain or allowable loss for the purposes of the UK taxation of chargeable gains.

Accrued Interest may, subject to certain exemptions (including the exemption for "small holdings" not exceeding £5,000), be chargeable to tax as income under the rules of the accrued income scheme as set out in Part 12 of the income Tax Act 2007.

United Kingdom Corporation Tax Payers

In general, Holders of 5.5555% Bonds which are within the charge to corporation tax should be charged to tax as income on any returns, profits or gains (whether attributable to currency fluctuations or otherwise) arising from the disposal of the 5.5555% Bonds in exchange for Bank T2 Notes pursuant to the relevant Exchange Offer or on exercise of the relevant Mandatory Exchange Option broadly in accordance with their statutory accounting treatment.

Taxation of deferred interest

Upon successful completion of the Exchange Offers, the deferred interest payment in respect of the 13% Bonds originally scheduled for 31 July 2013 will be paid and the deferred interest payment in respect of the 5.5555% Bonds originally scheduled for 14 December 2013 will also be paid.

UK withholding tax

Any such deferred interest payments on the Perpetual Subordinated Bonds may be made without deduction of or withholding on account of United Kingdom income tax provided that the Perpetual Subordinated Bonds continue to be listed on a "recognised stock exchange" within the meaning of section 1005 of the Income Tax Act 2007 (the "**Act**"). The London Stock Exchange is a recognised stock exchange. Perpetual Subordinated Bonds should be treated as listed on the London Stock Exchange if they are included in the Official List (within the meaning of and in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000) and admitted to trading on the London Stock Exchange. Provided, therefore, that the Perpetual Subordinated Bonds remain so listed at the time of payment, which is expected to be the case, deferred interest on the Perpetual Subordinated Bonds will be payable without withholding or deduction on account of United Kingdom tax.

Further United Kingdom Income Tax Issues

The payment of deferred interest on the Perpetual Subordinated Bonds should constitute United Kingdom source income for tax purposes and, as such, may be subject to income tax by direct assessment even where paid without withholding.

However, interest with a United Kingdom source received without deduction or withholding on account of United Kingdom tax should not be chargeable to United Kingdom tax in the hands of a Holder of Perpetual Subordinated Bonds (other than certain trustees) who is not resident for tax purposes in the United Kingdom unless that Holder carries on a trade, profession or vocation in the United Kingdom through a United Kingdom branch or agency in connection with which the interest is received or to which the Perpetual Subordinated Bonds are attributable (and where that Holder is a company, unless that Holder carries on a trade in the United Kingdom through a permanent establishment in connection with which the interest is received or to which the Perpetual Subordinated Bonds are attributable). There are exemptions for interest received by certain categories of agent (such as some brokers and investment managers). The provisions of an applicable double taxation treaty may also be relevant for such Holders.

Holders of Perpetual Subordinated Bonds which are within the charge to United Kingdom corporation tax should be charged to tax as income on all deferred interest broadly in accordance with their statutory accounting treatment.

Stamp duty and SDRT

No UK stamp duty or SDRT should be payable by a Holder of Perpetual Subordinated Bonds as a result of that Holder participating in the relevant Exchange Offer or being subject to the relevant Mandatory Exchange Option.

Dated Notes

Exchange of Dated Notes for New Ordinary Shares and Bank T2 Notes pursuant to the Scheme

United Kingdom Resident Individuals

The tax treatment of UK resident individual Holders of Dated Notes will depend on whether the Dated Notes that they hold constitute "qualifying corporate bonds". The Euro-denominated Dated Notes will not be "qualifying corporate bonds" for these purposes.

UK resident individual Holders of Dated Notes should consult their own tax advisers as to whether the Dated Notes that they hold constitute "qualifying corporate bonds" and the consequences of the disposal of such Dated Notes pursuant to the Scheme.

Dated Notes that are "qualifying corporate bonds"

Where the Dated Notes are "qualifying corporate bonds" within the meaning of section 117 of the Taxation of Chargeable Gains Act 1992, the disposal pursuant to the Scheme of those Dated Notes by an individual in exchange for New Ordinary Shares and Bank T2 Notes should not give rise to a chargeable gain or allowable loss for the purposes of the UK taxation of chargeable gains.

Accrued Interest may, subject to certain exemptions (including the exemption for "small holdings" not exceeding £5,000), be chargeable to tax as income under the rules of the accrued income scheme as set out in Part 12 of the income Tax Act 2007.

Euro-denominated Dated Notes that are not "qualifying corporate bonds"

Where the euro-denominated Dated Notes are not "qualifying corporate bonds" within the meaning of section 117 of the Taxation of Chargeable Gains Act 1992, the disposal pursuant to the Scheme of those euro-denominated Dated Notes by an individual in exchange for New Ordinary Shares and Bank T2 Notes may, depending on the Holder's circumstances (including the availability of exemptions and reliefs) give rise to a chargeable gain or an allowable loss.

Accrued Interest may, subject to certain exemptions (including the exemption for "small holdings" not exceeding £5,000), be chargeable to tax as income under the rules of the accrued income scheme as set out in Part 12 of the income Tax Act 2007, but such Accrued Interest should be excluded when calculating the chargeable gain or allowable loss realised by such Holder.

Any gain or loss that would otherwise have arisen on a disposal of the euro-denominated Dated Notes in exchange for New Ordinary Shares should be "rolled-over" into the New Ordinary Shares so that a Holder's holding of New Ordinary Shares should be treated as the same asset, acquired at the time he acquired his euro-denominated Dated Notes and for a proportion of the same acquisition cost (under the provisions of section 132 of the Taxation of Chargeable Gains Act 1992).

Any gain or loss that would otherwise have arisen on a disposal of the euro-denominated Dated Notes in exchange for Bank T2 Notes should be deferred and treated as arising only on a subsequent disposal of the Bank T2 Notes (under the provisions of sections 132 and 116(10) of the Taxation of Chargeable Gains Act 1992).

United Kingdom Corporation Tax Payers

In general, Holders of Dated Notes which are within the charge to corporation tax should be charged to tax as income on any returns, profits or gains (whether attributable to currency fluctuations or otherwise) arising from the disposal of the Dated Notes in exchange for New Ordinary Shares and Bank T2 Notes pursuant to the Scheme broadly in accordance with their statutory accounting treatment.

Capitalisation of accrued but unpaid interest

The issue of New Ordinary Shares or Bank T2 Notes in lieu of accrued but unpaid interest on the Dated Notes should be treated as a payment of interest by Bank (under the provisions of section 380 of the Income Tax (Trading and Other Income) Act 2005 and section 413 of the Corporation Tax Act 2009).

UK withholding tax

There should be no requirement to deduct or withhold amounts for or on account of United Kingdom income tax in relation to the issue of the New Ordinary Shares or Bank T2 Notes provided that the Dated Notes continue to be listed on a "recognised stock exchange" within the meaning of section 1005 of the Income Tax Act 2007 (the "Act"). The London Stock Exchange is a recognised stock exchange. Dated Notes should be treated as listed on the London Stock Exchange if they are included in the Official List (within the meaning of and in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000) and admitted to trading on the London Stock Exchange. Provided, therefore, that the Dated Notes remain so listed at the time the New Ordinary Shares or Bank T2 Notes are issued, which is expected to be the case, there should be no requirement to deduct or withhold amounts for or on account of United Kingdom tax in relation to the issue of the New Ordinary Shares or Bank T2 Notes in lieu of accrued but unpaid interest on the Dated Notes.

Further United Kingdom Income Tax Issues

The issue of New Ordinary Shares or Bank T2 Notes in lieu of accrued but unpaid interest on the Dated Notes should constitute United Kingdom source income for tax purposes and, as such, United Kingdom resident individuals may be subject to income tax by direct assessment on an amount equal to the market value of the New Ordinary Shares or Bank T2 Notes received in lieu of accrued but unpaid interest on the Dated Notes at the time of issue.

However, where New Ordinary Shares or Bank T2 Notes are received without deduction or withholding on account of United Kingdom tax there should be no charge to United Kingdom tax in the hands of a Holder of Dated Notes (other than certain trustees) who is not resident for tax purposes in the United Kingdom unless that Holder carries on a trade, profession or vocation in the United Kingdom through a United Kingdom branch or agency in connection with which the interest is received or to which the Dated Notes are attributable (and where that Holder is a company, unless that Holder carries on a trade in the United Kingdom through a permanent establishment in connection with which the interest is received or to which the Dated

Notes are attributable). There are exemptions for interest received by certain categories of agent (such as some brokers and investment managers). The provisions of an applicable double taxation treaty may also be relevant for such Holders.

Holders of Dated Notes which are within the charge to United Kingdom corporation tax should be treated as receiving an amount an amount of interest equal to the market value of the New Ordinary Shares or Bank T2 Notes received in lieu of accrued but unpaid interest on the Dated Notes at the time of issue. Holders of Dated Notes which are within the charge to United Kingdom corporation tax should charged to tax as income on such interest broadly in accordance with their statutory accounting treatment.

Additional New Ordinary Shares Offer

Holders are directed to the section headed "*Taxation*" in the Explanatory Statement for further information on the Additional New Ordinary Shares available for subscription pursuant to the Scheme.

Stamp duty and SDRT

No UK stamp duty or SDRT should be payable by a Holder of Dated Notes as a result of that Holder exchanging its Dated Notes for New Ordinary Shares or Bank T2 Notes pursuant to the Scheme.

SECTION J

DEALER MANAGERS, EXCHANGE AGENT, INFORMATION AGENT AND REGISTRARS

The Bank and the Group have retained HSBC Bank plc and UBS Limited to act as Dealer Managers for the Liability Management Exercise and Lucid Issuer Services Limited to act as Exchange Agent in respect of the Offers and Information Agent in respect of the Scheme. Computershare Investor Services PLC is registrar in respect of the Preference Shares and Equiniti Limited is registrar in respect of the Perpetual Subordinated Bonds.

The Dealer Managers and their affiliates may contact Holders regarding the Liability Management Exercise and may request brokerage houses, custodians, nominees, fiduciaries and others to forward this Offer Memorandum and related materials to Holders. The Bank and the Group have entered into a Dealer Manager Agreement on or about 4 November 2013 with the Dealer Managers, which contains certain provisions regarding payment for fees, expense reimbursement and indemnity arrangements. The Dealer Managers and their respective affiliates have provided and may continue to provide certain investment banking services to the Bank and the Group for which they have received and will receive compensation that is customary for services of such nature.

None of the Dealer Managers, the Exchange Agent, the Information Agent, the Registrars and their respective directors, employees or affiliates:

(A) assumes any responsibility for the accuracy or completeness of the information contained or referred to in this Offer Memorandum concerning the Liability Management Exercise or any part thereof, the Bank, the Group, the Existing Securities or the New Securities or any of them, or for any failure by the Bank and the Group to disclose events that may have occurred and may affect the significance or accuracy of the information in this Offer Memorandum; or

(B) expresses any view on the merits of, or makes any representation or recommendation whatsoever regarding, the Liability Management Exercise or any part thereof, including (without limitation) as to whether or not Holders should participate in the Liability Management Exercise.

Each of the Dealer Managers may submit Exchange Instructions and/or Account Holder Letters and/or enter into Lock-up Agreements (i) for its own account and/or (ii) subject to the Offer Restrictions, on behalf of other Holders.

The Exchange Agent, the Information Agent and the Registrars are agents of the Bank and/or the Group, as applicable, and owe no duty to any Holder except in the limited circumstances described in this Offer Memorandum.

The Dealer Managers are acting exclusively for the Bank and the Group and for no one else in connection with the arrangements described in this Offer Memorandum. The Dealer Managers and their respective directors, employees and affiliates will not be responsible to any Holder for providing the protections afforded to customers of the Dealer Managers or for advising any other person in connection with the arrangements described in this Offer Memorandum.

SECTION K

GENERAL NOTICES AND IMPORTANT INFORMATION

Holders of Existing Securities should only rely on the information contained in this Offer Memorandum, the Prospectuses and the Scheme Documents (as applicable) and any documents incorporated herein or therein by reference. No person has been authorised to give any information or make any representations other than those contained in such documents and, if given or made, such information or representations must not be relied upon as having been so authorised.

The contents of this Offer Memorandum and any information referred to herein should not be construed as legal, financial, accounting or tax advice. This Offer Memorandum is for your information only and nothing in this Offer Memorandum is intended to endorse or recommend a particular course of action. Each Holder should consult its own accountant or legal, financial and/or tax advisers for advice.

None of the Dealer Managers, the Exchange Agent, the Information Agent or the Registrars accepts any responsibility whatsoever for the contents of this Offer Memorandum and/or the information referred to herein, including in relation to the accuracy, completeness and/or verification thereof, and/or for any other statement made or purported to be made by any of them, or on behalf of any of them, which is consistent with the contents of this Offer Memorandum in connection with the Bank, the Group, the Existing Securities, the New Securities and/or the Liability Management Exercise or any other matter referred to in this Offer Memorandum. Each of the Dealer Managers, the Exchange Agent, the Information Agent and the Registrars disclaims all and any liability whatsoever arising in tort, contract or otherwise which any of them might otherwise have in respect of this Offer Memorandum or any such statement.

Each of HSBC Bank plc and UBS Limited are authorised by the PRA and regulated by the PRA and the FCA. To the fullest extent permitted by applicable law and regulation, no person will become a client of either Dealer Manager (within the meaning of the FCA's rules) by virtue of receipt of this Offer Memorandum or participation in the Liability Management Exercise or any component part thereof. The Dealer Managers are acting on their own account in relation to the Liability Management Exercise and, to the fullest extent permitted by applicable law and regulation, will not be responsible to any other person for providing the protections which would be afforded to clients of either Dealer Manager or for providing advice in relation to the Liability Management Exercise or any component part thereof.

Lucid Issuer Services Limited is authorised and regulated by the FCA. To the fullest extent permitted by applicable law and regulation, no person will become a client of Lucid Issuer Services Limited (within the meaning of the FCA's rules) by virtue of receipt of this Offer Memorandum or participation in the Liability Management Exercise or any component part thereof. Lucid Issuer Services Limited will not be responsible to any other person for providing the protections which would be afforded to clients or for providing advice in relation to the Liability Management Exercise or any component part thereof.

Canaccord Genuity Limited is authorised and regulated in the United Kingdom by the FCA. To the fullest extent permitted by applicable law and regulation, no person will become a client of Canaccord Genuity Limited (within the meaning of the FCA's rules) by virtue of receipt of this Offer Memorandum or participation in the Liability Management Exercise or any component part thereof. Canaccord Genuity Limited will not be responsible to any other person for providing the protections which would be afforded to clients or for providing advice in relation to the Liability Management Exercise or any component part thereof.

No offer is being made in connection with the Liability Management Exercise in any jurisdiction in which the making of the offer would not be in compliance with the laws or regulations of such jurisdictions. However, this is without prejudice to a Holder's rights under its Existing Securities.

The Law Debenture Trust Corporation p.l.c., as trustee for certain of the Existing Securities, has not been involved in the formulation of, and does not express any opinion on the merits of, or make any representation

or recommendation whatsoever regarding the terms of, the Liability Management Exercise or any part thereof or this Offer Memorandum. Except as expressly envisaged under the trust deeds dated 1 August 2009 constituting the Perpetual Subordinated Bonds in connection with the convening of the Meetings to consider the Proposals in respect of the Perpetual Subordinated Bonds, The Law Debenture Trust Corporation p.l.c. has not approved any matters in connection with the Liability Management Exercise or any information referred to in this Offer Memorandum, and neither it nor any of its directors, officers, employees or affiliates has verified or assumes any responsibility for the accuracy, completeness, validity or correctness of any of the information contained in or referred to in this Offer Memorandum. The Law Debenture Trust Corporation p.l.c. urges Holders who are in any doubt as to the impact of the Liability Management Exercise to seek their own financial, legal and other advice as they consider appropriate.

The Co-operative Bank p.l.c. is an authorised person, authorised and regulated by the Prudential Regulation Authority under the Financial Services and Markets Act 2000. In the United Kingdom, it is a criminal offence to acquire 10 per cent. or more of the shares or voting power in an authorised person without notifying the Prudential Regulation Authority or without obtaining the prior approval of the Prudential Regulation Authority. If any Holder of Dated Notes considers that it may, as a result of the Liability Management Exercise, acquire 10 per cent. or more of the ordinary shares in the Bank, it is advised to seek independent legal advice.

Websites

Any information regarding the Bank, the Group, the Liability Management Exercise, the Existing Securities and/or the New Securities appearing on the website of the Bank, the Group or any other person is for convenience only, does not form part of this Offer Memorandum and should not be relied upon by Holders making a decision whether or not to participate in the Liability Management Exercise.

Such Holders should have regard only to the relevant Prospectuses (including this Offer Memorandum as appended to each of the Prospectuses) and, in the case of Holders of Dated Notes, the Scheme Documents, and are strongly recommended to read them carefully.

SECTION L

DEFINITIONS

The following definitions apply throughout this Offer Memorandum unless the context otherwise requires:

"**13% Bonds**"	The Bank's 13% Perpetual Subordinated Bonds (ISIN: GB00B3VH4201).
"**13% Bondholders Meeting**"	The Meeting convened for the Holders of the 13% Bonds to vote on the Extraordinary Resolution proposed at such Meeting (and, if such Meeting is adjourned, shall include the adjourned meeting).
"**2016 Notes**"	The Bank's Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998).
"**5.5555% Bonds**"	The Bank's 5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45).
"**5.5555% Bondholders Meeting**"	The Meeting convened for the Holders of the 5.5555% Bonds to vote on the Extraordinary Resolution proposed at such Meeting (and, if such Meeting is adjourned, shall include the adjourned meeting).
"**Acceptance Conditions**"	The conditions which must be satisfied before the Bank is able to accept offers to exchange or sell Preference Shares or Perpetual Subordinated Bonds, as described at paragraph 9 of Section C, Part 1 of this Offer Memorandum.
"**Account Holder**"	A Direct Participant holding an interest in any Dated Notes in an account with Euroclear or Clearstream, Luxembourg at the Scheme Record Date.
"**Account Holder Letter**"	A letter to be submitted by an Account Holder on behalf of a Holder of Dated Notes, substantially in the form which will be set out in the Explanatory Statement.
"**Accrued Dividends**"	In respect of any Preference Shares accepted for exchange or sale in the relevant Exchange Offer, an amount equal to any accrued and unpaid dividends to be paid on the Settlement Date in accordance with the terms of such Exchange Offer, calculated on the basis of the terms of the Preference Shares set out in the Articles of Association and on the assumption that dividends accrue from day-to-day on a non-compounding basis.
"**Accrued Interest**"	In respect of any Perpetual Subordinated Bonds accepted for exchange or sale in the relevant Exchange Offer, an amount equal to any accrued and unpaid interest (excluding, for these purposes, any interest which has been deferred on a scheduled payment date) to be paid on the Settlement Date in accordance with the terms of the relevant Exchange Offer, calculated in accordance with the terms and conditions of such Perpetual Subordinated Bonds.
"**Additional New Ordinary Shares**"	62,500,000 New Ordinary Shares to be issued by the Bank pursuant to the Additional New Ordinary Shares Offer for an aggregate consideration equal to £125 million.

"**Additional New Ordinary Shares Offer**"	The offer of the Additional New Ordinary Shares to Holders of the Dated Notes for subscription under the terms of the Scheme.
"**Additional Preference Shares**"	Additional Preference Shares allotted (or deemed to be allotted) allotted on or around 29 November 2013 in lieu of a cash dividend scheduled for 30 November 2013 (and for these purposes, 6¼ per cent. of the aggregate nominal amount of the Preference Shares outstanding will be deemed to have been so allotted and to so constitute such amount of Additional Preference Shares).
"**Articles of Association**"	The Bank's Articles of Association.
"**Bank**"	The Co-operative Bank p.l.c. (incorporated with limited liability in England with registered number 990937).
"**Bank T2 Notes**"	New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853; SEDOL: BFXW085) which may be issued by the Bank pursuant to the Liability Management Exercise.
"**Bank T2 Prospectus**"	The prospectus dated 4 November 2013 and issued by the Bank in connection with the issue, offer and listing and admission to trading of the Bank T2 Notes, including any supplement(s) thereto (if any) which may be issued after that date.
"**beneficial owner**"	A person who is the owner of an interest in a particular nominal or principal amount of Existing Securities held in a Clearing System, as shown in the records of the relevant Clearing System or its participants.
"**Business Day**"	A day other than a Saturday or Sunday or a public holiday on which commercial banks and foreign exchange markets are open for business in London.
"**Certificated Holding Exchange Instruction**"	The form of Exchange Instruction to be submitted by Eligible Holders who hold Preference Shares or Perpetual Subordinated Bonds in certificated form outside the Clearing Systems and who wish to offer to exchange or sell their Preference Shares or Perpetual Subordinated Bonds (as the case may be) in the relevant Exchange Offer.
"**Chairman**"	The appointed Chairman at any Meeting.
"**Clearing System Notice**"	The relevant notice to be sent to Direct Participants (or, if applicable, CREST Participants) by each Clearing System on or about the date of this Offer Memorandum informing Direct Participants (or, where applicable, CREST Participants), *inter alia*, of the procedures to be followed in order to participate in the Liability Management Exercise.
"**Clearing Systems**"	Euroclear, Clearstream, Luxembourg and CREST (and each a "**Clearing System**").
"**Clearstream, Luxembourg**"	Clearstream Banking, *société anonyme*.
"**Common Equity Tier 1 capital**"	A form of regulatory capital, having a specific meaning in prevailing prudential and capital adequacy laws and regulations applicable in England. *Banks and other financial institutions are required to maintain certain levels of regulatory capital in order to absorb losses, with a view to enabling them to better withstand financial shocks.*

"**Computershare**"	Computershare Investor Services PLC.
"**Conversion Price**"	The notional price derived from the *pro rata* share of the 112,500,000 New Ordinary Shares available to Holders of Dated Notes in the Scheme in exchange for their aggregate Scheme Claims.
"**Court**"	The High Court of Justice of England and Wales.
"**CREST**"	The relevant system (as defined in the CREST Regulations) in respect of which EUI is the operator (as defined in the CREST Regulations).
"**CREST Manual**"	The rules governing the operation of CREST, consisting of the CREST Reference Manual, CREST International Manual, CREST Central Counterparty Service Manual, CREST Rules, Registrars Service Standards, Settlement Discipline Rules, CCSS Operations Manual, Daily Timetable, CREST Application Procedure and CREST Glossary of Terms (all as defined in the CREST Glossary of Terms).
"**CREST Participant**"	A person who is, in relation to CREST, a system-participant (as defined in the CREST Regulations).
"**CREST Regulations**"	The Companies Act 1996 (Uncertificated Securities) Regulations 1996 (S.I. No 68/1996) and the UK Uncertificated Securities Regulations 2001 (SI 2001No. 2001/3755), including any modifications thereof or any regulations in substitution therefor and for the time being in force.
"**Dealer Managers**"	HSBC Bank plc and UBS Limited (and each a "**Dealer Manager**").
"**Dated Notes**"	The following lower tier 2 bonds issued by the Bank: • Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) • 5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942) • 9.25% Subordinated Notes due 28 April 2021 (ISIN: XS0620315902) • Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984) • 7.875% Subordinated Notes due 19 December 2022 (ISIN: XS0864253868) • 5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183) • 5.875% Subordinated Notes due 2033 (ISIN: XS0145065602) (and each a "**Series**" of Dated Notes).
"**Designated Recipient**"	A person nominated by a Holder of Dated Notes in an Account Holder Letter to receive the New Ordinary Shares and Bank T2 Notes which such Holder is entitled to receive pursuant to the terms of the Scheme.

"**Direct Participant**"	Each person who is shown in the records of Euroclear or Clearstream, Luxembourg as a holder of an interest in the Existing Securities.
"**Early Consideration Amount**"	In respect of each Exchange Offer, the Early Consideration Amount set out in the summary offering table relevant to such Exchange Offer (see Section B of this Offer Memorandum).
"**Early Participation Deadline**"	4.30 p.m. (London time) on 29 November 2013 (subject to the right of the Bank and/or the Group to amend such date upon notice to Holders).
"**Early Participation Threshold**"	Has the meaning given in paragraph 3 of Part 1 of Section C of this Offer Memorandum.
"**Eligible Holder**"	A Holder that is eligible to participate in the Liability Management Exercise, or the relevant component part thereof, in accordance with the Offer Restrictions (and "**Holder**" shall be construed accordingly unless the context otherwise admits).
"**Equiniti**"	Equiniti Limited.
"**ESA Instruction**"	An escrow account adjustment input (AESN), transaction type "ESA" (as described in the CREST Manual).
"**EUI**"	Euroclear UK & Ireland Limited (previously CRESTCo Limited).
"**euro**" or "**€**"	The lawful currency of the member states of the European Union that have adopted the single currency in accordance with the Treaty on the functioning of the European Union, as amended.
"**Euroclear**"	Euroclear Bank S.A./N.V.
"**Exchange Agent**"	Lucid Issuer Services Limited, in its capacity as exchange agent in respect of the Offers.
"**Exchange Instruction**"	An instruction pursuant to which an Eligible Holder may, by the relevant deadlines, offer to exchange or sell (as the case may be) its Preference Shares or Perpetual Subordinated Bonds in the relevant Exchange Offer, and shall more particularly mean: (i) in respect of Preference Shares and Perpetual Subordinated Bonds held through Euroclear and Clearstream, Luxembourg, the electronic exchange or tender and blocking instruction in the form specified in the Clearing System Notice for submission by Direct Participants via Euroclear or Clearstream, Luxembourg and in accordance with the requirements of Euroclear or Clearstream, Luxembourg; (ii) in respect of Preference Shares and Perpetual Subordinated Bonds held through CREST, the settlement of a TTE Instruction in respect of the Holder's Preference Shares or Perpetual Subordinated Bonds, specifying the relevant Registrar as escrow agent; and (iii) in respect of Preference Shares and Perpetual Subordinated Bonds held in certificated form outside the Clearing Systems, the appropriate form of Certificated Holding

	Exchange Instruction to be mailed to relevant Holders and available from the relevant Registrar.
"**Exchange Offers**"	The invitations described in this Offer Memorandum by the Bank and the Group (as applicable) to Eligible Holders to offer to exchange or sell (as the case may be) their Preference Shares and Perpetual Subordinated Bonds and receive Final Repayment Notes, cash payable in instalments over twelve years (represented by Instalment Repayment Notes) or Bank T2 Notes (as the case may be) (and the offer in respect of each Series of Perpetual Subordinated Bonds and the Preference Shares Existing Securities each being an "**Exchange Offer**").
"**Existing Securities**"	The Preference Shares, the Perpetual Subordinated Bonds and the Dated Notes.
"**Explanatory Statement**"	The explanatory statement relating to the Scheme expected to be available by the Bank to Scheme Creditors on or around 19 November 2013.
"**Expiration Deadline**"	4.30 p.m. (London time) on 6 December 2013 (subject to the right of the Bank and/or the Group to amend such date upon notice to Holders).
"**Extraordinary Resolution**"	In respect of the Preference Shares and each Series of Perpetual Subordinated Bonds, the extraordinary resolution to be proposed at the relevant Meeting of Holders of such securities.
"**Final Repayment Notes**"	Sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630; SEDOL: BFXW063) which may be issued by the Group pursuant to the Liability Management Exercise and guaranteed (on a subordinated basis) by certain of the Group's subsidiaries.
"**General Meeting**"	The general meeting of the Bank convened for the holders of both the ordinary shares and the Preference Shares of the Bank to approve a resolution on substantially the same terms as the resolution proposed at the Preference Shareholders Meeting (and, if such meeting is adjourned, shall include the adjourned meeting).
"**Group**"	Co-operative Group Limited (incorporated and registered in England under the Industrial and Provident Societies Act 1965 to 2003 with registered number IP525R).
"**Group Notes**"	The Final Repayment Notes and/or the Instalment Repayment Notes, as the context admits.
"**Group Notes Prospectus**"	The prospectus dated 4 November 2013 and issued by the Group in connection with the issue, offer and listing and admission to trading of the Group Notes, including any supplement(s) thereto (if any) which may be issued after that date.
"**HMRC**"	HM Revenue & Customs.
"**Holder**"	Means (except as otherwise provided under the terms of the Scheme in respect of Holders of Dated Notes) a Holder of Existing Securities, which shall unless the context otherwise requires include:

(i) each Direct Participant or CREST Participant in respect of the Existing Securities;

(ii) any broker, dealer, commercial bank, trust company, custodian or other nominee or intermediary who holds Existing Securities on behalf of a beneficial owner; and

(iii) each beneficial owner of the Existing Securities, including Holders who hold their Existing Securities in certificated form outside the Clearing Systems and Holders who hold beneficial interests in Existing Securities through a Clearing System or another intermediary,

except that for the purposes of settling any Holder's entitlement to New Securities, Accrued Dividends, Accrued Interest and/or other amounts payable under the terms of the Liability Management Exercise, to the extent the beneficial owner of the relevant Existing Securities is not itself the direct holder of legal title to the Existing Securities, the Holder shall be the direct holder of legal title, to whom (or to whose order) delivery of the relevant New Securities and/or payment of the relevant Accrued Dividends, Accrued Interest and/or other relevant amounts will discharge the obligations of the Bank and the Group (as the case may be) in respect of such delivery and/or payment pursuant to the terms of the Liability Management Exercise.

"**Holding Period**" — The period of 36 months commencing on the Scheme Settlement Date.

"**Holding Period Trustee**" — Lucid Issuer Services Limited, as holding period trustee in respect of the Scheme.

"**Information Agent**" — Lucid Issuer Services Limited, as information agent in respect of the Scheme.

"**Instalment Repayment Notes**" — Sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29; SEDOL: BFXWHQ2), having their last payment date in 2025, which may be issued by the Group pursuant to the Liability Management Exercise and guaranteed (on a subordinated basis) by certain of the Group's subsidiaries.

"**Late Consideration Amount**" — In respect of each Exchange Offer, the Late Consideration Amount set out in the summary offering table relevant to such Exchange Offer (see Section B of this Offer Memorandum).

"**Liability Management Exercise**" — The liability management exercise of the Bank and the Group described in this Offer Memorandum, including the Exchange Offers and Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds and the Scheme in respect of the Dated Notes.

"**Lock-up Agreement**" — An agreement between the Bank and a Holder of Dated Notes, pursuant to which that Holder has agreed, among other things and subject to certain conditions, to vote the full amount of its Scheme Claim in favour of the Scheme.

"**Lock-up Arrangements**" — A Lock-up Agreement or a Lock-up Undertaking.

"**Lock-up Undertaking**"	An undertaking by an Account Holder given on behalf of a Holder of Dated Notes in favour of the Bank pursuant to a valid Account Holder Letter delivered to the Information Agent on behalf of that Holder, pursuant to which that Holder has agreed, among other things and subject to certain conditions, to vote the full amount of its Scheme Claim in favour of the Scheme.
"**London Stock Exchange**"	The London Stock Exchange plc.
"**Mandatory Exchange Option**"	In respect of each of the Preference Shares, the 13% Bonds and the 5.5555% Bonds, the option of the Bank (if the Extraordinary Resolution at the relevant Meeting is passed and the relevant Proposal implemented) to mandatorily effect the transfer of Preference Shares and 13% Bonds (which are not exchanged or sold pursuant to the Exchange Offers) to the Group and to mandatorily effect the exchange of 5.5555% Bonds (which are not exchanged or sold pursuant to the Exchange Offers), in each case on the same economic terms as Preference Shares, 13% Bonds and 5.5555% Bonds, respectively, are exchanged or sold (as the case may be) in the Exchange Offers.
"**Meeting**"	In respect of the Preference Shares and each Series of Perpetual Subordinated Bonds, the meeting of Holders of such securities convened to consider the relevant Extraordinary Resolution (and any adjournment thereof).
"**New Ordinary Shares**"	New voting ordinary shares in the Bank (with ISIN GB00BDW0BX87 and SEDOL number BDW0BX8) which may be issued pursuant to the Liability Management Exercise.
"**New Securities**"	The New Ordinary Shares, the Final Repayment Notes, the Instalment Repayment Notes and/or the Bank T2 Notes, as the context admits.
"**Notice of Meeting**"	The relevant notice convening each Meeting.
"**Notifying News Service**"	A recognised financial news service or services as selected by the Bank (e.g. Reuters/Bloomberg).
"**Offer Memorandum**"	This Consent and Exchange Offer Memorandum.
"**Offer Record Date**"	Expected to be 11 December 2013, unless any Meeting is required to be adjourned for want of a quorum (in which case the Offer Record Date is expected to be on or around 27 December 2013). The Offer Record Date is the last date on which Preference Shares, 13% Bonds and 5.5555% Bond can be traded.
"**Offer Restrictions**"	The offer restrictions set out in Section F of this Offer Memorandum (in respect of the Exchange Offers) and the offer restrictions set out in the Explanatory Statement (in respect of the Scheme).
"**Offers**"	The Exchange Offers and the Proposals.
"**Official List**"	The Official List maintained by the Financial Conduct Authority.
"**Perpetual Subordinated Bondholders Meeting**"	Each Meeting convened for the Holders of each Series of Perpetual Subordinated Bonds.

"**Perpetual Subordinated Bonds**"	The following bonds issued by the Bank: • 13% Perpetual Subordinated Bonds (ISIN: GB00B3VH4201) • 5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) (and each a "**Series**" of Perpetual Subordinated Bonds). *The Perpetual Subordinated Bonds were issued by the Bank in replacement of Britannia Building Society permanent interest bearing shares on its merger with Britannia on 1 August 2009.*
"**PRA**"	The Prudential Regulation Authority.
"**Preference Shareholders Meeting**"	The Meeting convened for the Holders of the Preference Shares to vote on the Extraordinary Resolution proposed at such Meeting (and, if such Meeting is adjourned, shall include the adjourned meeting).
"**Preference Shares**"	The Bank's 9.25 per cent. Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516).
"**Proposals**"	The proposals inviting Holders of Preference Shares and Perpetual Subordinated Bonds to vote on the Extraordinary Resolutions at the Meetings, in order to (amongst other things) approve modifications to the terms and conditions of the relevant Series (and each proposal being a "**Proposal**").
"**Prospectus Directive**"	Directive 2003/71/EC, as amended (including by Directive 2010/73/EU), of the European Parliament and Council and, where the context admits, includes any relevant implementing measure in any Member State of the European Economic Area.
"**Prospectuses**"	The Group Notes Prospectus and the Bank T2 Prospectus, and each a "**Prospectus**".
"**Recapitalisation Plan**"	The recapitalisation plan originally announced on 17 June 2013 by the Bank and the Group to strengthen the Bank's capital base.
"**Registrars**"	Computershare (in respect of the Preference Shares) and Equiniti (in respect of each Series of Perpetual Subordinated Bonds), and references to the "**relevant Registrar**" shall be construed accordingly.
"**Regulation S**"	Regulation S under the Securities Act.
"**RNS**"	Regulatory News Service operated by the London Stock Exchange.
"**Scheme**" or "**Scheme of Arrangement**"	The Bank's proposed scheme of arrangement in respect of the Dated Notes under Part 26 of the Companies Act 2006.
"**Scheme Chairman**"	The appointed Chairman at the Scheme Meeting.
"**Scheme Claim**"	The claim of a Holder of Dated Notes in the Scheme, being an amount equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date; provided that a Holder's Scheme Claim in respect of 2016 Notes (which are denominated in euro) shall be the

	Sterling-Equivalent of such sum, calculated on the basis of the Scheme FX Rate.
"**Scheme Consideration**"	The consideration to be provided to Holders of Dated Notes exchanged pursuant to the Scheme, as more fully described at paragraph 3 of Part 1 of Section D of this Offer Memorandum.
"**Scheme Convening Hearing**"	The initial Court hearing at which the Bank will seek leave to convene the Scheme Meeting, and which is expected to be held on 18 November 2013.
"**Scheme Creditors**"	The Holders of the Dated Notes.
"**Scheme Documents**"	The Explanatory Statement and other accompanying documents which will be made available to Scheme Creditors following the Scheme Convening Hearing at: http://www.co-operative.coop/bondholders.
"**Scheme Effective Date**"	The date upon which the sanction order relating to the Scheme is delivered to the registrar of companies at Companies House (at which point, the Scheme will become effective), which is currently expected to be on or around 17 December 2013.
"**Scheme FX Rate**"	£0.85644 per €1.00. *The Scheme FX Rate was determined on 30 October 2013 as the spot rate of exchange between euro and sterling appearing on or derived from the Bloomberg service designated as the "FXC" page for the purpose of displaying the euro/sterling exchange rate.*
"**Scheme Meeting**"	The meeting convened for Scheme Creditors to vote in favour of the proposals under the Scheme.
"**Scheme Record Date**"	10 December 2013.
"**Scheme Sanction Hearing**"	The second Court hearing, at which the Bank will request the sanction of the Scheme by the Court, and which is expected to be held on 16 December 2013.
"**Scheme Settlement Date**"	The date on which the Scheme settles, currently expected to be 18 December 2013.
"**Securities Act**"	The United States Securities Act of 1933, as amended.
"**Series**"	One or more series of Existing Securities (as the context admits).
"**Settlement Condition**"	The condition which must be satisfied in order for the Liability Management Exercise to settle, as more fully described in paragraph 8 of Part 1 of Section C to this Offer Memorandum.
"**Settlement Date**"	The date on which the Liability Management Exercise settles, currently expected to be 18 December 2013 (subject to the right of the Bank and/or the Group to amend such date upon notice to Holders).
"**Sterling**" or "**£**"	Pounds sterling, the lawful currency of the United Kingdom.
"**Sterling-Equivalent**"	The sterling-equivalent amount of euro amounts in respect of the 2016 Notes, determined by reference to the Scheme FX Rate.

"**Trustee**"	The Law Debenture Trust Corporation p.l.c. as trustee in respect of certain of the Existing Securities.
"**TTE Instruction**"	The "transfer to escrow" instruction pursuant to which CREST Participants may offer to exchange or sell Preference Shares and Perpetual Subordinated Bonds held in CREST pursuant to the terms of the Exchange Offers.
"**United Kingdom**" or "**UK**"	United Kingdom of Great Britain and Northern Ireland.
"**U.S. Holder**"	A Holder who is located or resident in the United States or who is a U.S. person.
"**U.S. person**"	A "U.S. person" as defined in Regulation S under the Securities Act.
"**Voting Instruction Deadline**"	The voting deadline in respect of the Scheme, which is expected to be 4.30 p.m. (London time) on 10 December 2013.

Interpretation of "offered for exchange", "exchange" and similar expressions:

There are a number of references in this document to Existing Securities being "offered for exchange", "exchanged" and similar expressions. Where these expressions are used in the context of holders of Preference Shares or 13% Bonds who elect the Instalment Repayment Notes option, such expressions are used for the Holders' convenience only in understanding what is being proposed, and must not be treated as a technical legal description of the mechanism through which they will receive the Instalment Repayment Notes. As set out in Part 1 of Section C of this Offer Memorandum, Holders of Preference Shares and 13% Bonds who opt for Instalment Repayment Notes will actually be selling their Preference Shares or 13% Bonds (as the case may be) to the Group in return for the cash consideration which will be payable in twelve equal instalments and it is these instalment payments which will be represented by the Instalment Repayment Notes.

SECTION M

INDICATIVE TIMETABLE FOR THE LIABILITY MANAGEMENT EXERCISE

The indicative timetable in this Section collates the indicative timetables for the Offers in respect of the Preference Shares, 13% Bonds and 5.5555% Bonds and the Scheme in respect of the Dated Notes.

The times and dates referred to below are indicative only and are subject to the right of the Bank and/or the Group to extend, re-open, amend and/or terminate the Exchange Offers or any of them at any time and the right of the Bank (if required or permitted by the Court) to amend and/or withdraw the Scheme at any time. Accordingly, the actual timetable may differ significantly from the expected timetable set out below.

If any of the below times and/or dates change, the revised time(s) and/or date(s) will be announced by the Bank and/or the Group as soon as reasonably practicable.

Scheme Events	*Dates and Times (all times are London time)*	*Offer Events*
Announcement of the Scheme	**4 November 2013**	**Announcement of the Exchange Offers**
Scheme announced.		Exchange Offers announced. Prospectuses published.
Practice statement letter sent to Scheme Creditors.		Offer period commences. Eligible Holders of Preference Shares, 13% Bonds or 5.5555% Bonds can offer to exchange or sell their Existing Securities and/or vote in respect of the Proposals.
Announcement of Consideration Amounts in the Scheme	**On or around 14 November 2013**	
Announcement of the final Consideration Amounts and New Ordinary Shares Conversion Price.		
Scheme Convening Hearing	**18 November 2013**	
Initial Court hearing for leave to convene the Scheme Meeting		
Explanatory Statement and Scheme Documents available	**19 November 2013**	
Explanatory Statement and Scheme Documents available to Scheme Creditors		

Scheme Events	*Dates and Times (all times are London time)*	*Offer Events*
	4.30 p.m. on 29 November 2013	**Early Participation Deadline** The deadline by which the Early Participation Threshold must be achieved in order for Preference Shares, 13% Bond and 5.5555% Bonds to be exchanged or sold on the basis of the Early Consideration Amounts for such Existing Securities.
	4.30 p.m. on 6 December 2013	**Expiration Deadline** Deadline for receipt of all Exchange Instructions from Eligible Holders in respect of Preference Shares, 13% Bonds and 5.5555% Bonds.
Voting Instructions Deadline Deadline for receipt of all Account Holder Letters containing voting instructions in order for Holders to vote on the Scheme and elections to subscribe for Additional New Ordinary Shares pursuant to the Additional New Ordinary Shares Offer in the Scheme.	**4.30 p.m. on 10 December 2013**	
Scheme Record Date Only those Holders who are Scheme Creditors as at the Scheme Record Date are entitled to attend and vote at the Scheme Meeting (unless the Bank, in its sole discretion, elects to recognise, for the purposes of the Scheme, a transfer of Dated Notes after the Scheme Record Date such that the transferee becomes a Scheme Creditor)	**10 December 2013**	

Scheme Events	*Dates and Times (all times are London time)*	*Offer Events*
Scheme Meeting	**11 December 2013**	**Meetings**
Meeting of the Scheme Creditors to vote on the Scheme The Bank will request the Court to convene the Scheme Meeting on 11 December 2013		Meetings of the Holders of the Preference Shares, 13% Bonds and 5.5555% Bonds held to consider the Extraordinary Resolutions pursuant to the Proposals. 1.00 p.m. in respect of the Preference Shares 2.00 p.m. in respect of the 13% Bonds 3.00 p.m. in respect of the 5.5555% Bonds
	11 December 2013	**Offer Record Date**
		The record date for the purposes of ceasing trading in the Preference Shares, 13% Bonds and 5.5555% Bonds, and for determining entitlement to receive the relevant Group Notes, Bank T2 Notes, Accrued Dividends, Accrued Interest and other amounts payable under the terms of the Liability Management Exercise (if successfully completed).
Results Announcement	**12 December 2013**	**Results Announcement**
Announcement of the results of the Liability Management Exercise		Announcement of the results of the Liability Management Exercise
Scheme Sanction Hearing	**16 December 2013**	
Second Court hearing for sanction of the Scheme by the Court. The Bank will announce as soon as reasonably practicable after the Scheme Sanction Hearing whether or not the Scheme is sanctioned.		

Scheme Events	*Dates and Times (all times are London time)*	*Offer Events*
Filing of sanction order	**The date of the Scheme Sanction Hearing or the following business day**	
Sanction order (if granted) delivered to the Registrar of Companies. Scheme becomes effective in accordance with its terms		
Settlement Date / Scheme Settlement Date	**18 December 2013**	**Settlement Date / Scheme Settlement Date**
Expected settlement of the Scheme (subject to satisfaction of the Settlement Condition), including issue and delivery of New Ordinary Shares, Bank T2 Notes and Additional New Ordinary Shares.		Expected settlement of the Offers (subject to satisfaction of the Settlement Condition), including issue and delivery of Bank T2 Notes and Group Notes and payment of Accrued Dividends, Accrued Interest and other relevant amounts.

The above timetable may be impacted in certain respects if any of the Meetings in respect of the Preference Shares, the 13% Bonds and the 5.5555% Bonds are required to be adjourned. If the timetable is changed for any reason, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

If any of the Meetings are required to be adjourned, the Bank currently expects that the adjourned meeting(s) would be held on or around 27 December 2013 and the settlement date for the Offers and the Scheme will be postponed to on or around 31 December 2013. In such event, the Bank will announce the new dates via the Regulatory News Service (RNS) operated by the London Stock Exchange.

Unless stated otherwise or required by order of the Court, announcements in relation to the Liability Management Exercise will be made: (i) by the issue of a press release to a Notifying News Service; (ii) by the delivery of notices to Euroclear and Clearstream, Luxembourg for communication to Direct Participants; (iii) via the Regulatory News Service (RNS) operated by the London Stock Exchange; and (iv) as otherwise required by the rules of the London Stock Exchange. Copies of all announcements, notices and press releases can also be obtained from the Exchange Agent and Information Agent, the contact details for which are at the end of this Offer Memorandum.

Holders are advised to check with any custodian, broker or other intermediary through which they hold their Existing Securities when such intermediary needs to receive instructions from a Holder in order for such Holder to participate in the Liability Management Exercise.

SECTION N

CANACCORD GENUITY LIMITED FAIRNESS OPINIONS

The Bank has sought an independent opinion from Canaccord Genuity Limited ("**Canaccord Genuity**") on the fairness of the Liability Management Exercise from a financial value perspective to the holders of the Preference Shares, the 13% Bonds and the 5.5555% Bonds. Canaccord Genuity is regulated in the United Kingdom by the Financial Conduct Authority. Canaccord Genuity's fairness opinions are set out in this Section N.

Canaccord Genuity's fairness opinions have been produced at the request of the Bank and are included, in the form and context in which they are included, with the consent of Canaccord Genuity who has authorised the contents of this Section N for the purposes of item 5.5.4R(2)(f) of the Prospectus Rules.

Save for any responsibility arising under Prospectus Rule 5.5.4R(2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law Canaccord Genuity does not assume any responsibility and will not accept any liability to any person for any loss suffered by any such other person as a result of, arising out of, or in accordance with the fairness opinions contained in this Section N.

This Section N contains the following parts:

- Part 1: Canaccord Genuity's consent letter
- Part 2: Canaccord Genuity's Fairness Opinion relating to the Preference Shares
- Part 3: Canaccord Genuity's Fairness Opinion relating to the 13% Bonds
- Part 4: Canaccord Genuity's Fairness Opinion relating to the 5.5555% Bonds

Holders should note that these opinions do not constitute financial or legal advice. By consenting to the inclusion of its opinions in this document, Canaccord Genuity is not providing any advice or recommendation to any Holder as to what action it should take in respect of the Liability Management Exercise. Canaccord Genuity will not be responsible or liable to any Holder for that Holder's decisions in respect of the Liability Management Exercise.

PART 1:

CANACCORD GENUITY'S CONSENT LETTER

CANACCORD GENUITY LIMITED

88 Wood Street
London
EC2V 7QR
United Kingdom

+44 (0)20 7523 8000

www.canaccordgenuity.com

PRIVATE & CONFIDENTIAL

4 November 2013

The Board of Directors
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

The Board of Directors
Co-operative Group Limited
1 Angel Square
Manchester
M60 0AG

Dear Sirs

Liability Management Exercise

We refer to the Consent and Exchange Offer Memorandum dated 4 November 2013 prepared by The Co-operative Bank p.l.c. ("**Bank**") and Co-operative Group Limited ("**Group**") and which is appended to, and forms part of (i) the Prospectus dated 4 November 2013 published by the Bank relating to fixed rate Subordinated Notes (the "**Bank T2 Prospectus**") and (ii) the Prospectus dated 4 November 2013 published by the Group relating to fixed rate Final Repayment Subordinated Notes and Instalment Repayment Subordinated Notes (the "**Group Notes Prospectus**").

The Consent and Exchange Offer Memorandum describes the Bank's and the Group's liability management exercise in respect of certain securities issued by Bank and more particularly set out in Appendix I to this letter (the "**Securities**").

Consent

In accordance with Annex IV.16.1 of the Prospectus Directive Regulation, we hereby consent to the inclusion in the Group Notes Prospectus of our fairness opinion letters dated 4 November 2013 relating to the Preference Shares, the 13% Bonds and the 5.5555% Bonds and of the references to ourselves in the form and context in which they are included.

In accordance with Annex XI.13.1 of the Prospectus Directive Regulation, we hereby consent to the inclusion in the Bank T2 Prospectus of our fairness opinion letters dated 4 November 2013 relating to the Preference Shares, the 13% Bonds and the 5.5555% Bonds and of the references to ourselves in the form and context in which they are included.

United Kingdom
Ireland
France
Germany
Italy
Canada
United States
China
Singapore
Australia

Canaccord Genuity Limited is authorised and regulated by the Financial Conduct Authority, is a member of the London Stock Exchange and is a wholly owned subsidiary of Canaccord Genuity Group Inc.
Registered in England and Wales, number 1774003. In the UK, Ireland, Italy and Germany offices are offices of Canaccord Genuity Limited. Offices in other countries are offices of other companies in the Canaccord Genuity Group of companies.
See www.canaccordgenuitygroup.com/en/companies for more information.

For the purposes of Prospectus Rule 5.5.4R (2)(f) we are responsible for the fairness opinion letters dated 4 November 2013 relating to the Preference Shares, the 13% Bonds and the 5.5555% Bonds as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in the fairness opinion letters is, to the best of our knowledge, in accordance with the facts and contains no omissions likely to affect its import. This declaration is included in the Prospectus in compliance with paragraph 1.2 of Annex XI and paragraph 1.2 of Annex IV (as applicable) of the Prospectus Directive Regulation.

Other Matters

We confirm that we are authorised and regulated in the United Kingdom by the Financial Conduct Authority

Yours faithfully

Canaccord Genuity

Canaccord Genuity Limited

Appendix I

Security Name	ISIN
9.25% Non-Cumulative Irredeemable Preference Shares (the "**Preference Shares**")	GB0002224516
13% Perpetual Subordinated Bonds (the "**13% Bonds**")	GB00B3VH4201
5.5555% Perpetual Subordinated Bonds (the "**5.5555% Bonds**")	GB00B3VMBW45
Floating Rate Callable Step-up Dated Subordinated Notes due 2016	XS0254625998
5.875% Subordinated Callable Notes due 2019	XS0189539942
9.25% Subordinated Notes due 28 April 2021	XS0620315902
Fixed/Floating Rate Subordinated Notes due November 2021	XS0274155984
7.875% Subordinated Notes due 19 December 2022	XS0864253868
5.75% Dated Callable Step-up Subordinated Noted due 2024	XS0188218183
5.875% Subordinated Notes due 2033	XS0145065602

PART 2:

CANACCORD GENUITY'S FAIRNESS OPINION RELATING TO THE PREFERENCE SHARES

CANACCORD GENUITY LIMITED

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United Kingdom

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PRIVATE & CONFIDENTIAL

4 November 2013

The Board of Directors
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

Dear Sirs

Further to our letter of engagement dated 25 October 2013 (the "**Engagement Letter**") we have been instructed by you to provide an assessment of whether the proposed restructuring of The Co-operative Bank p.l.c. (the "**Bank**"), as more particularly set out in the public announcement of the Bank on 4 November 2013 (the "**Announcement**" or together the "**Proposed Restructuring**"), is fair from a financial value perspective to the holders of the 9.25% Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516) in the Bank (the "**Preference Shares**") when compared with the alternative scenarios described below.

Proposed Restructuring

Under the Proposed Restructuring the holders of Preference Shares will receive a choice between Final Repayment Notes and Instalment Repayment Notes in exchange for their Preference Shares. Further details of the exchange can be found in the Announcement.

Scope of Work

In reaching our assessment of whether the Proposed Restructuring is fair from a financial value perspective to the holders of the Preference Shares we have considered the financial outcome to the holders of the Preference Shares in three particular scenarios as outlined below (the "**Assessment**").

The three scenarios considered included:

1. the Proposed Restructuring being implemented in full as outlined in the Announcement, including receipt of all necessary regulatory approvals;
2. the Proposed Restructuring failing to complete for whatever reason and the Bank entering into a Special Resolution Regime (as defined by the Banking Act 2009) ("**SRR**"). In analysing the various possible ultimate outcomes in this scenario we have reviewed third party reports provided by the Bank and its advisers which considered such possible outcomes including the Bank entering into a formal insolvency process. We have not considered alternative possible outcomes from SRR or the probability of such outcomes occurring; and
3. the restructuring option being considered by the Board of the Bank at the time of the Banks' public announcement on 17 June 2013.

We have not considered the net financial impact on individual holders of the Preference Shares, each of whose particular circumstances, including tax position, is unique.

United Kingdom
Ireland
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Germany
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See www.canaccordgenuitygroup.com/en/companies for more information.

Information Reviewed and Relied Upon

In performing our work we have reviewed and relied upon:

1. certain information about the Bank provided to us;
2. the Bank's business plan as at 24 October 2013, the final form of which was approved by the Board of Directors on 1 November 2013 without material amendment;
3. the details of the proposed financial restructuring of the Bank; and
4. the various SRR scenarios considered by the Bank and its advisers.

We also had the opportunity to discuss the contents of this letter with both senior management of the Bank and members of the ad hoc steering committee formed to informally represent the retail holders of the Preference Shares.

We have relied upon the completeness, accuracy and fair presentation of all of the financial and other information, data, documents, advice, opinions, representations and other materials, whether in written, electronic or oral form, obtained by us from public sources or provided to us by the Bank or any of its senior management, associates, affiliates, consultants, agents and advisors or otherwise, and we have assumed that this information did not omit to state any material fact or any fact necessary to be stated to make such information not misleading. The Assessment is necessarily conditional upon the completeness, accuracy and fair presentation of such information. Subject to the exercise of professional judgement, we have not, nor attempted to independently verify and have assumed the completeness, accuracy and fair presentation of any such information. With respect to the Bank's financial forecasts, projections or estimates provided to us by management of the Bank and used in the analysis of supporting the Assessment, we have assumed that they have been reasonably prepared on bases reflecting the best currently available estimates and judgements of management of the Bank as to the matters covered thereby and which, in the good faith opinion of the Bank, after careful consideration, are (or were at the time of preparation and continue to be) reasonable in the circumstances. By rendering the Assessment we (a) express no view as to the reasonableness of such forecasts, projections or estimates or the assumptions on which they are based and (b) have not taken into consideration the impact future events (such as, without limitation, market fluctuation and/or litigation risk and third party claims) may have on our Assessment. We have not, to the best of our knowledge, been denied access by the Bank to any information requested by us. We also have assumed that obtaining all regulatory and other approvals and third party consents required for consummation of the Proposed Restructuring (if any) will not have an adverse impact our Assessment, and we have assumed that the Proposed Restructuring will be consummated in accordance with the Announcement and without waiver or modification of any of the material terms or conditions contained therein by any party thereto.

Assumptions and Limitations

We have not prepared a formal valuation or appraisal of the Bank or the Preference Shares and the Assessment should not be construed as such. We have, however, conducted such analyses as we considered necessary in the circumstances. In addition, the Assessment is not, and should not be construed as, advice as to the future value of the Bank at any future date. The Assessment addresses only the fairness, from a financial value perspective point of view of the Preference Shares and subject to the terms of this letter, of the impact of the Proposed Restructuring of the Bank on the holders of the Preference Shares when compared with the alternative scenarios described above and does not address any other aspect or implication of the Proposed Restructuring.

We are not legal, tax or accounting advisors or experts, have not been engaged to review any legal, tax or accounting aspects of the Proposed Restructuring and express no opinion concerning any legal, tax or accounting matters concerning the Proposed Restructuring.

The Assessment is rendered on the basis of economic, financial and general business conditions prevailing as of the date of this letter and the conditions and prospects, financial and otherwise, of the Bank and its subsidiaries and affiliates, as they were reflected in the information provided to us and which we deem relevant to the Assessment. In our analyses and in preparing the Assessment, we made numerous assumptions with respect to

industry performance, general business and economic conditions and other matters, many of which are beyond our control or any party involved in the Proposed Restructuring.

This letter has been provided for the sole use and benefit of the Board of the Bank in connection with, and for the purpose of, its consideration of the Proposed Restructuring and its impact on the holders of the Preference Shares and may not be used or relied upon by any other person or for any other purpose without our prior written consent. This letter may however be made available on a non-reliance basis to the holders of the Preference Shares in its complete form.

The Assessment does not address the relative merits of the Proposed Restructuring as compared to other possible restructuring options not provided to us by the Bank. In considering fairness from a financial value perspective we considered the Proposed Restructuring from the perspective of the holders of the Preference Shares generally and did not consider the specific circumstances of any particular holder of the Preference Shares including, without limitation, with regard to their individual tax positions.

The Assessment is given as at the date of the letter and we disclaim any undertaking or obligation to advise any person of any change in any fact or matter affecting the Assessment which may come, or be brought, to our attention after the date of this letter. Without limiting the foregoing, in the event that there is any material change in any fact or matter affecting the Assessment after the date of this letter, including, without limitation, the terms and conditions of the Proposed Restructuring, or if we learn that the information relied upon in rendering the Assessment was inaccurate, incomplete or misleading in any material respect, we reserve the right (but are not obliged) to change, modify or withdraw the Assessment.

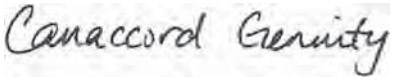
Conclusion

We note the difference in treatment between the various classes of debt and equity instruments despite their respective ranking. However, notwithstanding this and based upon and subject to the foregoing and such other matters we considered relevant, it is our view that the Proposed Restructuring is fair from a financial value perspective to the holders of the Preference Shares as at the date of this letter.

This Assessment is provided strictly in pursuant to our Engagement Letter. All terms and conditions of the Engagement Letter are deemed to apply to this letter.

This letter will be governed by and construed exclusively in accordance with English law, and, save in respect of Canaccord Genuity Limited's affiliates, it shall confer no rights on a third party pursuant to the Contract (Rights of Third Parties) Act of 1999.

Yours faithfully



Canaccord Genuity Limited

PART 3:

CANACCORD GENUITY'S FAIRNESS OPINION RELATING TO THE 13% BONDS

CANACCORD GENUITY LIMITED

88 Wood Street
London
EC2V 7QR
United Kingdom

+44 (0)20 7523 8000

www.canaccordgenuity.com

PRIVATE & CONFIDENTIAL

4 November 2013

The Board of Directors
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

Dear Sirs

Further to our letter of engagement dated 25 October 2013 (the "**Engagement Letter**") we have been instructed by you to provide an assessment of whether the proposed restructuring of The Co-operative Bank p.l.c. (the "**Bank**"), as more particularly set out in the public announcement of the Bank on 4 November 2013 (the "**Announcement**" or together the "**Proposed Restructuring**"), is fair from a financial value perspective to the holders of the 13% Perpetual Subordinated Bonds (ISIN: GB00B3VH4201) in the Bank (the "**13% Bonds**") when compared with the alternative scenarios described below.

Proposed Restructuring

Under the Proposed Restructuring the holders of the 13% Bonds will receive a choice between Final Repayment Notes and Instalment Repayment Notes in exchange for their 13% Bonds. Further details of the exchange can be found in the Announcement.

Scope of Work

In reaching our assessment of whether the Proposed Restructuring is fair from a financial value perspective to the holders of the 13% Bonds we have considered the financial outcome to the holders of the 13% Bonds in three particular scenarios as outlined below (the "**Assessment**").

The three scenarios considered included:

1. the Proposed Restructuring being implemented in full as outlined in the Announcement, including receipt of all necessary regulatory approvals;
2. the Proposed Restructuring failing to complete for whatever reason and the Bank entering into a Special Resolution Regime (as defined by the Banking Act 2009) ("**SRR**"). In analysing the various possible ultimate outcomes in this scenario we have reviewed third party reports provided by the Bank and its advisers which considered such possible outcomes including the Bank entering into a formal insolvency process. We have not considered alternative possible outcomes from SRR or the probability of such outcomes occurring; and
3. the restructuring option being considered by the Board of the Bank at the time of the Banks' public announcement on 17 June 2013.

We have not considered the net financial impact on individual holders of the 13% Bonds, each of whose particular circumstances, including tax position, is unique.

United Kingdom
Ireland
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Italy
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United States
China
Singapore
Australia

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Information Reviewed and Relied Upon

In performing our work we have reviewed and relied upon:

1. certain information about the Bank provided to us;
2. the Bank's business plan as at 24 October 2013, the final form of which was approved by the Board of Directors on 1 November 2013 without material amendment;
3. the details of the proposed financial restructuring of the Bank; and
4. the various SRR scenarios considered by the Bank and its advisers.

We also had the opportunity to discuss the contents of this letter with both senior management of the Bank and members of the ad hoc steering committee formed to informally represent the retail holders of the 13% Bonds.

We have relied upon the completeness, accuracy and fair presentation of all of the financial and other information, data, documents, advice, opinions, representations and other materials, whether in written, electronic or oral form, obtained by us from public sources or provided to us by the Bank or any of its senior management, associates, affiliates, consultants, agents and advisors or otherwise, and we have assumed that this information did not omit to state any material fact or any fact necessary to be stated to make such information not misleading. The Assessment is necessarily conditional upon the completeness, accuracy and fair presentation of such information. Subject to the exercise of professional judgement, we have not, nor attempted to independently verify and have assumed the completeness, accuracy and fair presentation of any such information. With respect to the Bank's financial forecasts, projections or estimates provided to us by management of the Bank and used in the analysis of supporting the Assessment, we have assumed that they have been reasonably prepared on bases reflecting the best currently available estimates and judgements of management of the Bank as to the matters covered thereby and which, in the good faith opinion of the Bank, after careful consideration, are (or were at the time of preparation and continue to be) reasonable in the circumstances. By rendering the Assessment we (a) express no view as to the reasonableness of such forecasts, projections or estimates or the assumptions on which they are based and (b) have not taken into consideration the impact future events (such as, without limitation, market fluctuation and/or litigation risk and third party claims) may have on our Assessment. We have not, to the best of our knowledge, been denied access by the Bank to any information requested by us. We also have assumed that obtaining all regulatory and other approvals and third party consents required for consummation of the Proposed Restructuring (if any) will not have an adverse impact our Assessment, and we have assumed that the Proposed Restructuring will be consummated in accordance with the Announcement and without waiver or modification of any of the material terms or conditions contained therein by any party thereto.

Assumptions and Limitations

We have not prepared a formal valuation or appraisal of the Bank or the 13% Bonds and the Assessment should not be construed as such. We have, however, conducted such analyses as we considered necessary in the circumstances. In addition, the Assessment is not, and should not be construed as, advice as to the future value of the Bank at any future date. The Assessment addresses only the fairness, from a financial value perspective point of view of the 13% Bonds and subject to the terms of this letter, of the impact of the Proposed Restructuring of the Bank on the holders of the 13% Bonds when compared with the alternative scenarios described above and does not address any other aspect or implication of the Proposed Restructuring.

We are not legal, tax or accounting advisors or experts, have not been engaged to review any legal, tax or accounting aspects of the Proposed Restructuring and express no opinion concerning any legal, tax or accounting matters concerning the Proposed Restructuring.

The Assessment is rendered on the basis of economic, financial and general business conditions prevailing as of the date of this letter and the conditions and prospects, financial and otherwise, of the Bank and its subsidiaries and affiliates, as they were reflected in the information provided to us and which we deem relevant to the Assessment. In our analyses and in preparing the Assessment, we made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond our control or any party involved in the Proposed Restructuring.

This letter has been provided for the sole use and benefit of the Board of the Bank in connection with, and for the purpose of, its consideration of the Proposed Restructuring and its impact on the holders of the 13% Bonds and may not be used or relied upon by any other person or for any other purpose without our prior written consent. This letter may however be made available on a non-reliance basis to the holders of the 13% Bonds in its complete form.

The Assessment does not address the relative merits of the Proposed Restructuring as compared to other possible restructuring options not provided to us by the Bank. In considering fairness from a financial value perspective we considered the Proposed Restructuring from the perspective of the holders of the 13% Bonds generally and did not consider the specific circumstances of any particular holder of the 13% Bonds including, without limitation, with regard to their individual tax positions.

The Assessment is given as at the date of the letter and we disclaim any undertaking or obligation to advise any person of any change in any fact or matter affecting the Assessment which may come, or be brought, to our attention after the date of this letter. Without limiting the foregoing, in the event that there is any material change in any fact or matter affecting the Assessment after the date of this letter, including, without limitation, the terms and conditions of the Proposed Restructuring, or if we learn that the information relied upon in rendering the Assessment was inaccurate, incomplete or misleading in any material respect, we reserve the right (but are not obliged) to change, modify or withdraw the Assessment.

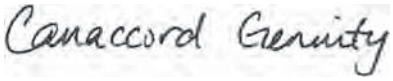
Conclusion

We note the difference in treatment between the various classes of debt and equity instruments despite their respective ranking. However, notwithstanding this and based upon and subject to the foregoing and such other matters we considered relevant, it is our view that the Proposed Restructuring is fair from a financial value perspective to the holders of the 13% Bonds as at the date of this letter.

This Assessment is provided strictly in pursuant to our Engagement Letter. All terms and conditions of the Engagement Letter are deemed to apply to this letter.

This letter will be governed by and construed exclusively in accordance with English law, and, save in respect of Canaccord Genuity Limited's affiliates, it shall confer no rights on a third party pursuant to the Contract (Rights of Third Parties) Act of 1999.

Yours faithfully



Canaccord Genuity Limited

PART 4:

CANACCORD GENUITY'S FAIRNESS OPINION RELATING TO THE 5.5555% BONDS

CANACCORD GENUITY LIMITED

88 Wood Street
London
EC2V 7QR
United Kingdom

+44 (0)20 7523 8000

www.canaccordgenuity.com

PRIVATE & CONFIDENTIAL

4 November 2013

The Board of Directors
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

Dear Sirs

Further to our letter of engagement dated 25 October 2013 (the "**Engagement Letter**") we have been instructed by you to provide an assessment of whether the proposed restructuring of The Co-operative Bank p.l.c. (the "**Bank**"), as more particularly set out in the public announcement of the Bank on 4 November 205.5555 (the "**Announcement**" or together the "**Proposed Restructuring**"), is fair from a financial value perspective to the holders of the 5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) in the Bank (the "**5.5555% Bonds**") when compared with the alternative scenarios described below.

Proposed Restructuring
Under the Proposed Restructuring the holders of the 5.5555% Bonds will receive Bank T2 Notes in exchange for their 5.5555% Bonds. Further details of the exchange can be found in the Announcement.

Scope of Work
In reaching our assessment of whether the Proposed Restructuring is fair from a financial value perspective to the holders of the 5.5555% Bonds we have considered the financial outcome to the holders of the 5.5555% Bonds in three particular scenarios as outlined below (the "**Assessment**").

The three scenarios considered included:

1. the Proposed Restructuring being implemented in full as outlined in the Announcement, including receipt of all necessary regulatory approvals;
2. the Proposed Restructuring failing to complete for whatever reason and the Bank entering into a Special Resolution Regime (as defined by the Banking Act 2009) ("**SRR**"). In analysing the various possible ultimate outcomes in this scenario we have reviewed third party reports provided by the Bank and its advisers which considered such possible outcomes including the Bank entering into a formal insolvency process. We have not considered alternative possible outcomes from SRR or the probability of such outcomes occurring; and
3. the restructuring option being considered by the Board of the Bank at the time of the Banks' public announcement on 17 June 2013.

We have not considered the net financial impact on individual holders of the 5.5555% Bonds, each of whose particular circumstances, including tax position, is unique.

United Kingdom
Ireland
France
Germany
Italy
Canada
United States
China
Singapore
Australia

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Registered in England and Wales, number 1774003. In the UK, Ireland, Italy and Germany offices are offices of Canaccord Genuity Limited. Offices in other countries are offices of other companies in the Canaccord Genuity Group of companies.
See www.canaccordgenuitygroup.com/en/companies for more information.

Information Reviewed and Relied Upon

In performing our work we have reviewed and relied upon:

1. certain information about the Bank provided to us;
2. the Bank's business plan as at 24 October 2013, the final form of which was approved by the Board of Directors on 1 November 2013 without material amendment;
3. the details of the proposed financial restructuring of the Bank; and
4. the various SRR scenarios considered by the Bank and its advisers.

We also had the opportunity to discuss the contents of this letter with both senior management of the Bank and members of the ad hoc steering committee formed to informally represent the retail holders of the 5.5555% Bonds.

We have relied upon the completeness, accuracy and fair presentation of all of the financial and other information, data, documents, advice, opinions, representations and other materials, whether in written, electronic or oral form, obtained by us from public sources or provided to us by the Bank or any of its senior management, associates, affiliates, consultants, agents and advisors or otherwise, and we have assumed that this information did not omit to state any material fact or any fact necessary to be stated to make such information not misleading. The Assessment is necessarily conditional upon the completeness, accuracy and fair presentation of such information. Subject to the exercise of professional judgement, we have not, nor attempted to independently verify and have assumed the completeness, accuracy and fair presentation of any such information. With respect to the Bank's financial forecasts, projections or estimates provided to us by management of the Bank and used in the analysis of supporting the Assessment, we have assumed that they have been reasonably prepared on bases reflecting the best currently available estimates and judgements of management of the Bank as to the matters covered thereby and which, in the good faith opinion of the Bank, after careful consideration, are (or were at the time of preparation and continue to be) reasonable in the circumstances. By rendering the Assessment we (a) express no view as to the reasonableness of such forecasts, projections or estimates or the assumptions on which they are based and (b) have not taken into consideration the impact future events (such as, without limitation, market fluctuation and/or litigation risk and third party claims) may have on our Assessment. We have not, to the best of our knowledge, been denied access by the Bank to any information requested by us. We also have assumed that obtaining all regulatory and other approvals and third party consents required for consummation of the Proposed Restructuring (if any) will not have an adverse impact our Assessment, and we have assumed that the Proposed Restructuring will be consummated in accordance with the Announcement and without waiver or modification of any of the material terms or conditions contained therein by any party thereto.

Assumptions and Limitations

We have not prepared a formal valuation or appraisal of the Bank or the 5.5555% Bonds and the Assessment should not be construed as such. We have, however, conducted such analyses as we considered necessary in the circumstances. In addition, the Assessment is not, and should not be construed as, advice as to the future value of the Bank at any future date. The Assessment addresses only the fairness, from a financial value perspective point of view of the 5.5555% Bonds and subject to the terms of this letter, of the impact of the Proposed Restructuring of the Bank on the holders of the 5.5555% Bonds when compared with the alternative scenarios described above and does not address any other aspect or implication of the Proposed Restructuring.

We are not legal, tax or accounting advisors or experts, have not been engaged to review any legal, tax or accounting aspects of the Proposed Restructuring and express no opinion concerning any legal, tax or accounting matters concerning the Proposed Restructuring.

The Assessment is rendered on the basis of economic, financial and general business conditions prevailing as of the date of this letter and the conditions and prospects, financial and otherwise, of the Bank and its subsidiaries and affiliates, as they were reflected in the information provided to us and which we deem relevant to the Assessment. In our analyses and in preparing the Assessment, we made numerous assumptions with respect to

industry performance, general business and economic conditions and other matters, many of which are beyond our control or any party involved in the Proposed Restructuring.

This letter has been provided for the sole use and benefit of the Board of the Bank in connection with, and for the purpose of, its consideration of the Proposed Restructuring and its impact on the holders of the 5.5555% Bonds and may not be used or relied upon by any other person or for any other purpose without our prior written consent. This letter may however be made available on a non-reliance basis to the holders of the 5.5555% Bonds in its complete form.

The Assessment does not address the relative merits of the Proposed Restructuring as compared to other possible restructuring options not provided to us by the Bank. In considering fairness from a financial value perspective we considered the Proposed Restructuring from the perspective of the holders of the 5.5555% Bonds generally and did not consider the specific circumstances of any particular holder of the 5.5555% Bonds including, without limitation, with regard to their individual tax positions.

The Assessment is given as at the date of the letter and we disclaim any undertaking or obligation to advise any person of any change in any fact or matter affecting the Assessment which may come, or be brought, to our attention after the date of this letter. Without limiting the foregoing, in the event that there is any material change in any fact or matter affecting the Assessment after the date of this letter, including, without limitation, the terms and conditions of the Proposed Restructuring, or if we learn that the information relied upon in rendering the Assessment was inaccurate, incomplete or misleading in any material respect, we reserve the right (but are not obliged) to change, modify or withdraw the Assessment.

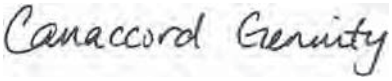
Conclusion

We note the difference in treatment between the various classes of debt and equity instruments despite their respective ranking. However, notwithstanding this and based upon and subject to the foregoing and such other matters we considered relevant, it is our view that the Proposed Restructuring is fair from a financial value perspective to the holders of the 5.5555% Bonds as at the date of this letter.

This Assessment is provided strictly in pursuant to our Engagement Letter. All terms and conditions of the Engagement Letter are deemed to apply to this letter.

This letter will be governed by and construed exclusively in accordance with English law, and, save in respect of Canaccord Genuity Limited's affiliates, it shall confer no rights on a third party pursuant to the Contract (Rights of Third Parties) Act of 1999.

Yours faithfully



Canaccord Genuity Limited

THE BANK

The Co-operative Bank p.l.c.
1 Balloon Street
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THE GROUP

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(if calling from outside the UK: +44 20 7704 0880)

Fax: +44 20 7067 9098
Attention: Sunjeeve Patel / David Shilson / Yves Theis
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United Kingdom

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To the Dealer Managers and the Trustee as trustee in respect of the Notes as to English law
Linklaters LLP
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London EC2Y 8HQ

AUDITORS TO THE ISSUER

KPMG Audit Plc
15 Canada Square
London E14 5GL

PART (B)

SUPPLEMENTARY PROSPECTUS DATED 4 DECEMBER 2013

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THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in doubt as to the action you should take in connection with this document or the proposals contained in it, you are recommended to seek your own personal financial advice immediately from your stockbroker, bank manager, solicitor, accountant or other independent financial adviser authorised under the Financial Services and Markets Act 2000, if you are taking advice in the United Kingdom, or from another appropriately authorised independent financial adviser if you are taking advice in a jurisdiction outside the United Kingdom.

SUPPLEMENT DATED 4 DECEMBER 2013 TO THE PROSPECTUS DATED 4 NOVEMBER 2013

The co-operative bank

The Co-operative Bank p.l.c.

(incorporated with limited liability in England with registered number 00990937)

11 per cent. Subordinated Notes due 2023

This Supplement (the **Supplement**) to the Prospectus (the **Prospectus**) dated 4 November 2013 prepared by The Co-operative Bank p.l.c. (the **Issuer**) constitutes a supplementary prospectus for the purposes of Section 87G of the Financial Services and Markets Act 2000 (the **FSMA**). Terms defined in the Prospectus have the same meaning when used in this Supplement.

This Supplement is supplemental to, and should be read in conjunction with, the Prospectus and any other supplements to the Prospectus issued by the Issuer.

The Issuer accepts responsibility for the information contained in this Supplement. To the best of the knowledge of the Issuer (which has taken all reasonable care to ensure that such is the case) the information contained in this Supplement is in accordance with the facts and does not omit anything likely to affect the import of such information.

Purpose of the Supplement

This Supplement has been prepared:

(i) because the Scheme has been modified with the effect that the pricing and, as a result, the allocation of the new ordinary shares by the Bank to be delivered pursuant to the Scheme has been amended, together with amendments to the timetable, as set out on pages 2 to 7 of this Supplement;

(ii) to include a new risk factor titled "*The Bank is facing an independent investigation by HM Treasury into events at the Bank and the circumstances surrounding them and may in the future face additional enforcement investigations by the PRA and the FCA or formal investigation by the Financial Reporting Council*" which contains certain information in relation to (a) the independent investigation announced by the Chancellor of the Exchequer on 22 November 2013 and the responses of the PRA and the FCA to such announcement, (b) the possibility of additional enforcement investigations from the PRA and/or the FCA and (c) the potential for formal investigations by the Financial Reporting Council, as set out on pages 7 to 8 of this Supplement;

(iii) to supplement the paragraph titled "*Litigation and Arbitration*" in Section 20 (*Additional Information*) with certain information in relation to the independent investigation announced by the

Chancellor of the Exchequer on 22 November 2013 and the responses of the PRA and the FCA to such announcement, as set out on pages 8 to 9 of this Supplement;

(iv) to reflect the downgrade to the ratings assigned to the Issuer by Fitch Ratings Ltd. (**Fitch**), following the announcement by Fitch on 14 November 2013 of revisions to those ratings, as set out on page 9 of this Supplement; and

(v) to update the Summary with respect to the modification of the terms of the Scheme and the amendments to the timetable, to update the "*Key risks specific to the Issuer*" in the Summary and the ratings downgrade to the ratings assigned to the Issuer by Fitch in the Summary, all as set out below.

(i) Modification to the terms of the Scheme

Holders of the Dated Notes were invited to consider, and if thought fit, approve the Scheme (as described in the explanatory statement dated 18 November 2013). If the Scheme was approved by the requisite statutory majorities and sanctioned by the High Court of Justice of England and Wales (the **Court**), and if the Scheme became unconditional, it would have resulted in all of the Dated Notes (plus accrued and unpaid interest on those Dated Notes up to a specified record date) being exchanged for a combination of Bank T2 Notes and New Ordinary Shares.

The holders of the Dated Notes were also entitled to subscribe for 62,500,000 additional new ordinary shares in the Bank at a price of £2.00 per new ordinary share representing 25 per cent. of the total issued share capital of the Bank following completion of the Liability Management Exercise, for an aggregate consideration equal to £125 million, pursuant to, and on the terms of, the Scheme with such subscription being underwritten by certain persons who were holders of Dated Notes as at 4 November 2013. The Scheme also provided that any holder of Dated Notes was entitled to elect to subscribe for between a minimum election of 50,000 (for an aggregate subscription price of £100,000) and a maximum election of 62,500,000 additional new ordinary shares in the Bank pursuant to, and on the terms of, the Scheme.

Pursuant to the modification to the Scheme requested by certain members of an ad hoc group of holders of the Dated Notes (the **Ad Hoc Group**) which was approved by the Court following a Court hearing and adjourned hearing on 3 December 2013, on 4 December 2013 (the Scheme, as modified by the requested modification, the **Modified Scheme**), if the Modified Scheme is approved by the requisite statutory majorities and sanctioned by the Court, and if the Modified Scheme becomes unconditional, all of the Dated Notes (plus accrued and unpaid interest on those Dated Notes up to a specified record date) will be exchanged for a combination of:

- £100 million of Bank T2 Notes; and

- 141,666,666 new ordinary shares in the Bank representing 56.67 per cent. of the total issued share capital of the Bank following completion of the Liability Management Exercise.

The holders of the Dated Notes will also be entitled to subscribe for 33,333,334 additional new ordinary shares in the Bank at a subscription price of £3.75 per new ordinary share representing 13.33 per cent. of the total issued share capital of the Bank following completion of the Liability Management Exercise, for an aggregate consideration of £125 million[1], pursuant to, and on the terms of, the Modified Scheme. This subscription will be underwritten by, amongst others, the Ad Hoc Group. The Modified Scheme provides that any holder of Dated Notes will be entitled to elect to subscribe for between a minimum election of

[1] See note 2(iii) to the table below

26,667 (for an aggregate subscription price of £100,001.25) and a maximum election of 33,333,334 additional new ordinary shares pursuant to, and on the terms of, the Modified Scheme. The allocation mechanism for the allocation of additional new ordinary shares described in the explanatory statement dated 18 November 2013 relating to the Scheme is otherwise unchanged.

The total number of new ordinary shares in the Bank issued to holders of Dated Notes as a class under the Modified Scheme will be the same as the number to be issued under the Scheme.

The table below shows the Scheme Consideration to which holders of the Dated Notes will be entitled under the terms of the Scheme and the Modified Scheme:

Existing Securities	**ISIN**	**Consideration Amount** (per £1,000 of Scheme Claim[3])				**New Ordinary Shares Conversion Price**	
		Bank T2 Notes[1]		**New Ordinary Shares[2]**			
		Scheme	Modified Scheme	Scheme	Modified Scheme	Scheme	Modified Scheme
Floating Rate Callable Step-up Dated Subordinated Notes due 2016	XS0254625998	£102.63	£102.57	£897.37	£897.43	£7.7718276 per share	£6.17566631 per share
5.875% Subordinated Callable Notes due 2019	XS0189539942	£102.63	£102.57	£897.37	£897.43		
9.25% Subordinated Notes due 28 April 2021	XS0620315902	£102.63	£102.57	£897.37	£897.43		
Fixed/Floating Rate Subordinated Notes due November 2021	XS0274155984	£102.63	£102.57	£897.37	£897.43		
7.875% Subordinated Notes due 19 December 2022	XS0864253868	£102.63	£102.57	£897.37	£897.43		
5.75% Dated Callable Step-up Subordinated Notes due 2024	XS0188218183	£102.63	£102.57	£897.37	£897.43		
5.875% Subordinated Notes due 2033	XS0145065602	£102.63	£102.57	£897.37	£897.43		

Notes:

1 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank.

2 New ordinary shares to be issued by the Bank. If the Liability Management Exercise is successfully completed, Co-operative Group's existing equity stake in the Bank will be converted into deferred shares and effectively reduced to nil and a total of 250,000,000 new ordinary shares will be issued at that time, of which:

(i) 75,000,000 (representing 30 per cent. of the total) will be issued to Co-operative Group in consideration for its fresh injection of capital into the Bank through the Liability Management Exercise and the 2014 Commitment (representing an effective subscription price of £6.16 per share);

(ii) 141,666,666 (representing 56.67 per cent. of the total) will be issued to holders of the Dated Notes in the Scheme in exchange for their Dated Notes, to be distributed in the Modified Scheme *pro rata* amongst such holders based on their respective Scheme Claims (representing, based on the total value of Scheme Claims and the number of New Ordinary Shares issued in the Modified Scheme to holders of Dated Notes, an implied subscription price equal to the New Ordinary Shares Conversion Price). The New Ordinary Shares referred to in the table above are these 141,666,666 new ordinary shares; and

(iii) 33,333,334 (representing the balance of 13.33 per cent. of the total) will be available for subscription by holders of Dated Notes pursuant to, and on the terms of, the Modified Scheme for an aggregate consideration equal to £125,000,002.50 (representing an effective subscription price of £3.75 per share).

[3] A Holder's claim in the Modified Scheme (its **Scheme Claim**) will be equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date (13 December 2013), provided that a Holder's Scheme Claim in respect of Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (which are denominated in euro) shall be the Sterling-Equivalent of such sum, calculated on the basis of an exchange rate of £0.85644 per €1.00.

All references to the terms of the Scheme (including, without limitation, the Additional New Ordinary Shares Offer and the Scheme Consideration) appearing in the Prospectus (including the Offer Memorandum) and appearing below in this Supplement should be read accordingly and all references to the Scheme and the Liability Management Exercise appearing in the Prospectus (including the Offer Memorandum) and appearing below in this Supplement should be read as references to the Scheme and the Liability Management Exercise as so amended.

As a result of the above amendment to the terms of the Scheme, the remainder of the timetable for the Liability Management Exercise is now expected to be as follows:

Scheme Events	**Dates and Times (all times are London time)**	**Offer Events**
	4.30 p.m. on 6 December 2013	**Expiration Deadline**
		Deadline for receipt of all Exchange Instructions from Eligible Holders in respect of Preference Shares, 13% Bonds and 5.5555% Bonds.
	11 December 2013	**Meetings**
		Meetings of the Holders of the Preference Shares, 13% Bonds and 5.5555% Bonds held to consider the Extraordinary Resolutions pursuant to the Proposals.
		1.00 p.m. in respect of the Preference Shares.
		2.00 p.m. in respect of the 13% Bonds.
		3.00 p.m. in respect of the 5.5555% Bonds.

	11 December 2013	**Offer Record Date** The record date for the purposes of ceasing trading in the Preference Shares, 13% Bonds and 5.5555% Bonds, and for determining entitlement to receive the relevant Group Notes, Bank T2 Notes, Accrued Dividends, Accrued Interest and other amounts payable under the terms of the Liability Management Exercise (if successfully completed).
Voting Instructions Deadline Deadline for receipt of all Account Holder Letters containing voting instructions in order for Holders to vote on the Scheme, elections to subscribe for Additional New Ordinary Shares pursuant to the Additional New Ordinary Shares Offer in the Scheme, elections to participate in the Sub-purchase Offer and confirming eligibility to receive Scheme Consideration under the Scheme on the Scheme Settlement Date.	**4.30 p.m. on 13 December 2013**	
Scheme Record Date Only those Holders who are Scheme Creditors as at the Scheme Record Date are entitled to attend and vote at the Scheme Meeting (unless the Bank, in its sole discretion, elects to recognise, for the purposes of the Scheme, a transfer of Dated Notes after the Scheme Record Date such that the transferee becomes a	**13 December 2013**	

Scheme Creditor).		
Scheme Meeting Meeting of the Scheme Creditors to vote on the Scheme. The Court has ordered the Bank to convene the Scheme Meeting on 16 December 2013.	**16 December 2013**	
Notification of allocation of Additional New Ordinary Shares and Sub-purchasing Commitments	**On or around 16 December 2013**	
Results Announcement Announcement of the results of the Liability Management Exercise	**On or around 16 December 2013**	**Results Announcement** Announcement of the results of the Liability Management Exercise.
Scheme Sanction Hearing Second Court hearing for sanction of the Scheme by the Court. The Bank will announce as soon as reasonably practicable after the Scheme Sanction Hearing whether or not the Scheme is sanctioned.	**18 December 2013**	
Filing of sanction order Sanction order (if granted) delivered to the Registrar of Companies. Scheme becomes effective in accordance with its terms.	**The date of the Scheme Sanction Hearing or the following business day**	
Settlement Date /Scheme Settlement Date Expected settlement of the Scheme (subject to satisfaction of the Settlement Condition), including issue and delivery of New Ordinary Shares, Bank T2	**20 December 2013**	**Settlement Date/ Scheme Settlement Date** Expected settlement of the Offers (subject to satisfaction of the Settlement Condition), including issue and

Notes and Additional New Ordinary Shares.	delivery of Bank T2 Notes and Group Notes and payment of Accrued Dividends, Accrued Interest and other relevant amounts.

All references to the dates of such Scheme Events or Offer Events in the Prospectus shall be amended accordingly.

The times and dates referred to above are indicative only and are subject to the right of the Bank and/or Co-operative Group to extend, re-open, amend and/or terminate the Exchange Offers or any of them at any time and the right of the Bank (if required or permitted by the Court) to amend and/or withdraw the Scheme at any time. Accordingly, the actual timetable may differ significantly from the expected timetable set out above.

If any of the above times and/or dates change, the revised time(s) and/or date(s) will be announced by the Bank and/or Co-operative Group as soon as reasonably practicable by publication of a supplement to the Prospectus.

(ii) Risk Factors

A new risk factor titled "*The Bank is facing an independent investigation by HM Treasury into events at the Bank and the circumstances surrounding them and may in the future face additional enforcement investigations by the PRA and the FCA or formal investigation by the Financial Reporting Council*", is hereby included in the Prospectus:

"On 22 November 2013 the Chancellor of the Exchequer ordered an independent investigation into events at the Bank and the circumstances surrounding them to take place under section 77 of the Financial Services Act 2012. The investigation has been jointly agreed with the PRA and the FCA, both of whom agree that there is a public interest in a statutory investigation. It will be led by an independent person appointed by the FCA and the PRA, with the approval of the Treasury.[2] Separately, the FCA and the PRA each announced on 22 November 2013 that they are considering whether they should also launch their own formal enforcement investigations.[3] The precise scope and timing of these investigations is yet to be determined.

In November 2013, it was reported that the Financial Reporting Council has announced in a statement that it is making enquiries into the Bank's financial reporting in accordance with its normal procedures and if it commences a formal investigation, it will announce this via a press announcement.[4]

The events which led to the announcements of the investigations (or potential investigations) and the related negative publicity have caused, and the investigations and their findings may cause, further reputational damage to the Bank and its brand. The investigations may lead to greater scrutiny and/or intervention from regulators, further regulatory and/or legislative actions and litigation.

The outcome of these investigations or any other future legal, regulatory or other enquiries, investigations or proceedings, including any legal, regulatory or other enquiries, investigations or proceedings arising out of any other allegations made against the Bank, is difficult to predict. However, the Bank may incur significant

2 Source: https://www.gov.uk/government/news/chancellor-confirms-independent-inquiry-into-events-at-co-op-bank

3 Source: http://www.fca.org.uk/news/statements/fca-statement-regarding-cooperative-bank and http://www.bankofengland.co.uk/publications/Pages/news/2013/154.aspx

4 Source: as reported in the Guardian (5 November 2013) (http://www.theguardian.com) and Reuters (22 November 2013) (http://uk.reuters.com)

expenses in connection with these investigations and they may expose the Bank to any of the following: substantial monetary damages and fines; other penalties and injunctive relief; potential for additional civil or private litigation; potential for criminal prosecution in certain circumstances; potential regulatory restrictions on the Bank's business; and/or a negative effect on the Bank's reputation.

Any adverse findings of the investigations may therefore reduce – directly or indirectly – the attractiveness of the Bank to stakeholders and may lead to customer attrition, reduced workforce morale and difficulties in recruiting and retaining talent. Sustained damage arising from any adverse findings of the investigations could therefore lead to loss of revenue for the Bank and could have a materially negative impact on the Bank's operations, financial results, financial condition and prospects.

The regulatory and other investigations that have been recently announced are likely to subject the Bank to greater scrutiny from regulators, will take management time and result in the Bank incurring costs not currently included in its business plan which cannot be quantified at this time, thereby potentially taking a significant amount of resources away from the implementation of the Bank's strategy. Recent events may have caused some brand and reputational damage, but it is too early to form a definitive view as to the extent of such damage. These recent events, together with the competitive landscape in which the Bank operates, the introduction of seven day account switching and the associated increased competitor marketing activity at a time when the Bank has been constrained in its ability to undertake its own marketing activity, may be a contributing factor to an increase the Bank has seen in the switching out of current accounts. However, the Bank's retail deposit base remains broadly stable and it is too early to identify any significant trends at this point. Further, the Bank's liquidity position remains stable. Overall, the Bank's performance has been consistent with or, in the case of costs, slightly better than, management's expectations."

(iii) Litigation and Arbitration

The paragraph titled "*Litigation and Arbitration*" in Section 20 (*Additional Information*) appearing in the Prospectus, is hereby supplemented with the following:

"On 22 November 2013, a statement from HM Treasury confirmed that:

"*The Chancellor of the Exchequer is to use the powers he has brought in under the Financial Services Act 2012 to order an independent investigation into events at the Co-op Bank and the circumstances surrounding them.*

The investigation has been jointly agreed with the two regulators – the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) – who agree there is a public interest in a statutory investigation.

It will be led by an independent person appointed by the regulators, with the approval of the Treasury.

Separately, the FCA and PRA have today announced they are both considering whether they should also launch formal enforcement investigations.

The independent investigation under the Financial Services Act will therefore not start until it is clear it will not prejudice any actions the relevant authorities may take, including the potential FCA and PRA enforcement investigations.

The detailed direction that will order the independent investigation and set out its terms will take into account any issues arising, including from this potential FCA and PRA enforcement investigations and be

determined in consultation with the independent person appointed to lead it. It will cover the actions of relevant authorities (regulators and government) and the institution itself, including prudential issues, governance (including the appointment of senior staff) and acquisitions. The period that the investigation will review will start from at least 2008 and run to at least the present time.

The direction and the investigation's report will be laid before Parliament.

The government is determined to create a stronger and safer banking system. A key part of this is reforming the regulatory regime for senior managers. That is why the government's Banking Reform Bill, which is currently passing through the House of Lords, will introduce a new senior managers' regime, subjecting decision makers in banks to higher standards that means if they fail in their duties they will be held to account.[5]"

The outcome of these investigations, the Kelly Review or any other future legal, regulatory or other enquiries, investigations or proceedings, including any legal, regulatory or other enquiries, investigations or proceedings arising out of any other allegations made against the Bank, are difficult to predict. However, investors are referred to the risk factor titled "*The Bank is facing an independent investigation by HM Treasury into events at the Bank and the circumstances surrounding them and may in the future face additional enforcement investigations by the FCA and the PRA or formal investigation by the Financial Reporting Council*" for an analysis of the potential risks of such investigations."

(iv) Ratings

On 14 November 2013, the issuer ratings for the Issuer provided by Fitch were downgraded to the following:

B (long-term) (Rating Watch Negative); and

B (short-term) (Rating Watch Negative).

Fitch is established in the European Union and is registered under the CRA Regulation. As such Fitch is included in the list of credit rating agencies published by the European Securities and Markets Authority on its website (at *http://www.esma.europa.eu/page/List-registered-and-certified-CRAs*) in accordance with the CRA Regulation. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

(v) Update of the Summary

The Summary included in the Prospectus is updated in the Appendix to this Supplementary Prospectus.

General Information

Copies of this Supplement, the Prospectus and the documents incorporated by reference in the Prospectus are available free of charge from the Issuer's registered office at 1 Balloon Street, Manchester M60 4EP and from http://www.morningstar.co.uk/uk/NSM.

To the extent that there is any inconsistency between (a) any statement in this Supplement and (b) any other statement in or incorporated by reference in the Prospectus, the statements in (a) above will prevail.

5 See footnotes 2 and 3 above

Save as disclosed in this Supplement, there has been no other significant new factor, material mistake or inaccuracy relating to information included in the Prospectus since the publication of the Prospectus.

In accordance with section 87Q(4) - (6) FSMA, Holders who have submitted Exchange Instructions before this Supplement is published have the right, exercisable before the end of the period of two working days beginning with the working day after the date on which this Supplement was published, to withdraw their Exchange Instructions. This right to withdraw shall expire at close of business on 6 December 2013. Holders can exercise their right to withdraw their Exchange Instructions by following the revocation procedures set out in the Consent and Exchange Offer Memorandum appended to the Prospectus. Holders who are in any doubt as to these procedures should contact the person to whom such Exchange Instruction was originally submitted before the above deadline.

APPENDIX

SUMMARY OF THE NOTES

Summaries are made up of disclosure requirements known as "Elements". These elements are numbered in Sections A-E (A.1 – E.7).

This summary contains all the Elements required to be included in a summary for this type of security and issuer. Because some Elements are not required to be addressed, there may be gaps in the numbering sequence of the Elements.

Even though an Element may be required to be inserted in the summary because of the type of security and issuer, it is possible that no relevant information can be given regarding the Element. In this case a short description of the Element is included in the summary with the mention of "not applicable".

Section A – Introduction and warnings		
Element	**Title**	
A.1	**Warning**	This summary should be read as an introduction to the Prospectus. Any decision to invest in the securities should be based on consideration of the Prospectus as a whole by the investor. Where a claim relating to the information contained in the Prospectus is brought before a court, the plaintiff investor might, under the national legislation of the Member States, have to bear the costs of translating the Prospectus before the legal proceedings are initiated. Civil liability attaches only to those persons who have tabled the summary including any translation thereof, but only if the summary is misleading, inaccurate or inconsistent when read together with the other parts of the Prospectus or it does not provide, when read together with the other parts of the Prospectus, key information in order to aid investors when considering whether to invest in such securities.
A.2	**Consent for Financial Intermediaries**	Not Applicable. The Bank has not consented to the use of the Prospectus for any subsequent resale or final placement of securities by financial intermediaries.

Section B – Issuer		
Element	**Title**	
B.1	**Legal and commercial name of the Issuer**	The Co-operative Bank p.l.c. (the **Bank**)
B.2	**Domicile/legal form/ legislation/country of**	The Bank is a public limited company, incorporated and domiciled in the UK with its registered office situated in England and Wales. The

	incorporation	Bank operates under the Companies Act 2006 and is registered by the UK Prudential Regulation Authority (the **PRA**) and the UK Financial Conduct Authority (the **FCA**). The Bank's Firm Reference Number is 121885.
B.4b	**A description of any known trends affecting the Issuer and the industry in which the Issuer operates**	***The Bank*** The Bank is currently facing a number of financial pressures which, following a review of the financial position of the Bank, led the boards of the Bank and Co-operative Group Limited (**Co-operative Group**) to announce on 17 June 2013 that the Bank required an additional £1.5 billion of common equity tier 1 capital, as assessed by the PRA. To meet the capital shortfall, on 4 November 2013 Co-operative Group and the Bank announced details of their comprehensive recapitalisation plan (the **Recapitalisation Plan**) to strengthen the Bank's capital base, which is expected to result in an increase in the common equity tier 1 capital of the Bank of £1.5 billion by the end of 2014. The capital shortfall is a result of continuing losses incurred by the Bank predominantly driven by impairment charges to the carrying value of the Bank's loans, in particular corporate loans acquired as part of the merger with Britannia Building Society (**Britannia**) in 2009. Impairment charges for the six months ended 30 June 2013 were £496.0 million. The Bank also has a high cost base relative to its revenue when compared with its peers. The Bank has an ageing IT platform that has suffered from under-investment in recent years and has failed to integrate Britannia into the Bank's operations, resulting in significant cost duplications in front, middle and back office functions and a significant overlap in the branch network. In addition, the Bank's revenues are impacted by it not having achieved sufficient penetration of its current account customer base and historically pricing certain of its products on terms more generous to customers than the market. In response, the Bank has recently strengthened its management team and has adopted a comprehensive new business strategy that is targeted at addressing the issues identified above, reducing the overall risk profile of the Bank and restoring the Bank to health. Whilst the Bank has already taken a number of actions to try to address the challenges it faces, it is clear that it is in the early stages of turning itself around and that the legacy issues identified above will continue to have an impact on the Bank for some time.
B.5	**Description of Co-operative Group and the Issuer's position within Co-operative Group**	Co-operative Group is the UK's largest mutual business, owned by over 7 million consumer members. It is the UK's fifth biggest food retailer, a leading farmer and a major financial services provider. Among its other businesses are a funeral services provider, a pharmacy chain and a legal services provider.

		The Bank is currently a subsidiary of Co-operative Banking Group Limited (**Banking Group**) which is itself a subsidiary of Co-operative Group. Co-operative Group is the ultimate holding entity of Banking Group and its subsidiaries.
B.8	**Selected key pro forma financial information**	The unaudited pro forma balance sheet as at 30 June 2013 has been prepared to show the pro forma impact of the liability management exercise being conducted by the Bank and Co-operative Group (the **Liability Management Exercise**), on assets, liabilities, equity and certain capital and leverage ratios, as if it had taken place as at 30 June 2013. It has been prepared for illustrative purposes only in accordance with Annex II of the Prospectus Directive (Directive 2003/71/EC as amended) and should be read in conjunction with the notes set out below. Because of its nature, it addresses a hypothetical situation and therefore does not represent the Bank's actual financial position as at 30 June 2013, nor is it indicative of the results that may or may not be expected to be achieved in the future. The successful completion of the Liability Management Exercise is expected to be earnings enhancing as a result of interest savings on Existing Securities (as defined below) surrendered in the Liability Management Exercise, net of coupon payments on New Securities issued in the Liability Management Exercise. **Balance sheet as at 30 June 2013** *Adjustments* *As at 30 June 2013*[(1)] / *Liability Management Exercise*[(2)] / *Additional New Ordinary Share Offer*[(3)] / *Expenses of the Exchange Offers*[(4)] / *Unaudited pro forma* *(£ millions)* Cash and balances at central banks: 5,402.1 / – / 125.0 / (43.0) / 5,484.1 Other assets: 41,230.2 / – / – / – / 41,230.2 **Total assets**: 46,632.3 / – / 125.0 / (43.0) / 46,714.3 **Liabilities** Other borrowed funds: 1,248.1 / (1,042.1) / – / – / 206.0 Other liabilities: 44,369.5 / – / – / – / 44,369.5 **Total liabilities**: 45,617.6 / (1,042.1) / – / – / 44,575.5 Total equity: 1,014.7 / 1,042.1 / 125.0 / (43.0) / 2,138.8 **Total liabilities and equity**: 46,632.3 / – / 125.0 / (43.0) / 46,714.3 **Notes:** (1) The accounting policies adopted in preparing the pro forma balance sheet as at 30 June 2013 are consistent with the accounting policies adopted in preparing the Interim Financial Information. No account has been taken of actual changes in the trading or financial position of the Bank since 30 June 2013. (2) The Liability Management Exercise is assumed to generate £1,042.1 million of capital on the basis of full participation in the Liability Management Exercise.

		(3) £125,000,002.50 of Additional New Ordinary Shares will be issued as a result of the Additional New Ordinary Shares Offer. (4) The expenses of the Liability Management Exercise to be borne by the Bank are estimated at approximately £51.0 million (inclusive of VAT), of which approximately £8.0 million was recorded in the six months ended 30 June 2013. The remaining balance of approximately £43.0 million will be paid by the Bank out of cash resources. A portion of these expenses may be allocated to the Bank Tier 2 Notes rather than wholly against total equity. This allocation has not yet been determined. (5) No adjustment has been made to reflect the legally binding and irrevocable commitment, provided to Bank by Banking Group on 4 November 2013, conditional only upon the successful completion of the Liability Management Exercise, to contribute up to £333.0 million of capital to the Bank during 2014.
B.9	**Profit forecast or estimate**	On 29 August 2013, the Bank published its interim results for the six months ended 30 June 2013. The interim results contained the following statement: "*Clearly there are lessons to be learned from the last few years but it is vital that the new management team focuses on navigating the short-term issues and building the strategy that is targeted at returning the business to health in the future. We have already taken a number of actions but it is clear that we are in the early stages of turning the Bank around. Indeed, we do not expect to be profitable for some years and legacy issues will continue to have an impact on the Bank for some time*." The statement above regarding profitability represents a profit forecast under the prospectus rules published by the FCA under Part VI of the Financial Services and Markets Act 2000, as amended (the **Prospectus Rules**). The Directors have considered the above statement and continue to believe that it is valid based on the assumptions below as the Bank will not be profitable in 2013 and 2014 and can give no assurance that the Bank will generate a profit for some years thereafter. **Basis of preparation and principal assumptions** This profit forecast is based on the interim results for the six months ended 30 June 2013, the unaudited management accounts for the eight months ended 31 August 2013, management's forecast for the remaining four months ending 31 December 2013 and management's latest available projections for the financial years ending 31 December 2013 and 2014. The principal assumptions on which the profit forecast is based comprise: (a) assumptions that are within management's control including:

		• deleveraging of non-core business will be underwritten in such a manner that the anticipated future losses from deleveraging do not materially exceed the capital released from the reduction in risk-weighted assets; and • there will be no material variation to the assumed level of cost reductions and to the assumption that the cost-to-income ratio for the core business, of not less than 60 per cent., is only achieved in the longer term. (b) assumptions that are not within management's control including: • there will be no material change in legislation or regulatory capital and liquidity requirements impacting the Bank's operations; • there will be no material change in the accounting standards applicable to the Bank; • there will be no material change in interest rates affecting the Bank from those currently applicable to the Bank; • there will be no material improvement in the economic and general trading environment currently prevailing in the UK; and • there will be no material change to the competitive environment which impacts on consumer preferences. The profit forecast has been properly compiled on the basis of the stated assumptions and using accounting policies which are in accordance with International Financial Reporting Standards and consistent with those used by the Bank in the six months ended 30 June 2013 and which will be applicable for the financial years ending 31 December 2013 and 2014.
B.10	**Audit report qualifications**	The Accountant's Report on the Bank's audited Interim Financial Information for the six months ended 30 June 2013 of KPMG Audit Plc contains an "emphasis of matter" statement relating to going concern. In the opinion of KPMG Audit Plc, the risks associated with the successful execution of the Recapitalisation Plan, the main cornerstone of which is the Liability Management Exercise, indicate the existence of a material uncertainty which may cause significant doubt on the Bank's ability to continue as a going concern. There are no qualifications in the audit reports for the other periods covered by the historical financial information.

B.12	**Selected historical key financial information/significant change/no material adverse change**	The following table sets out the consolidated income statement of the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013 and 2012.

	Financial year ended 31 December			*Six months ended 30 June (Unaudited)*	
	2012	*2011*	*2010*	*2013*	*2012*
	(£millions)			*(£millions)*	
Income	771.2	817.6	821.8	355.8	385.1
Operating costs – steady state	(568.2)	(548.2)	(555.5)	(303.1)	(282.8)
Operating costs – strategic initiatives	(14.8)	(13.4)	(26.0)	(14.3)	(9.2)
	188.2	256.0	240.3	38.4	93.1
Impairment losses	(468.7)	(114.9)	(95.8)	(496.0)	(91.9)
Operating results	(280.5)	141.1	144.5	(457.6)	1.2
Significant items	(85.1)	(53.3)	(55.5)	(34.6)	(39.3)
Intangible asset impairment	(150.0)	–	–	(148.4)	–
Customer redress (including PPI)	(149.7)	(90.0)	(4.3)	(163.0)	(40.0)
Share of post-tax profits from joint venture	1.2	0.2	0.7	0.3	0.6
Financial Services Compensation Scheme levies	(24.8)	(14.5)	(11.5)	0.1	(0.8)
Fair value amortisation	15.2	86.3	(14.2)	(8.2)	19.7
Profit (loss) before taxation and distributions	(673.7)	69.8	59.7	(811.4)	(58.6)
Profit-based payments to members of Co-operative Group	–	(15.6)	(10.8)	–	–
Profit (loss) before taxation	(673.7)	54.2	48.9	(811.4)	(58.6)

The following table sets out the consolidated balance sheet of the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013.

	As at	*As at 31 December*		
	30 June 2013	*2012**	*2011*	*2010*
	(£ millions)		*(£ millions)*	
Assets				
Loans and advances to customers	32,932.9	33,693.7	34,132.3	35,144.1
Cash and balances at central banks	5,402.1	5,433.0	6,696.6	1,735.6
Loans and advances to banks	1,737.5	1,904.1	2,006.5	2,394.1
Investment securities	5,082.6	6,889.8	4,571.0	4,903.1
Derivative financial instruments	804.3	818.8	975.8	975.6
Other assets	672.9	834.0	573.4	428.8
Total assets	46,632.3	49,573.4	48,955.6	45,581.3

	As at	*As at 31 December*		
	30 June 2013	*2012**	*2011*	*2010*
	(£ millions)		*(£ millions)*	
Liabilities				
Amounts owed to customers	34,922.3	36,772.5	36,420.4	34,114.7
Wholesale liabilities	3,517.8	3,612.0	3,302.7	2,938.6
Debt securities in issue	4,610.0	4,713.7	4,164.8	4,212.2

Derivative financial instruments	662.7	967.6	1,087.9	702.4
Other liabilities	656.7	398.8	447.9	564.9
Other borrowed funds	1,248.1	1,258.6	1,258.8	975.4
Total liabilities	45,617.6	47,723.2	46.682.5	43,508.2
Total equity	1,014.7	1,850.2	2,273.1	2,073.1
Total liabilities and equity	46,632.3	49,573.4	48,955.6	45,581.3

Note:

* On 29 August 2013, the Bank published its interim financial report for 2013. The 2012 balance sheet comparatives contained in the interim financial report were represented to reflect that certain deferred tax liabilities cannot be offset against the deferred tax assets. As a result, the 'Other assets', 'Total assets', 'Other liabilities', 'Total liabilities' and 'Total liabilities and equity' each increased by £121.4 million.

The following table sets out the consolidated cash flow statement of the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013 and 2012.

	Financial year ended 31 December			*Six months ended 30 June*	
	2012	*2011*	*2010*	*2013*	*2012*
	(£ millions)			*(£ millions)*	
Net cash flows from operating activities	805.2	3,470.2	(1,333.5)	(1,978.9)	(1,654.5)
Net cash flows from investing activities	(2,344.7)	831.9	2,220.6	1,842.2	(194.2)
Net cash flows from financing activities	(34.7)	183.1	128.8	(47.2)	(51.2)
(Decrease) increase in cash and cash equivalents	(1,574.2)	4,485.2	1,015.9	(183.9)	(1,899.9)
Cash and cash equivalents at the beginning of the period	7,888.4	3,403.2	2,387.3	6,314.2	7,888.4
Cash and cash equivalents at the end of the period	6,314.2	7,888.4	3,403.2	6,130.3	5,988.5

The following table sets out selected consolidated financial information which is unaudited but which has been derived from the Bank's consolidated financial statements for the financial years ended 31 December 2012, 2011 and 2010, and the Bank's interim financial information for the six months ended 30 June 2013 and 2012.

	Financial year ended 31 December			*Six months ended 30 June*	
	2012	*2011*	*2010*	*2013*	*2012*
	(percentages)			*(percentages)*	
Core Tier 1 ratio	8.8	9.6	9.6	4.9	9.6
Loans to deposit ratio	91.6	93.9	102.5	94.3	100.5

Set out below is a description of significant changes to the Bank's financial condition and operating results during each of the periods covered in the tables above. The Bank has experienced challenging market conditions in each of the financial years ended 31 December 2010 (**FY 2010**), 31 December 2011 (**FY 2011**) and 31 December 2012 (**FY 2012**), with the UK economy failing to recover at the speed expected.

		The Bank incurred losses of £673.7 million in FY 2012, compared with a profit-before-tax of £54.2 million earned in FY 2011. These losses reflect the continuing economic downturn and prolonged low interest rates which have put pressure on the Bank's margins. In addition, and in line with the rest of the banking industry, the Bank saw an increase in the volume of Payment Protection Insurance (**PPI**) complaints in FY 2012 which resulted in an increased provision for PPI. Significant items of £85.1 million were also incurred in FY 2012, notably more than in FY 2011 (£53.3 million) and FY 2010 (£55.5 million): of these significant items costs, a significant amount was incurred in relation to the bid for the Lloyds Banking Group branches, with the remainder primarily associated with investment in the Bank's transformation and integration programmes. While the non-core business (being those business activities no longer congruent with the Bank's strategy) generated an operating loss in FY 2012, the core business delivered an operating profit, reflecting the strategy and risk appetite of the Bank. Credit impairments in FY 2012 of £468.7 million were £353.8 million higher than the £114.9 million recorded in FY 2011. This increase relates principally to credit impairment on non-core assets following a reassessment of the carrying value of the customer loan portfolios of the Bank in light of the continued and persistent weakness in the economy. In FY 2012, total income was £771.2 million, down from £817.6 million in FY 2011, a reduction of £46.4 million. This reduction reflects the cost of retained and incremental funding raised during FY 2012 in challenging market conditions and arose principally in the non-core business. In FY 2011, profit-before-tax was £54.2 million, an increase of £5.3 million over the £48.9 million recorded in FY 2010. Strategic initiative operating costs decreased by £12.6 million between FY 2010 and FY 2011 following significant strategic investment in the Bank's business in FY 2010. Income in FY 2011 was broadly stable at £817.6 million following the generation of £821.8 million of income in FY 2010. The Bank incurred significant losses of £811.4 million for the six months ended 30 June 2013, compared to losses of £58.6 million for the six months ended 30 June 2012. These losses have arisen primarily from significant additional impairment charges, intangible asset impairment and customer redress (including PPI) provisions. The Bank has announced a regulatory capital shortfall of £1.5 billion which it plans to address through the implementation of the Recapitalisation Plan comprising the Liability Management Exercise and a contribution from Banking Group (supported by Co-operative Group). The Bank's impairment charge on loans and advances for the six

		months ended 30 June 2013 was £496.0 million, up from £91.9 million for the six months ended 30 June 2012. These credit impairments, made up of £165.5 million in the core business and £330.5 million in the non-core business, are the reason for the level of operating loss for the six months ended 30 June 2013. The increase in the overall credit impairment charge is due to various factors, including the Bank's strategy of targeting non-core assets for run down and exit, improvements in the Bank's credit risk management approach and impairments incurred in the ordinary course of business due to changes in customer circumstances. In addition, the losses incurred in the six months ended 30 June 2013 were also driven by a number of significant items including a £148.4 million write-down of IT assets, £163.0 million of additional customer redress provisions and £10 million of costs incurred in connection with the aborted bid for the Lloyds Banking Group branch network. Save as set out in "*Recent events impacting the Issuer's solvency*" below (other than the first paragraph) there has been no significant change in the financial or trading position of the Bank or its subsidiaries since 30 June 2013, the date to which the last historical audited consolidated financial information of the Bank was prepared. Save as set out in "*Recent events impacting the Issuer's solvency*" below (other than the first paragraph) there has been no material adverse change in the prospects of the Bank or its subsidiaries since 30 June 2013.
B.13	**Recent events impacting the Issuer's solvency**	The Accountant's Report to the Bank's audited Interim Financial Information for the six months ended 30 June 2013 of KPMG Audit Plc contains an "emphasis of matter" statement relating to going concern. In their opinion, the risks associated with the successful execution of the Recapitalisation Plan, the main cornerstone of which is the Liability Management Exercise, indicate the existence of a material uncertainty which may cause significant doubt on the Bank's ability to continue as a going concern. The Bank believes that the failure of the Liability Management Exercise will result in the Bank ceasing to be a going concern. ***Current trading*** Consistent with the Bank's unaudited interim results for the period ended 30 June 2013, which were announced on 29 August 2013, the short term outlook for the Bank continues to be challenging. Monthly revenue and cost trends since 30 June 2013 have remained consistent with those observed in the first half of the year. The average monthly level of impairment charges in July and August has fallen as compared to average monthly levels for the first half of the year. In the period from 30 June 2013 to 30 September 2013, £0.6 billion of Non-core Assets (consisting of Non-core Business loans) were deleveraged,

		through a combination of asset sales, run-off and managed repayments, net of new drawdowns and the Bank raised £1.5 billion of secured wholesale funding. As at 30 September 2013, the encumbrance ratio was 29.8 per cent. The Bank's capital position has not materially changed since 30 June 2013 and the Bank remains dependent on the successful completion of the Liability Management Exercise.
B.14	**Dependence upon other entities in Co-operative Group**	The Bank is dependent on Co-operative Group for the provision of certain administrative services (such as finance, marketing, human resources, some risk functions and, in particular, IT) although the extent of this reliance is expected to be reduced following completion of the Liability Management Exercise as services are likely to be repatriated to the Bank. These arrangements may need to be renegotiated as a result of the successful implementation of the Liability Management Exercise. In addition the Bank is dependent on the strength of the wider Co-operative brand and its reputation with customers and potential customers of the Bank.
B.15	**A description of the Issuer's principal activities**	The Bank's core business (which as at 30 June 2013 had total segment assets of £30,021.8 million) includes the core retail and corporate banking businesses, treasury and certain other businesses. The core retail banking business product offering consists of a range of current accounts and money transmission services, lending and savings products, to individuals, households and certain small businesses in the UK, while the core corporate banking business targets small- and medium-sized businesses. The Bank's strategy is to become a retail and commercial bank focused on retail and small- and medium-sized enterprises and franchise businesses in the UK, built around the Bank's existing brand and franchise strength. The Bank had total assets of £46,632.3 million as at 30 June 2013 (£49,694.8 million as at 31 December 2012). These assets include non-core business asset classes which are not consistent with the Bank's business strategy, are being targeted for run-down or exit, and include non-performing commercial and residential real estate exposures, including non-prime residential mortgages (both income verified and self-certified), buy-to-let and other non-conforming mortgages. The Bank has approximately 4.7 million customers, and operates through a network of branches, call centres, ATMs, the internet and digital channels.
B.16	**Controlling shareholders**	The Bank is currently a wholly-owned subsidiary of Banking Group. Co-operative Group is the ultimate holding entity of Banking Group and its subsidiaries.

		Successful completion of the Liability Management Exercise will involve the issue by the Bank of ordinary shares to a number of existing investors in the Bank, being the holders of the Bank's existing lower tier 2 securities. Upon successful completion of the Liability Management Exercise, Co-operative Group will continue to own (through Banking Group) 30 per cent. of the issued shares of the Bank with the remaining 70 per cent. of the issued shares of the Bank being held by holders of the Bank's existing lower tier 2 securities. The Bank does not anticipate that, following completion of the Liability Management Exercise, any of the holders of the Bank's Dated Notes shall acquire a controlling interest in the Bank simply by participating in the Liability Management Exercise.
B.17	**Solicited credit ratings**	The Bank is rated B (long-term) (Rating Watch Negative) and B (short-term) (Rating Watch Negative) by Fitch Ratings Ltd. (**Fitch**) and Caal (long-term) and NP (short-term) by Moody's Investors Service Limited (**Moody's**). The Notes will not be rated.

Section C – Securities		
Element	**Title**	
C.1	**Description of Notes**	11 per cent. Subordinated Notes due 2023 (the **Notes**). The International Securities Identification Number (**ISIN**) for the Notes is: GB00BFXW0853.
C.2	**Currency**	British pounds Sterling.
C.5	**Transferability**	Not Applicable. There are no restrictions on the free transferability of the Notes provided that no Noteholder may require the transfer of a Note to be registered during the period of 15 days ending on the due date for any payment of principal or interest on that Note.
C.8	**A description of rights attached to the Notes including ranking and limitations to those rights**	The Notes are issued upon terms and conditions (the **Conditions**) which set out the obligations of the Bank and the rights of the Noteholders. ***Status of the Notes*** The Notes will be unsecured and, in accordance with the paragraph below describing rights on a winding-up of the Bank, subordinated obligations of the Bank and will rank equally without any preference among themselves. ***Rights on a winding-up of the Bank***

		On a winding-up of the Bank, the Trustee (on behalf of the Noteholders) will have a claim for the principal amount of the Notes together with accrued and unpaid interest which will rank at least equally with all claims of holders of all other subordinated obligations of the Bank which constitute tier 2 capital of the Bank (or are expressed to rank equally with such instruments). That claim will, however, be subordinated to the claims of depositors and other unsubordinated creditors of the Bank. Accordingly, the Noteholders will only recover any amounts under their claims if there are assets remaining once senior-ranking creditors have been paid in full. If the Bank's assets are sufficient to repay senior creditors in full, but are insufficient to repay fully the Noteholders and other creditors whose claims rank alongside the Noteholders' claims, then the Noteholders will lose some of their investment in the Notes. ***Rights of enforcement upon default*** The Notes will contain the following events of default: (a) non-payment of principal when due in respect of any of the Notes for a period of seven days; (b) non-payment of interest when due in respect of any of the Notes for a period of fifteen days; or (c) the winding-up of the Bank. In the event of a payment default, Law Debenture Trustees Limited as trustee for the Noteholders (the **Trustee**) may elect to institute proceedings for the winding-up of the Bank. The Trustee may also prove in a winding-up of the Bank on behalf of the Noteholders. If directed in writing by the holders of at least one-fifth in nominal amount of the Notes then outstanding or by an Extraordinary Resolution of the Noteholders, the Trustee shall be obliged to institute such proceedings and/or prove in a winding-up, provided it is indemnified and/or secured and/or pre-funded to its satisfaction (which means it receives assurance that it will receive the funds or be entitled or able to receive the funds to cover any costs that the Trustee incurs). Noteholders will be unable to take the above enforcement action directly unless the Trustee has become bound to act and fails to do so. Further, no other remedy (including any right of set-off in respect of any amounts owed to the Bank by a Noteholder) is available to the Trustee or the Noteholders. Accordingly, the Noteholders' rights of enforcement available are limited to the above. ***Taxation***

		All payments in respect of Notes will be made without withholding or deduction for or on account of taxes imposed by the United Kingdom or any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law. In the event that any such deduction is made, the Bank will, save in certain limited circumstances, be required to pay additional amounts to cover the amounts so deducted. ***Meetings of Noteholders*** The Conditions contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions will permit defined majorities of the holders present and voting at the relevant meeting to bind all Noteholders, including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority. The powers afforded to majorities to bind minorities are significant, and could result in material changes to the terms of the Notes, including potentially reducing the amounts of interest and/or principal payable by the Bank, changing the maturity of the Notes, including extending the time to maturity of the Notes, the timing of payments of interest and/or principal in respect of the Notes, mandatory substitution of the Notes with other securities and, in the extreme, the complete abrogation (i.e. annulment) of all rights of the holders under the Notes. ***Governing law*** English law.
C.9	**Interest, redemption, yield and representative**	***Interest*** Interest will accrue from (and including) the date of issue of the Notes at a fixed rate of 11 per cent. per year and will be payable quarterly in arrear every three-month anniversary of the issue date up to and including the date of redemption of the Notes. ***Redemption*** Unless redeemed or purchased and cancelled earlier, the Bank will be required to repay the Notes on the tenth anniversary of the issue date at their principal amount. The Bank will also have the option (subject to PRA approval) to repay the Notes before their final maturity date if there is a change in law or regulation which results in certain adverse tax consequences for the Bank or in the Notes ceasing to be eligible to qualify as regulatory capital of the Bank at an amount equal to 101 per cent. of their principal amount.

		Indication of yield The Notes will be issued at 100 per cent. of their principal amount and will pay a fixed rate of interest of 11 per cent. per year to maturity. Accordingly, the yield to an investor who initially subscribes the Notes and holds them to maturity will be 11 per cent. per annum. The yield above is stated as at the issue date on the basis of the issue price and is not an indication of future yield. ***Representative of the Noteholders*** Law Debenture Trustees Limited will be trustee (the **Trustee**) for the Noteholders. As well as taking enforcement action on behalf of the Noteholders as described above, the Trustee may (without the consent of the Noteholders) agree to certain formal, technical or minor modifications to the Notes, to any modification to correct a manifest error or which, in the opinion of the Trustee, is not materially prejudicial to the interests of the Noteholders and to waivers of breaches or proposed breaches under the Notes which it considers not to be materially prejudicial to the interests of the Noteholders.
C.10	**Derivative component in the interest payment**	Not Applicable. The Notes will not have a derivative component in the interest provisions.
C.11	**Listing/admission to trading**	Application has been made to the UK Listing Authority for the Notes to be admitted to the Official List and to the London Stock Exchange for the Notes to be admitted to trading on the London Stock Exchange's regulated market upon issue.

Section D – Risks		
Element	**Title**	
D.2	**Key risks specific to the Issuer**	***Risks relating to the Liability Management Exercise*** • Following a review of the capital position of the Bank and discussions with the PRA, it was determined and announced on 17 June 2013 that the Bank requires additional aggregate common equity tier 1 capital of £1.5 billion. Co-operative Group and the Bank have developed the Recapitalisation Plan which is intended to address this capital shortfall. The Recapitalisation Plan includes, amongst other things, the implementation of the Liability Management Exercise. At least £1 billion of this capital requirement is intended to be contributed pursuant to the Liability Management Exercise in 2013. Conditional on completion of the Liability Management Exercise, £333 million of the capital requirement is intended to be contributed by Banking Group

		during 2014 of which £170 million is to be contributed by 30 June 2014 (with £70 million of this contribution to be paid before 31 January 2014) and the remaining £163 million by 31 December 2014. The remainder of the common equity tier 1 capital is intended to be generated pursuant to an offer to subscribe for between a minimum election of 26,667 (for an aggregate subscription price of £100,001.25) and a maximum election of 33,333,334 Additional New Ordinary Shares for an aggregate consideration of £125,000,002.50 to Holders of the Dated Notes in accordance with the Scheme (as defined below) and the capital created through interest savings on the Existing Securities exchanged pursuant to in the Liability Management Exercise. Given that the success of the Liability Management Exercise is dependent on the participation of holders of Existing Securities, there is a risk that holders of the Existing Securities will fail to participate in the Liability Management Exercise in sufficient numbers such that the Liability Management Exercise fails. The Liability Management Exercise will only successfully complete if the entire principal amount of all Existing Securities is exchanged or sold pursuant to the Liability Management Exercise. In addition, there is the risk that, notwithstanding the fact that the PRA reconfirmed its assessment on 29 August 2013 and on 21 October 2013 that the Bank needed to generate an additional £1.5 billion in common equity tier 1 capital, the PRA concludes that the aggregate £1.5 billion of common equity tier 1 capital to be contributed pursuant to the Recapitalisation Plan is inadequate, which may result in either the Bank deciding not to proceed with the Liability Management Exercise or holders of the existing securities electing not to participate in the Liability Management Exercise. Whilst in the event that the Liability Management Exercise is not successfully implemented, with the result that the Bank would fail to raise sufficient common equity tier 1 capital by 31 December 2013, the Bank would take immediate action to try to address the Bank's capital shortfall, the Bank believes that, in such circumstances, the failure of the Liability Management Exercise would result in the Bank becoming subject to a resolution procedure under the Banking Act 2009 (**Banking Act**). In the event that the authorities exercise their powers under the Banking Act or there is market speculation regarding the occurrence of any such event, it is highly probable that the Bank would be materially adversely affected, and the market price of existing securities (if they remain outstanding in such circumstances) would be materially adversely affected. The Bank considers that there are fundamental uncertainties as to whether the Bank could be successfully resolved such that the Bank remains a going concern without the active participation of Co-operative Group and a substantial amount of additional capital. The Bank believes that if the Bank were to be resolved and go into an insolvency proceeding as a result of that resolution,

		Holders of existing securities would receive no recovery in respect of their existing securities. As a result, the Bank believes that the outcome of a successful Liability Management Exercise is a substantially more favourable outcome to Holders of any class of existing securities than a resolution of the Bank. • The Bank is exposed to the risk that litigation seeking to challenge the implementation of the Liability Management Exercise could materially impact or prevent the success of the Liability Management Exercise or result in all or part of the Liability Management Exercise being declared unlawful or invalid retrospectively. The success of any such arguments or claims or delay to the implementation of the Liability Management Exercise arising out of any such arguments or claims could result in the failure of the Liability Management Exercise or, if such claims were successful following the implementation of the Liability Management Exercise, could result in the Bank no longer meeting the PRA's requirement that the Bank raise an additional £1.5 billion common equity tier 1 capital. • As a result of the Bank's capital position and its dependency on the success of the Liability Management Exercise, along with other matters and uncertainties, the audit report in respect of the Bank's Interim Financial Information contains an "emphasis of matter" statement to the effect that there is material uncertainty which casts significant doubt on the ability of the Bank to continue as a going concern. Therefore the Bank believes that the failure of the Liability Management Exercise will result in the Bank ceasing to be a going concern. ***Risks relating to the Bank and its business*** The Bank is directly and indirectly subject to inherent risks arising from general economic conditions in the UK and other economies and the state of the global financial markets both generally and as they specifically affect financial institutions. Weakness or deterioration in general economic conditions or political instability in the UK or other economies could have a material adverse effect on the Bank's operations, financial condition and prospects. • ***Risks associated with implementation of the Bank's strategy:*** The difficult situation currently faced by the Bank is unprecedented for the Bank. To improve its financial and operational performance and capital position the Bank has recently adopted a new four to five year business plan. The Bank's newly adopted strategy was developed in a relatively short time-frame, has yet to be implemented and its performance and effectiveness is not yet proven. It is possible that the Bank's

		strategy may not sufficiently address the Bank's problems or deliver the expected benefits. In addition, the successful implementation 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. The Bank also does not have a track record of successfully implementing large-scale changes. In addition, notwithstanding the recent strengthening of the board and senior management team, including the appointment of Richard Pym as Chairman of the board and Niall Booker as Chief Executive Officer (amongst others), a number of further appointments are still required. Following completion of the Liability Management Exercise, the Bank intends to appoint a finance director to the Bank's board and to appoint a new Chief Operating Officer with business transformation experience. Grahame McGirr is currently both head of Co-operative Asset Management and Chief Risk Officer; following completion of the Liability Management Exercise the expectation is that a new Chief Risk Officer will be appointed allowing Grahame McGirr to focus solely on Co-operative Asset Management. In addition, Rodney Bulmer, the current Deputy Chief Executive Officer of the Bank and the Executive Director responsible for the Bank's core business has given notice to terminate his contract and is expected to leave the Bank in March 2014. A replacement will need to be found for Rodney Bulmer. The failure to recruit, or a delay in recruiting, suitable members of the senior management team or the loss of one or more members of senior management without finding suitable replacements may delay or impact on the ability of the Bank to successfully implement its strategy, notwithstanding the appointment of additional non-executive directors following completion of the Liability Management Exercise. The Bank is also reliant on the commitment and ability of persons employed by or seconded to the Bank to deliver the strategy and effectively and appropriately implement and support the numerous changes required by the strategy at the same time that significant changes, cost reductions and redundancies are being implemented. As a result, there can be no assurance that the Bank will, over the longer term, be able to successfully implement all or parts of its strategy or implement it when expected or targeted. • In addition, the implementation of the Bank's strategy has a number of specific risks: • The Bank's strategy includes leveraging the Bank's strong and differentiated brand and leading levels of customer satisfaction. The implementation of significant cost reductions, branch closures, redundancies and the reorientation of the

		Bank's distribution network may have a negative impact on the Bank's brand and levels of customer satisfaction which may, in turn, result in customer attrition. The Bank may also be unsuccessful in achieving the required shift in customer behaviour towards self-service and digital banking such that the Bank will fail to meet its cost saving objectives. Actions taken by the Bank in the implementation of its strategy may inadvertently be, or may be perceived, to be contrary to the principles of the co-operative movement which could negatively impact on the Bank's brand and its relationship with Co-operative Group. • The Bank's strategy also includes improving revenue in its core business in the medium-term through improved pricing of its products, appropriate re-pricing of existing products towards market rates, growing primary account customers in the Bank's key market segments, cross-selling products and growing the volume of higher margin unsecured lending. The Bank's ability to improve revenue in its core business is dependent upon a number of factors, including prevailing macroeconomic conditions (including the level of interest rates), the Bank's relative position versus its competitors and the ability of persons working for the Bank to appropriately cross sell products. • There is also a risk that the recent credit rating downgrades, the Bank's capital shortfall and/or the Bank's disappointing financial results for the six months ended 30 June 2013, continuing press reporting and public scrutiny of the same and of the Recapitalisation Plan and/or actions by the holders of the Bank's Existing Securities may, individually or cumulatively, over the longer term have a negative impact on the Bank's brand and reputation. • The Bank's high cost-to-income ratio continues to impact on its profitability and its capital position, and reducing its cost base remains a priority for the Bank. This cost reduction will be delivered through a number of management actions and there is no guarantee that these actions will achieve the intended cost benefits and will be successful or that they will otherwise be delivered on time or when expected. In addition, the reorientation of the Bank's distribution model and its cost reduction programme may negatively impact the Bank's customer service, which may result in customer attrition. • The Bank needs and intends to significantly improve and re-engineer its existing IT platform. This re-engineering of its IT platform is significant, both in terms of scale and cost, and involves a number of risks.

		• The inability of the Bank to deleverage its non-core assets in a controlled and capital efficient manner may have a negative impact on the Bank's operating results and financial position (in particular, its net interest margin) and its regulatory capital position. In addition, any greater than expected costs or delays in deleveraging the non-core assets may divert funding from and adversely impact the longer term development and growth of the core business. • A failure or delay in implementing the Bank's strategy or a failure by the Bank to achieve its targets may adversely affect the Bank's business, results of operation, financial position and/or prospects and, in the longer term, its ability to comply with its regulatory capital requirements. • ***Risks associated with implementation of the Bank's non-core business strategy:*** A failure by the Bank to deleverage its non-core assets in a controlled manner in accordance with its strategy may (for example, through greater than currently expected losses from the run-off or sale of non-core assets) negatively impact on the Bank's operating results and financial position (in particular, its net interest margin) and, in the longer term, its ability to comply with its regulatory capital requirements. The failure of the non-core business to deleverage its assets in a controlled manner may also hinder or restrict the longer term development and growth of the core business' business, and divert management attention from the core business. For example, it may restrict the ability of the core business to grow its existing loan portfolios or to expand its growth of other products, such as unsecured lending. In addition, notwithstanding the significant impairments already made to the non-core assets, the non-core business also has significant additional impairment risk given the underlying assets, which includes Optimum, a book of predominantly interest-only intermediary and acquired mortgage book assets (as at 30 June 2013, £7.3 billion). Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in the non-core assets suffering from more than expected impairments which would adversely impact on the Bank's operating results and financial position (in particular, its net interest margin) and, in the longer term, its ability to comply with its regulatory capital requirements. The non-core business' corporate asset book is also relatively concentrated, with the result that a small number of borrowers account for a large proportion of the total loans outstanding. A significant impairment of any of these borrowers would result in a disproportionate impact on the Bank's operating results and financial position.

		• ***Risks associated with the 2014 Commitment:*** The commitment of Banking Group to contribute £333 million of common equity tier 1 capital during 2014 (the **2014 Commitment**), in addition to being conditional upon the successful completion of the Liability Management Exercise, is subject to the ability of Banking Group to fund the commitment (supported by Co-operative Group), which is dependent on certain actions which are partially outside the control of Banking Group. In the event that Banking Group is unable to meet its obligations under the 2014 Commitment and is also unable to draw down on its support from Co-operative Group, Banking Group will be in breach of its obligations under the 2014 Commitment with the consequence that the Bank may have insufficient common equity tier 1 capital by 2014 to meet the PRA's requirements. • ***Risks associated with the Bank's requirement to maintain adequate regulatory capital, and with future changes to its regulatory capital requirements:*** The Bank is required to maintain adequate regulatory capital and capital ratios at all times. The Bank may require further capital and liquidity to meet new international capital and liquidity requirements (such reforms being commonly referred to as Basel III) as implemented in the EU through the introduction of the Prudential Requirements Regulation (the **PRR**) and a further iteration of the Capital Requirements Directive (the **PRD** and together with the PRR, **CRD IV**) beyond the level that the Bank has currently forecast and taken account of as part of the development of the Recapitalisation Plan and/or the implementation of (i) ring-fencing in the UK as currently proposed in the Financial Services (Banking Reform) Bill (the **Banking Reform Bill**) and (ii) the minimum requirement for eligible liabilities under the provisions of the European Commission's legislative proposal for a directive providing for the establishment of an EU-wide framework for the recovery and resolution of credit institutions and investment firms (the **RRD**) could also potentially impact the capital position of the Bank and require additional regulatory capital to be raised by the Bank. The actual impact of CRD IV on the Bank's capital requirements is also dependent on the European Banking Authority's technical standards, a large number of which are yet to be finalised. Based on its current understanding of how CRD IV will be implemented in the UK, the Bank believes it will, following the completion of the Recapitalisation Plan, be in compliance with the requirements of CRD IV upon their implementation. However, the risk that the final content of these technical standards may differ materially from current expectations cannot be excluded. There is also a risk of the introduction by the PRA of higher regulatory capital requirements on major UK banks. These risks that the final content of these

		technical standards may differ from the Bank's current expectations and/or that the PRA introduces higher regulatory capital requirements on the Bank than currently anticipated are not currently quantifiable and so have not been accounted for by the Bank. As a result, the Bank may become subject to regulatory capital requirements not currently anticipated or provided for. In addition, the regulatory position of the Bank may, in the future, be adversely affected by a currently unanticipated adverse economic and market environment and/or increasing interest rates in the UK or elsewhere, which may: (i) result in a deterioration in the quality of the Bank's assets; (ii) adversely impact the Bank's access to funding and capital, and (iii) negatively impact on unemployment, house prices and other factors, each of which may lead to lower than anticipated profits and higher than anticipated impairments. • The Bank is not compliant with its Individual Capital Guidance (**ICG**), although the Bank does meet its Pillar 1 requirements. The Bank has discussed, and agreed, with the PRA the Bank's recently adopted four to five year business plan which contemplates that the Bank will meet its ICG by the end of the plan period. The Bank's business plan envisages that the Bank will raise approximately £400 million by way of additional tier 2 capital during the business plan period. • Effective management of the Bank's capital is critical to its ability to operate and grow its business and to pursue its strategy. Any change that limits the Bank's ability to manage effectively its balance sheet and capital resources could have a material adverse impact on its business, financial condition, results of operations, liquidity and/or prospects. In the event that the impact of any of the new Basel III regulatory capital and liquidity requirements is greater than is currently anticipated by management, and if the Bank, as a consequence, were to suffer a shortage of regulatory capital, the Bank would expect to enter into discussions with the PRA and consider what actions to take in light of such circumstances, taking into account the regulatory capital position and requirements of the Bank at that time. Any such discussions with the PRA could take some time before agreement is reached. Any such actions, or any delay in implementing such actions or in agreeing them with the PRA, may have a material adverse effect on the Bank and its business. Possible actions might include accelerating the non-core business's asset disposal plan. Failure by the Bank to maintain adequate regulatory capital could lead to an inability of the Bank to support its business operations and implement its strategy, meet regulatory requirements, implement its investment plans, raise (in the medium term) further capital, make distributions, and could result in further changes to its credit ratings. Such consequences could, in turn, have a material adverse effect on the Bank's business, operating results, financial

		condition and prospects. A regulatory capital shortfall may result in the Bank being subject to a resolution procedure under the Banking Act. • ***Liquidity risk:*** The Bank's business is subject to inherent risks concerning liquidity, particularly if the availability of traditional sources of funding such as retail and corporate deposits and, to a lesser extent, unsecured wholesale funding (these being the principal sources of the Bank's funding) become limited and/or more expensive. This may result in an inability to operate in the ordinary course, and/or a failure to meet liquidity requirements, and/or may adversely impact the Bank's business and/or the implementation of its strategy. Given that the Bank's main source of funds is deposits, the Bank faces the risk of not being able to replace funds when they are withdrawn or, should a significant number of depositors seek to withdraw their funds, of not being able to meet its obligations to fund such withdrawals, repay lenders in accordance with its financing arrangements or fulfil commitments to lend. However, notwithstanding the steps that the Bank has taken to maintain its levels of total liquidity, given the reliance by the Bank on its customer deposits to provide funding for the Bank, any severe decline in customer confidence in the Bank could increase the amount of deposit withdrawals in a short space of time or over a sustained period. Given the relative size of the Bank's deposit base as compared with its other sources of funding, the Bank is particularly exposed to any serious loss of confidence by its depositors. Should the Bank experience an unusually high level of withdrawals which exceed the Bank's ability to manage through the application of its liquidity controls and contingency planning, this may have an adverse effect on the Bank's day-to-day operations, maintain the Bank's planned lending which may have an adverse effect on the Bank's business, results and financial position and could, in extreme circumstances, prevent the Bank from meeting its financial obligations as they fall due, meeting its regulatory minimum liquidity requirements or fulfilling its commitments to lend. In such circumstances, the Bank may be subject to a resolution procedure under the Banking Act. The credit rating downgrade experienced by the Bank has: (i) 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; (ii) negatively impacted the Bank's ability to access short-term unsecured wholesale funding; and (iii) increased the Bank's collateral requirements used in the clearing systems. In addition, the total amount of the Bank's corporate deposits also fell by approximately £1.4 billion in the first half of 2013, probably caused by the credit rating downgrade. To a lesser extent, the Bank's regulatory capital shortfall, its disappointing

		results for the six months ended 30 June 2013, and the continued press attention and speculation to which the Bank is subject have also affected the Bank's funding profile and the cost to the Bank of raising new funding. This continued impact on access to funding and increased cost of funding may, over the longer term, have adverse effects on the Bank's business, financial performance or future prospects and/or adversely affect the Bank's ability to achieve its strategic objectives. • In addition, whilst the Bank's retail deposit base has remained broadly stable (in appropriate circumstances, the Bank has managed its retail offering to mitigate against the risk of depositors withdrawing funds), a failure by the Bank to achieve its strategy, a deterioration in the Bank's operating results or financial position, or the continued press attention and speculation to which the Bank is subject may in extreme circumstances result in a severe decline in customer confidence which could result in the withdrawal of retail funds. Recent events may have caused some brand and reputational damage, but it is too early to form a definitive view as to the extent of such damage. These recent events, together with the competitive landscape in which the Bank operates, the introduction of seven day account switching and the associated increased competitor marketing activity at a time when the Bank has been constrained in its ability to undertake its own marketing activity, may be a contributing factor to an increase the Bank has seen in the switching out of current accounts. • ***Credit risk:*** The Bank is directly and indirectly subject to inherent risks arising from general economic conditions in the UK and other economies and the state of the global financial markets both generally and as they specifically affect financial institutions. These risks have been enhanced by the period of significant turbulence and uncertainty affecting the global economy and the global financial system, and the Eurozone in particular (including the risk of a break-up of the single European currency). 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 significantly lower revenues and/or greater than expected losses which could have a material adverse effect on the Bank's operations, financial condition and prospects. • ***Changes in laws and regulations and regulatory risk:*** The Bank is subject to wide-ranging legal and regulatory (including liquidity and capital) requirements and supervision. There is a risk that changes to the legal and regulatory environment may result in additional compliance costs (including the raising of further capital and/or liquidity) and diversion of management time and resources, which may adversely affect the Bank's business,

		strategy and prospects. In addition, failure to comply with such requirements may result in investigations, disciplinary action, fines, reputational damage and the revocation of the Bank's licences, permissions or authorisations which could have a material adverse effect on the Bank's operations, financial condition and prospects. Known future changes in legislation include the new capital regime commonly known as Basel III which will be implemented in the UK pursuant to CRD IV (as described above) and which will be effective from 1 January 2014. • ***Risk of litigation against the Bank:*** The Bank faces the risk that the past, current or future actions of the Bank (including in respect of the implementation of the Recapitalisation Plan, and the Liability Management Exercise of which it is a part) may result in litigation. The Bank is currently co-operating with enquiries received from the Conduct Committee of the Financial Reporting Council relating to the Bank's disclosures in its 2012 annual report and the accounts of the Bank's regulatory capital position, amongst other matters, and the FCA with respect to the Bank's compliance with the FCA's Disclosure and Transparency Rules. In addition, on 12 July 2013, Co-operative Group and the Bank announced the launch of an independent review, to be chaired by Sir Christopher Kelly, into the events that led to the recent announcement of the Recapitalisation Plan to address the Bank's £1.5 billion capital shortfall, the decision to merge the Bank with Britannia in 2009 and the proposed acquisition of the Lloyds TSB branches (the **Kelly Review**). The Kelly Review will include an analysis of strategic decision-making, management structures, culture, governance and accounting practices and aspects of the role of the Bank's auditors. The intention is to present the findings of the Kelly Review to Co-operative Group's members at its annual general meeting in May 2014. The Bank may face additional investigations or proceedings arising out of the Kelly Review. On 22 November 2013 the Chancellor of the Exchequer ordered an independent investigation into events at the Bank and the circumstances surrounding them. Separately, the FCA and the PRA each announced on 22 November 2013 that they are considering whether they should also launch their own formal enforcement investigations. Any of these risks, should they materialise, could have an adverse impact on the Bank's operations, financial results, condition and prospects, and the confidence of the Bank's customers in the Bank, as well as taking a significant amount of management time and resources away from the implementation of the Bank's strategy. • ***Conduct risk:*** The Bank is exposed to risks relating to the mis-selling of financial products, acting in breach of legal or regulatory principles or requirements and giving negligent advice.

		Any failure to manage these risks adequately could lead to significant liabilities and/or reputational damage. In addition, the Bank faces both financial and reputational risk where legal or regulatory proceedings are brought against it or members of its industry generally, or where complaints are made against it or members of the industry generally to the Financial Ombudsman Service or another relevant body. Sustained conduct reputational damage could affect the Bank's operations, financial condition and prospects. • ***Pensions:*** The main Co-operative Group pension scheme is The Co-operative Pension Scheme (Pace) (**Pace**), in which the Bank participates. At present there is an actuarial deficit in Pace: the most recent actuarial report indicated that there was a funding deficit of £715 million as at 5 April 2013. Contributions towards the deficit are agreed between the Co-operative Group and the scheme trustee following the advice of the independent scheme actuary. However, Co-operative Group has undertaken to agree with the Bank its proportion of the employer contributions in Pace (if not agreed, the matter will be referred to an independent third party). CFSMS is the employer in relation to the Britannia Scheme and charges the Bank for any payments due to the scheme in respect of members employed by CFSMS and working for the Bank. In addition, the Bank has provided guarantees in respect of the Britannia Scheme under which the Bank may become liable to contribute towards that scheme. However, Co-operative Group has undertaken to procure that if CFSMS is not controlled by the Bank, CFSMS will not take or omit to take any action without the Bank's prior agreement if the result would be to increase the Bank's liabilities or contributions in respect of the Britannia Scheme. The most recent actuarial report indicated that the funding deficit in the Britannia Scheme as at 5 April 2013 was £61 million. There are risks associated with the pension schemes due to the value of the asset portfolios and returns from them being less than expected and because there may be greater than expected increases in the estimated value of the schemes' liabilities. In addition, Pace is a non-segregated, hybrid pension scheme in which several Co-operative Group companies participate, including the Bank. On an on-going basis, each employer is responsible for funding a proportion of the Pace liabilities. In addition, an exit debt is payable where an employer exits Pace and this liability is a material risk for the Bank if it exits Pace following the LME. However Co-operative Group has undertaken not to exercise its powers without the Bank's prior written approval except (i) where the Bank is in breach of the rules of Pace, (ii) where required by law or (iii) where all other employers cease participation at the same time so that a liability of this type does not arise. There are other circumstances in which funding from an employer may be required for liabilities relating

		to members' service with another employer. In particular, where other employers in Co-operative Group have ceased to participate in the pension scheme without satisfying their liabilities (for example due to insolvency) the Bank's share of the deficit could include liabilities relating to those other employers, up to the level of the entire buy-out deficit in the scheme. These additional liabilities could have an adverse impact on the Bank's operations, financial condition and prospects. • ***Information technology:*** The Bank needs and intends to progressively re-engineer its existing IT platform. This re-engineering of its IT platform is significant, both in terms of scale and cost, and involves a number of risks. Any failure in systems as a result of not mitigating the IT risks, or in the period prior to such remediation being completed, could adversely affect the Bank's ability to conduct its business and lead to regulatory focus on the Bank, which may impact on the Bank's operations, financial condition and prospects. The Bank is also, and will continue to be, dependent on the use of third-party IT, software, data and service providers, including Co-operative Group. A failure on the part of either Co-operative Group or a third party to provide the agreed services could have an adverse impact on the Bank's operations, financial condition and prospects.
D.3	**Key risks regarding the Notes**	• ***The Notes are not protected by the Financial Services Compensation Scheme (FSCS):*** Unlike a bank deposit, the Notes will not be protected by the FSCS. As a result, if the Bank does go out of business or becomes insolvent, or if the United Kingdom authorities take action under the Banking Act (or similar future legislation) to preserve or restore the viability of the Bank, the FSCS will not pay compensation to an investor. Accordingly, in such circumstances, an investor in the Notes may lose some, or the entire amount, of its investment in the Notes. • ***The Notes are subordinated obligations of the Bank:*** The Notes will constitute unsecured and subordinated obligations of the Bank. On a winding-up or dissolution of the Bank, claims in respect of the Notes would rank behind the claims of all depositors and other unsubordinated creditors of the Bank. In a winding-up, the assets of the Bank would be applied first in satisfying all senior ranking claims in full, and payments would be made to holders of the Notes, proportionately with payments made to holders of any other equally ranking instruments (if any), only if and to the extent that there were any assets remaining after satisfaction in full of all such senior ranking claims. • ***The Notes may become subject to provisions enabling the UK authorities to convert the Notes to equity or write-down or write-off the principal amount of the Notes, and/or the UK authorities***

		may exercise existing powers under the Banking Act: There are current proposals both in the European Union (through the RRD) and in the United Kingdom (such proposals were announced by HM Treasury on 1 October 2013) which, if implemented in the United Kingdom, will enable the UK authorities to convert an instrument issued by the bank from one form or class to another (for example, a debt instrument into equity), to write down or write off instruments such as the Notes in certain circumstances relating to preserving or restoring the stability of the financial systems in the UK, the protection and enhancement of public confidence in the stability of the banking systems of the UK and/or the protection of depositors. If implemented in the United Kingdom, the use of any such powers could result in Noteholders losing some, or potentially all, of their investment in the Notes, even if the Bank does not become insolvent. In addition, the UK authorities already have considerable powers under the Banking Act to resolve a bank which is failing (or likely to fail) the threshold conditions for its authorisation to conduct banking business. These powers include, but are not limited to, the power to modify or annul the effect of an instrument or to convert securities from one form or class to another through the making of a share transfer instrument or order in respect of a bank. If the United Kingdom authorities take action under the Banking Act, Noteholders may also lose some or potentially all of their investment in the Notes. • ***Rights of enforcement in respect of the Notes are limited:*** The only events of default under the terms of the Notes are failure to pay interest or principal when due and the winding-up of the Bank. Further, the Noteholders will have limited rights to enforce default, and will only have direct rights of enforcement in the event that the Trustee representing the Noteholders fails to act having become bound to do so. • ***The conditions of the Notes contain provisions which may permit their modification without the consent of all investors:*** The terms of the Notes provide for the calling of meetings of Noteholders at which, subject to certain requirements regarding the conduct of the meeting, a specified majority of the holders present and voting may approve amendments to the terms of the Notes in a manner which will bind all holders (whether or not present at the meeting and/or voting in favour) and such amendments could have a material adverse effect on the Notes and/or the rights of Noteholders under the Notes. • ***There can be no assurance that a secondary market in the Notes will develop:*** The Notes may have no established trading market when issued, and one may never develop. If a market does develop, it may not be very liquid. The market price of Notes can

		go down as well as up, and Noteholders may be unable to sell their Notes, or may only be able to sell them at a loss.

Section E - Offer		
Element	**Title**	
E.2b	**Reasons for the Offer and use of proceeds when different from making profit and/or hedging certain risks**	The offer of the Notes forms part of the Liability Management Exercise, which is being conducted in order to raise at least £1 billion of common equity tier 1 capital for the Bank as part of its wider Recapitalisation Plan to generate £1.5 billion of common equity tier 1 capital. The Recapitalisation Plan is being implemented to ensure that the Bank has sufficient common equity tier 1 capital to meet its regulatory obligations, to minimise the risk of being resolved under the Banking Act and to ensure it can continue as a going concern. Common equity tier 1 capital is a form of capital which banks and other financial institutions are required to maintain to help absorb losses. As a direct result of the recent global financial crisis, the PRA, in line with banking regulators around the world, is requiring UK banks to bolster their capital resources so that the banks, and the UK banking system generally, is better able to withstand future losses and financial shocks. As the Notes are being offered in connection with an exchange for the Dated Notes of the Bank and 5.5555% Bonds of the Bank, the issue of the Notes will not generate cash proceeds. However, the Notes are being offered in exchange for the Dated Notes of the Bank and the 5.5555% Bonds of the Bank at a discount to the Bank's book value for those securities, which will generate common equity tier 1 capital to the extent that the liability is reduced to less than such book value.
E.3	**Terms and conditions of the offer**	The offer of the Notes (also referred to in this section as the **Bank T2 Notes**) is part of the Liability Management Exercise. The Notes will be issued at the issue price (which is 100% of the principal amount of the Notes) only upon successful completion of the Liability Management Exercise, and no Notes will be issued if the Liability Management Exercise does not successfully complete. If the Liability Management Exercise is successful and settles on 20 December 2013, the maximum principal amount of Notes which may be issued is expected to be £206,000,000. The final principal amount of Notes to be issued (if any) will be announced by the Bank via the Regulatory News Service (**RNS**) operated by the London Stock Exchange, which announcement is currently expected to be made on or around 16 December 2013 or, in the event that any meeting pursuant to the Proposals (as defined below)

		is adjourned, is currently expected to be made on or around 30 December 2013. ***Introduction*** The Liability Management Exercise is being conducted in respect of the Preference Shares, the 13% Bonds, the 5.5555% Bonds and the Dated Notes (each as defined below) (together, the **Existing Securities**). Holders who are eligible to participate in the Exchange Offers for the Preference Shares, 13% Bonds and 5.5555% Bonds in accordance with applicable securities laws are referred to below as **Eligible Holders**. The Liability Management Exercise consists of the Exchange Offers, the Proposals and the Scheme described below. The **Exchange Offers** consist of: • an invitation to Eligible Holders of the Bank's outstanding 9.25 per cent. Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516) (the **Preference Shares**) and 13 per cent. Perpetual Subordinated Bonds (ISIN: GB00B3VH4201) (the **13% Bonds**) to either: (a) offer to exchange their Preference Shares and 13% Bonds for new 11 per cent. Final Repayment Subordinated Notes due 2025 (the **Final Repayment Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group; or (b) offer to sell their Preference Shares and 13% Bonds to Co-operative Group for cash consideration payable in twelve equal instalments over twelve years and represented by new Instalment Repayment Subordinated Notes (the **Instalment Repayment Notes** and, together with the Final Repayment Notes, the **Group Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group; and • an invitation to Eligible Holders of the Bank's outstanding 5.5555 per cent. Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) (the **5.5555% Bonds**) to offer to exchange their 5.5555% Bonds for Bank T2 Notes. The **Proposals** consist of the convening of meetings of the holders of the Preference Shares, 13% Bonds and 5.5555% Bonds to vote on resolutions which, if passed, will, amongst other things (i) enable the Bank to mandatorily effect the exchange (or transfer to Co-operative Group), of any remaining Preference Shares, 13% Bonds and 5.5555% Bonds (as applicable) on the same economic terms as the terms of the

		relevant Exchange Offer(s) and (ii) result in holders agreeing to certain waivers and releases in favour of the Bank, Co-operative Group, their respective directors and certain other persons. In addition, the holders of the Preference Shares will be asked to vote on a resolution which, if passed, will enable the Bank to purchase and cancel any share capital of the Bank (which would include Preference Shares) from time-to-time without any further consent of such holders being needed. It is a term of the Exchange Offers that any holder who offers to exchange (or sell to Co-operative Group) its Preference Shares, 13% Bonds or 5.5555% Bonds in the Exchange Offers will also vote in favour of the resolutions proposed at the relevant meeting. If such resolutions are passed and implemented by the Bank they will bind all holders of the relevant Existing Securities, including those who did not vote in favour of the Proposals. The **Scheme** is a scheme of arrangement under Part 26 of the Companies Act 2006. Pursuant to the Scheme, the holders of seven series of lower tier 2 subordinated bonds of the Bank (the **Dated Notes**) will vote on proposals which, if approved by the requisite statutory majorities and sanctioned by the court and if the Settlement Condition is satisfied, will result in all of the Dated Notes (and accrued but unpaid interest on the Dated Notes up to a specified record date) being exchanged for a combination of £100 million of Bank T2 Notes and 141,666,666 new ordinary shares in the Bank representing 56.67 per cent. of the total issued share capital of the Bank following completion of the Liability Management Exercise (**New Ordinary Shares**). The holders of the Dated Notes will also be entitled to elect to subscribe for 33,333,334 additional new ordinary shares in the Bank at a price of £3.75 per additional new ordinary share representing 13.33 per cent. of the total issued share capital of the Bank following completion of the Liability Management Exercise (**Additional New Ordinary Shares**), for an aggregate consideration of £125,000,002.50, pursuant to, and on the terms of, the Scheme and, to the extent any such Additional New Ordinary Shares are not subscribed, certain holders of Dated Notes have agreed to purchase them. Holders of Dated Notes are entitled to elect to subscribe for between a minimum election of 26,667 (for an aggregate subscription price of £100,001.25) and a maximum election of 33,333,334 Additional New Ordinary Shares. ***Conditionality of the Liability Management Exercise*** The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities is exchanged or sold pursuant to the Liability Management Exercise. The last date on which the Liability Management Exercise may successfully complete is 31 December 2013. In order for the entire principal amount of all Existing Securities to be exchanged or sold pursuant to the Liability Management Exercise (i)

		each of the Proposals in respect of the Preference Shares, 13% Bonds and 5.5555% Bonds must be approved by the Holders thereof at meetings convened for the purposes of voting on such Proposals (and, in the case of the Preference Shares, a resolution in similar terms must also be approved at a general meeting of the shareholders of the Bank) and the Proposals must be capable of being implemented in accordance with their terms, and (ii) the Scheme must be approved by the requisite majority of the Holders of the Dated Notes at the Scheme meeting and sanctioned by the Court, an office copy of the sanction order must be delivered to the Registrar of Companies at Companies House and the Scheme must become unconditional in accordance with its terms (subject only to satisfaction of the Settlement Condition) (together referred to as the **Settlement Condition**). ***Offer period*** The offer period for the Liability Management Exercise is expected to commence on 4 November 2013 and end at 4.30 p.m. (London time) on 6 December 2013 (or such later date and time to which the Bank and Co-operative Group may extend the offer period by publication of a supplement to the Prospectus). However, in order to incentivise holders of the Preference Shares, 13% Bonds and 5.5555% Bonds to participate in the Liability Management Exercise early, if the Early Participation Threshold is achieved by 4.30 p.m. (London time) on 29 November 2013 (the **Early Participation Deadline**), all such holders will (if the Liability Management Exercise settles) receive more Bank T2 Notes or Group Notes on the exchange (or sale) of their Preference Shares, 13% Bonds and 5.5555% Bonds than if the Early Participation Threshold is not achieved by the Early Participation Deadline. The **Early Participation Threshold** will be achieved by the Early Participation Deadline only if, by that time, at least 75 per cent. of the aggregate nominal amount outstanding of each of the Preference Shares, the 13% Bonds and the 5.5555% Bonds has been validly offered for exchange (or sale) and/or otherwise validly voted in favour of the Proposals (and not revoked). Settlement of the Liability Management Exercise (the date on which, if the Settlement Condition is satisfied, Existing Securities will be exchanged or sold) is currently expected to be on 20 December 2013. The Bank and Co-Operative Group are entitled to amend the timetable at their discretion (subject where relevant to the approval of the Court in relation to the Scheme), and will announce any amendments by publication of a supplement to the Prospectus. ***Offer Terms***

		Preference Shares Eligible Holders of Preference Shares are being invited either: • to offer to transfer their Preference Shares to Co-operative Group in exchange for Final Repayment Notes. Holders electing this option will receive, per £1,000 in nominal amount of Preference Shares exchanged, (i) £601 in principal amount of Final Repayment Notes if the Early Participation Threshold is achieved by the Early Participation Deadline; or (ii) £551 in principal amount of Final Repayment Notes if the Early Participation Threshold is not achieved by the Early Participation Deadline (in each case subject to rounding); or • to offer to sell their Preference Shares to Co-operative Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025 and which will be represented by Instalment Repayment Notes. Holders electing this option will receive, per £1,000 in nominal amount of Preference Shares sold to Co-operative Group, (i) £1,110 in principal amount of Instalment Repayment Notes if the Early Participation Threshold is achieved by the Early Participation Deadline; or (ii) £1,060 in principal amount of Instalment Repayment Notes if the Early Participation Threshold is not achieved by the Early Participation Deadline (in each case subject to rounding). Such holders will also receive a cash amount equal to accrued but unpaid dividends on their Preference Shares from 30 November 2013, up to the Settlement Date. The next instalment of the Preference Share dividend is, under the terms of the Preference Shares, scheduled to be paid on 30 November 2013 (which is during the offer period for the Liability Management Exercise). Under the terms of the Preference Shares, the Bank will not be permitted to pay the dividend in cash, but will instead be required to allot additional Preference Shares to each holder in lieu of cash payment (**Additional Preference Shares**). The Bank expects to allot such Additional Preference Shares on 29 November 2013 (since 30 November is a Saturday). However, if the Liability Management Exercise successfully completes, then upon transfer to Co-operative Group of those Additional Preference Shares, the relevant holders will not receive Final Repayment Notes or Instalment Repayment Notes in respect thereof but rather will receive an amount in cash (in pounds sterling) equal to the cash dividend which the

		Bank would have paid on 29 November 2013 had it been able to do so under the terms of the Preference Shares. *The references above to an exchange (or sale) of £1,000 in nominal amount of Preference Shares are for illustrative purposes only. Holders of Preference Shares will be able to offer to exchange (or sell) Preference Shares in any whole multiple of £1, subject to a minimum of £2 if such holder elects the Final Repayment Notes option. There is no minimum offer amount for the Instalment Repayment Notes option.* *13% Bonds* Eligible Holders of 13% Bonds are being invited either: • to offer to transfer their 13% Bonds to Co-operative Group in exchange for Final Repayment Notes. Holders electing this option will receive, per £1,000 in nominal amount of 13% Bonds exchanged, (i) £844 in principal amount of Final Repayment Notes if the Early Participation Threshold is achieved by the Early Participation Deadline; or (ii) £794 in principal amount of Final Repayment Notes if the Early Participation Threshold is not achieved by the Early Participation Deadline (in each case subject to rounding); or • to offer to sell their 13% Bonds to Co-operative Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025 and which will be represented by Instalment Repayment Notes. Holders electing this option will receive, per £1,000 in nominal amount of 13% Bonds sold to Co-operative Group, (i) £1,560 in principal amount of Instalment Repayment Notes if the Early Participation Threshold is achieved by the Early Participation Deadline; or (ii) £1,510 in principal amount of Instalment Repayment Notes if the Early Participation Threshold is not achieved by the Early Participation Deadline (in each case subject to rounding). Such holders will also receive a cash amount equal to accrued but unpaid interest on their 13% Bonds from 31 July 2013 up to the Settlement Date. Upon successful completion of the Liability Management Exercise the Bank will also pay to all holders of the 13% Bonds the deferred interest payment originally scheduled for 31 July 2013. *The specified denomination of each 13% Bond is £1,000. Accordingly, 13% Bonds must be offered for exchange (or sale) in principal amounts equal to £1,000 or a whole multiple of £1,000.* *5.5555% Bonds*

		Eligible Holders of the 5.5555% Bonds will be invited to offer to exchange their 5.5555% Bonds for Bank T2 Notes at the following exchange ratios: • if the Early Participation Threshold is achieved by the Early Participation Deadline, £530 in principal amount of Bank T2 Notes for every £1,000 in principal amount of 5.5555% Bonds exchanged; or • if the Early Participation Threshold is not achieved by the Early Participation Deadline, £480 in principal amount of Bank T2 Notes for every £1,000 in principal amount of 5.5555% Bonds exchanged. Such holders will also receive a cash amount equal to accrued but unpaid interest on their 5.5555% Bonds from (and including) 14 December 2013 to (but excluding) the Settlement Date. The next scheduled interest payment date for the 5.5555% Bonds is 14 December 2013. The Bank intends to defer that interest payment (which it is entitled to do under the terms of the 5.5555% Bonds). If the Liability Management Exercise subsequently successfully completes, the Bank will (in addition to the accrued interest referred to in the paragraph above) pay the deferred interest payment originally scheduled for 14 December 2013. *The specified denomination of each 5.5555% Bond is £1,000. Accordingly, 5.5555% Bonds must be offered for exchange in principal amounts equal to £1,000 or a whole multiple of £1,000.* *Dated Notes* Holders of the Dated Notes will, if the Scheme is sanctioned and implemented, be entitled to receive Bank T2 Notes and New Ordinary Shares in exchange for their Scheme Claim at approximately the following exchange ratio: • £102.57 in principal amount of Bank T2 Notes and 145 New Ordinary Shares for every £1,000 of its Scheme Claim. A holder's claim in the Scheme (its **Scheme Claim**) will be equal to the sum of (i) the aggregate principal amount outstanding of such holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date; provided that a Holder's Scheme Claim in respect of any Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (which are denominated in euro) shall be the sterling equivalent of such sum, calculated on the basis of an exchange rate of £0.85644 per €1.00.

		The Scheme will provide that any interest that accrues or falls due for payment after the Scheme Record Date will be irrevocably cancelled. The Scheme Record Date (the **Scheme Record Date**) is currently expected to be 13 December 2013. The principal amount of Bank T2 Notes and the number of New Ordinary Shares which such holder will receive will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline. The holders of the Dated Notes will also be entitled to elect to subscribe for between a minimum election of 26,667 (for an aggregate subscription price of £100,001.25) and a maximum election of 33,333,334 Additional New Ordinary Shares pursuant to, and on the terms of, the Scheme. ***Delivery of Bank T2 Notes, Group Notes and New Ordinary Shares*** The Bank T2 Notes, Group Notes and New Ordinary Shares will be capable of being held and traded (i) in uncertificated form in CREST; (ii) in uncertificated form in Euroclear and Clearstream, Luxembourg (via CREST); and (iii) in certificated form outside the clearing systems. Eligible Holders of Preference Shares, 13% Bonds and 5.5555% Bonds and holders of Dated Notes who offer to exchange or sell their securities in Euroclear, Clearstream, Luxembourg or CREST will (subject as provided under "*Holding Period in respect of Dated Notes*" below) receive interests in their new Bank T2 Notes, Group Notes and/or New Ordinary Shares (as the case may be) in the same securities account as that in which they currently hold their Preference Shares, 13% Bonds, 5.5555% Bonds or Dated Notes (as applicable). Where holders currently hold Preference Shares, 13% Bonds or 5.5555% Bonds in certificated form outside Euroclear, Clearstream, Luxembourg and CREST, any Bank T2 Notes and Group Notes (as applicable) to be delivered to them will be delivered in certificated form outside Euroclear, Clearstream, Luxembourg and CREST. ***Holding Period in respect of Dated Notes*** If any holder of Dated Notes fails to comply with certain procedures in connection with the Scheme, the Bank T2 Notes and New Ordinary Shares to which such holder would become entitled pursuant to the Scheme will be transferred to Lucid Issuer Services Limited in its capacity as holding period trustee (the **Holding Period Trustee**). The relevant Bank T2 Notes and New Ordinary Shares will be held on trust by the Holding Period Trustee pending:

		(a) confirmation for or on behalf of the relevant holder of the Dated Notes that it or its Designated Recipient is eligible to receive the Bank T2 Notes and New Ordinary Shares, at which time the Holding Period Trustee will transfer the relevant Bank T2 Notes and New Ordinary Shares to the relevant holder of the Dated Notes or its Designated Recipient; (b) confirmation for or on behalf of the relevant holder of the Dated Notes that it is not eligible to receive the Bank T2 Notes and the New Ordinary Shares, at which time the relevant Bank T2 Notes and New Ordinary Shares will be sold by or on behalf of the Holding Period Trustee and the net proceeds of such sale (after deduction of all applicable taxes and expenses) will be distributed to the relevant holder of the Dated Notes; and (c) the date falling 36 months following the Scheme Settlement Date, at which time the Holding Period Trustee will sell or procure the sale of the Bank T2 Notes and New Ordinary Shares not already distributed or sold as described in paragraphs (a) and (b) above and the net proceeds of such sale (after deduction of all applicable taxes and expenses) will be distributed to the Bank. **Designated Recipient** means a person nominated by a holder of Dated Notes to receive the New Ordinary Shares and Bank T2 Notes which such holder is entitled to receive pursuant to the terms of the Scheme.
E.4	**Material Interests to the Offer, including conflicting Interests**	The Bank is as, at the date of this Prospectus, a subsidiary of Banking Group. Following completion of the Liability Management Exercise, Banking Group is expected to have a 30 per cent. holding in the Bank's ordinary shares. As a result, Banking Group and, indirectly, Co-operative Group, are expected to continue to be able to exercise influence over matters requiring shareholder approval. HSBC Bank plc (**HSBC**) has been appointed as a dealer manager and adviser to the Bank, and UBS Limited (**UBS**) has been appointed as a dealer manager, to facilitate the Liability Management Exercise. HSBC will be paid fees and expenses by the Bank in connection with the Liability Management Exercise. Each of UBS and HSBC and their respective affiliates may also have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform other services for, the Bank and its affiliates in the ordinary course of business.
E.7	**Estimated expenses charged to the investor by the Issuer**	Not applicable. There are no expenses to be charged to the investor (being the Existing Holders) by the Bank.