The Co-operative Financial Services Half Year Results 2010

The co-operative financial services

The world's most sustainable bank

Britannia

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Distinctive new force in financial services

- Member owned, customer led, ethically guided, financially strong
- Uniquely diversified amongst UK mutuals
  - offers retail & corporate customers a full range of products (banking, savings, investment, insurance and mortgages)
- Purpose, givens, values and vision
  - define us as a business, informing the decisions we make and how we behave
- Balanced scorecard
  - reflects business goals over three year corporate plan
  - measures success in four areas: financial, customer, people, process

Summary

- Strong financial performance
  - profitability improved despite impact of low interest rates
  - underlying profit up to £85m from £21m in H2 2009
  - rigorous cost control
  - like-for-like impairments down 39% from H2 2009
- Balance sheet reflects underlying strength
  - well-managed asset quality
  - continuing, strong capital position
  - excellent liquidity and funding profile
- Building a platform for growth and transformation
  - integration on track
  - moving towards integrated customer proposition

Market context

- Overall market conditions remain difficult
  - UK Financial Services market slowly recovering from recent financial crisis
  - banks repairing funding models and recapitalising
  - also preparing for future regulatory tightening
- Considerable uncertainty over UK economic outlook
  - potential fallout from Eurozone sovereign debt crisis
  - risks of double-dip recession
  - scale and timing of future changes to interest rates, inflation etc. remains uncertain

Strong financial performance

Excellent results, despite difficult conditions

- CFS operating profit up 47% on a statutory basis (vs H109, excluding change costs), and from £21m to £85m on a like-for-like basis (vs H209,excluding change costs), despite:
  - low interest rate environment
  - weakness in funding markets
  - impact of poor weather on GI claims
- downward pressure maintained on underlying costs
  - like-for-like costs down 3% (6% real terms reduction)
  - forecast synergies for 2010 are ahead of target and expected to achieve c. £40m by December 2010
  - cost-efficiency ratio (including L&S business) of 35.8% (41.4% for H2 2009, like-for-like)
- continuing to benefit from strong diversification between CAM and Retail sectors

Prudent balance sheet

Balance sheet reflects underlying strength:

- well-managed asset quality
  - reducing LTVs
  - reducing arrears
- continued strong capital position
  - Bank tier 1 ratio of 10.4% excluding H1 2010 profits (9.0% excluding PSBs)
- continuing to be strongly customer funded:
  - excellent growth of £1.4bn in deposits reflecting 97% ISA retentions, attraction of new funds and successful relationship business model
  - customer funding ratio* shows a substantial increase to 110% (104% at December 2009)

* deposits as a percentage of loans, excluding securitised assets

Strengthening profitability

Profitability | Asset quality | Capital | Liquidity

Statutory P&L

- income and cost growth reflect larger post merger business
- impairments down, arrears down
- claims in line with insurance income growth

	H1 2010 £m	H1 2009 £m	Change %
Net interest income	**356**	259	37%
Net earned premium	**216**	202	7%
Non interest income	**101**	95	6%
Income	**673**	556	21%
Costs - Steady State	**(338)**	(247)	(37%)
Claims	**(162)**	(148)	(10%)
Impairment	**(43)**	(73)	41%
Operating result before change costs	**130**	88	47%
Significant items & change costs	**(43)**	(29)	(47%)
Other	**(11)**	(9)	(31%)
Profit before tax, distribution and FVA	**76**	50	50%
Fair value amortisation	**(23)**	-	-
Profit before taxation and distributions	**53**	50	6%

Strengthening profitability

Like-for-like P&L

- significant increase in underlying profitability
- costs down
- impairments down, arrears down
- claims in line with insurance income growth
- profits up:
  - 299% on H2 2009 (like-for-like)
  - 25% on H1 2009 (like-for-like)
  - 47% on H1 2009 (statutory)

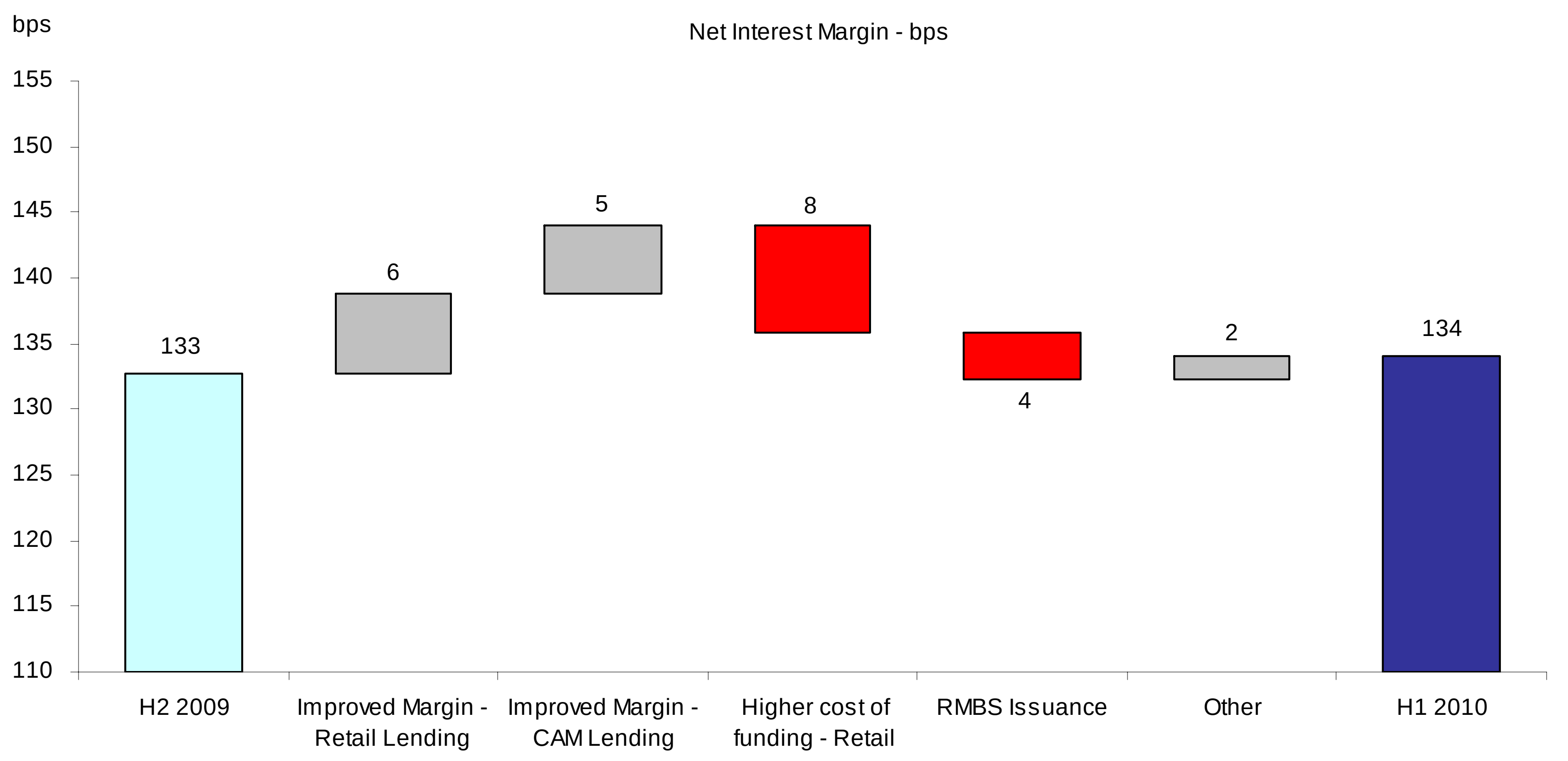
	H1 2010 £m	H2 2009 £m	Change %
Net interest income	**356**	365	(2%)
Net earned premium	**216**	195	11%
Non interest income	**101**	104	(3%)
Income	**673**	664	1%
Costs - Steady State	**(338)**	(350)	3%
Claims	**(162)**	(149)	(9%)
Impairment	**(89)**	(144)	39%
Underlying operating profit	**85**	21	299%
Significant items & change costs	**(43)**	(52)	17%
Sub debt buy back	**-**	58	(100%)
Other	**(11)**	11	(207%)
Profit before tax & distributions	**30**	38	(20%)

Revenue growth

- Total income
  - 21.0% up on H1 2009 (statutory basis)
  - 1.5% up on H2 2009 (like-for-like basis)
- Strong GI performance:
  - healthy growth in volume of both written and net earned premiums (earned premiums up 11% like-for-like)
  - more than offsetting increase in claims
- Net interest margins broadly unchanged
  - improved mortgage margins offset by higher costs of term deposit and wholesale funding
- New lending: £1.1bn mortgage lending, £0.4 bn corporate lending
- Mortgage applications up: over 18,000 new Retail mortgage applications in H1 2010 (up 31% by value)
- Current account balances up 6% against H2 2009

Margins remain robust

Profitability | Asset quality | Capital | Liquidity



Tight control of costs

Profitability | Asset quality
Capital | Liquidity

Like-for-like costs

- costs down 3.3% on H2 2009, despite inflationary increases
  - reflects rigorous cost management
  - cost-efficiency ratio (including L&S business) of 35.8% (41.4% for H2 2009, like-for-like)
- real terms reduction of 6%, based on RPI of 2.4%
- reduction in FTE from 11,902 (June 2009) and 11,666 (Dec 2009) to 11,594 as at June 2010
- forecast synergies for 2010 are ahead of target and expected to achieve c. £40m by December 2010

Tight control of claims

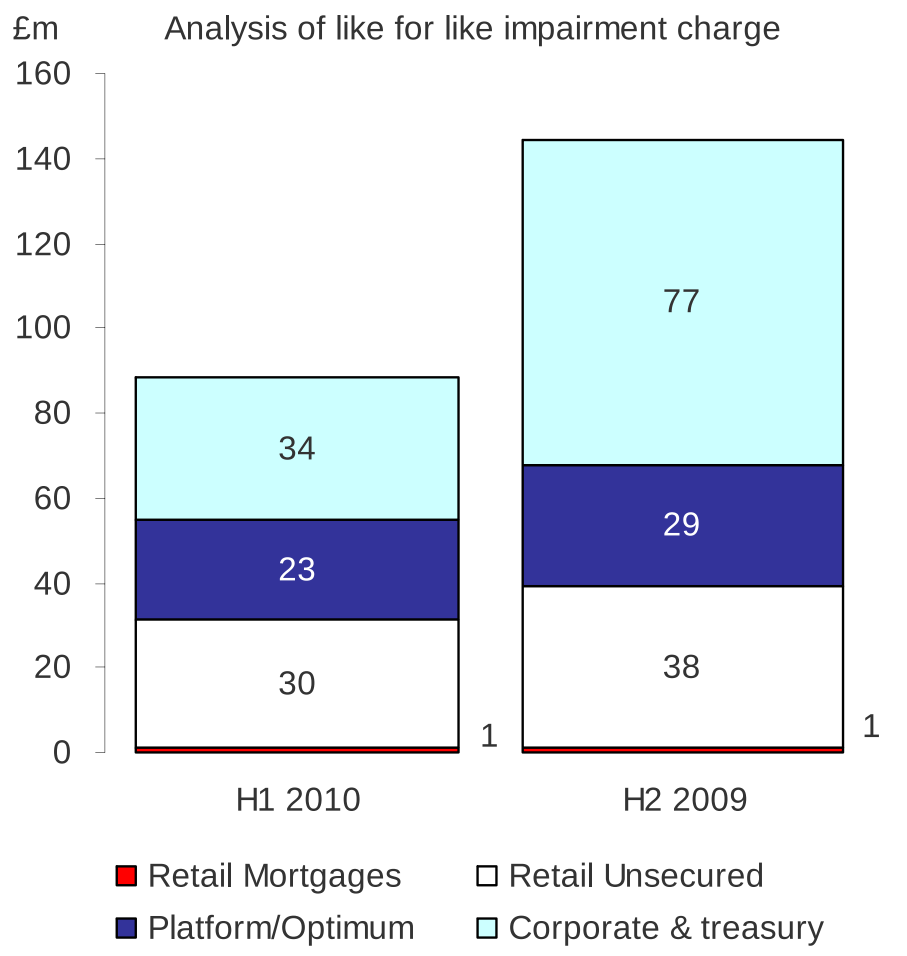
- GI claims 9.1% higher
- Increase due to increased business being written (11% increase in like-for-like net earned premiums)
- £7m (5%) impact from weather related claims due to exceptionally cold weather in early 2010

	Like for Like Basis	
	H1 2010	**H2 2009**
Gross written premium	270.5	220.4
Net earned premium (NEP)	216.0	195.3
Claims cost	162.3	148.8
Claims / NEP	75.1%	76.2%

Lower impairments

Profitability | Asset quality | Capital | Liquidity

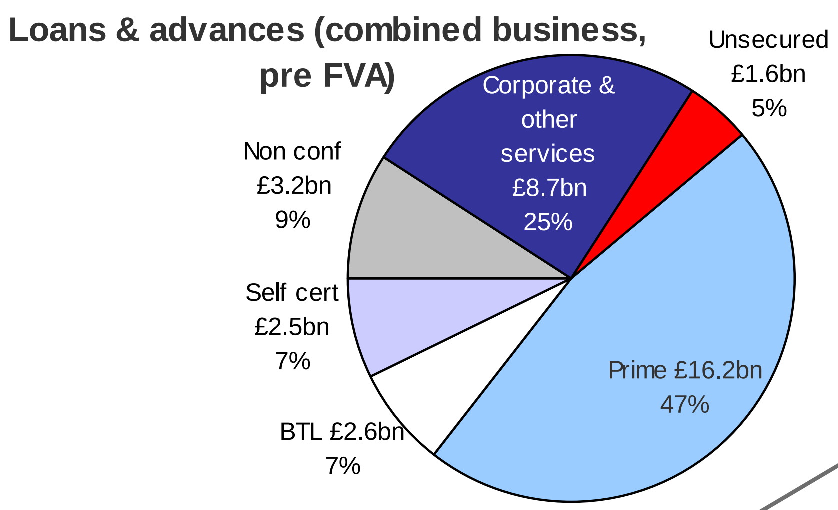
- Like-for-like impairments down 38.6% on H2 2009 (excl FVA benefit)
- Reduction in all impairment categories due to:
  - continued focus on credit risk, and prudent 2009 provisioning
  - improved arrears collection processes
  - tightening of credit risk scorecards in unsecured lending
- Substantial FVA asset protection



Well managed asset quality

- High quality, diversified loan portfolios
  - residential book
    - reducing arrears
    - predominantly prime, with broad geographical spread
    - well seasoned
    - low and reducing LTVs
  - downwards arrears trend in unsecured book
  - strong corporate book
    - minimal residual risk post FVA
    - granular book
  - high quality treasury assets
- Assets from hBBS business covered by FVA

High quality loan portfolios



Of which, assets from heritage Britannia business are covered by prudent FVA protection

Heritage Britannia assets with credit FVA protection

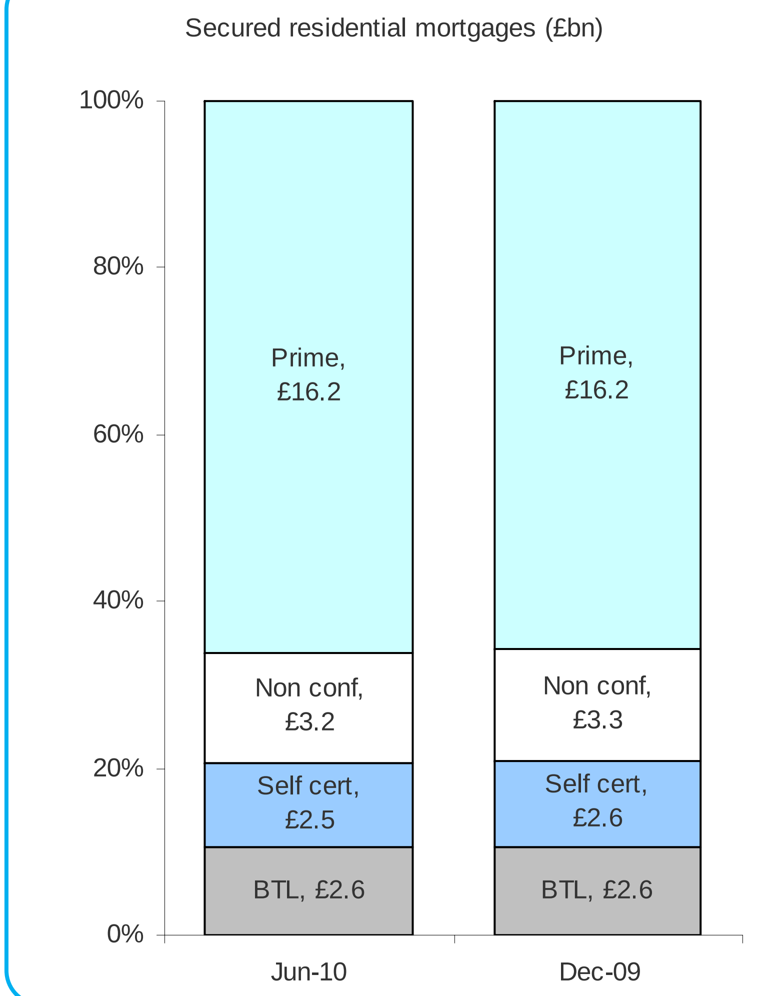
£m	Gross balances	LEL + existing prov'n at merger *	Utilised since merger	LEL prov'n remaining	as % of assets
Retail residential	10,434	10	(1)	10	0.1%
Optimum / Platform	9,322	310	(65)	245	2.6%
Corporate	3,610	312	(31)	281	7.8%
Loans & advances	**23,366**	**632**	**(96)**	**536**	**2.3%**
Treasury	5,878	113	(17)	97	1.6%
Total	**29,244**	**745**	**(113)**	**632**	**2.2%**

* including exchange rate movements

Low risk residential portfolio

Profitability | Asset quality | Capital | Liquidity

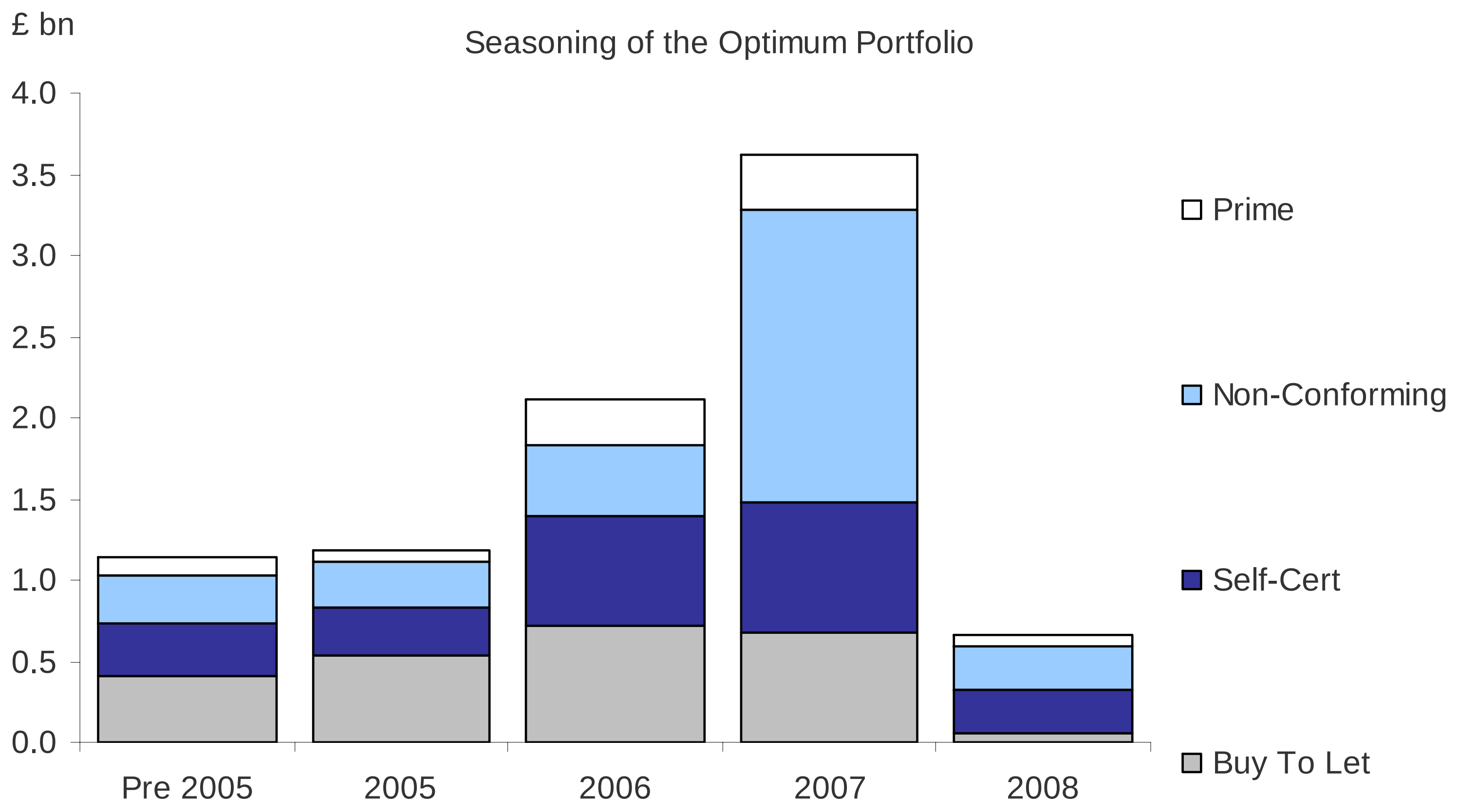
- Predominance of prime
- Broad geographic spread
- Clear focus on:
  - affordability
  - back book management
- Appropriate cover of Optimum portfolio
  - 23% with arrears – covered by provisions
  - 77% with no arrears – covered by Fair Value
  - non-arrears book weighted towards lower risk lending



Low risk residential portfolio

Profitability | Asset quality | Capital | Liquidity

- 92% of the Optimum non-prime book was originated before 2008



Low risk residential portfolio

Profitability | Asset quality
Capital | Liquidity

Self cert loans originated by Platform

- borrower's income declaration assessed by underwriters for reasonability re:
  - business trade and location
  - existing versus new commitments
- verification call also made or proof of self-employment obtained
- in any case, loans are now well seasoned

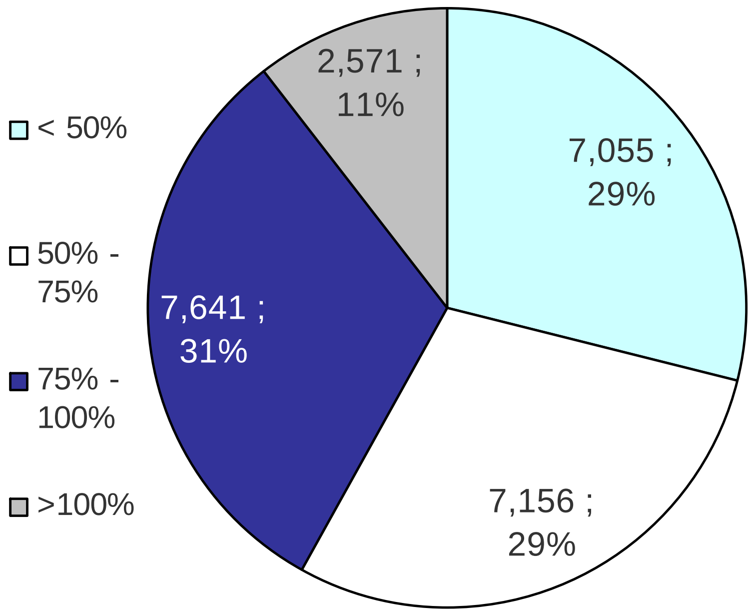
Low risk residential portfolio

Profitability | **Asset quality** | Capital | Liquidity

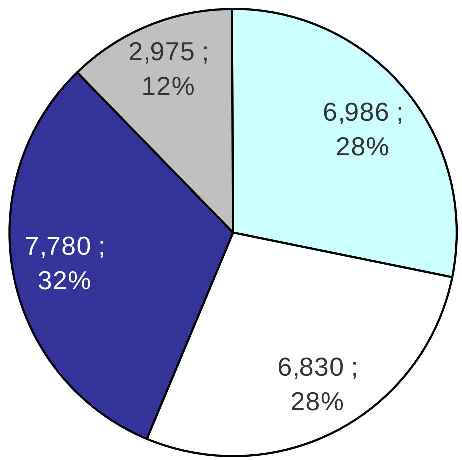
Low, and reducing, LTVs

- average indexed LTV (book): 51.5% (51.9% at Dec 09)
- average LTV (new lending): 57.1% (59.1% at Dec 09)

June 2010 LTV analysis (£m)



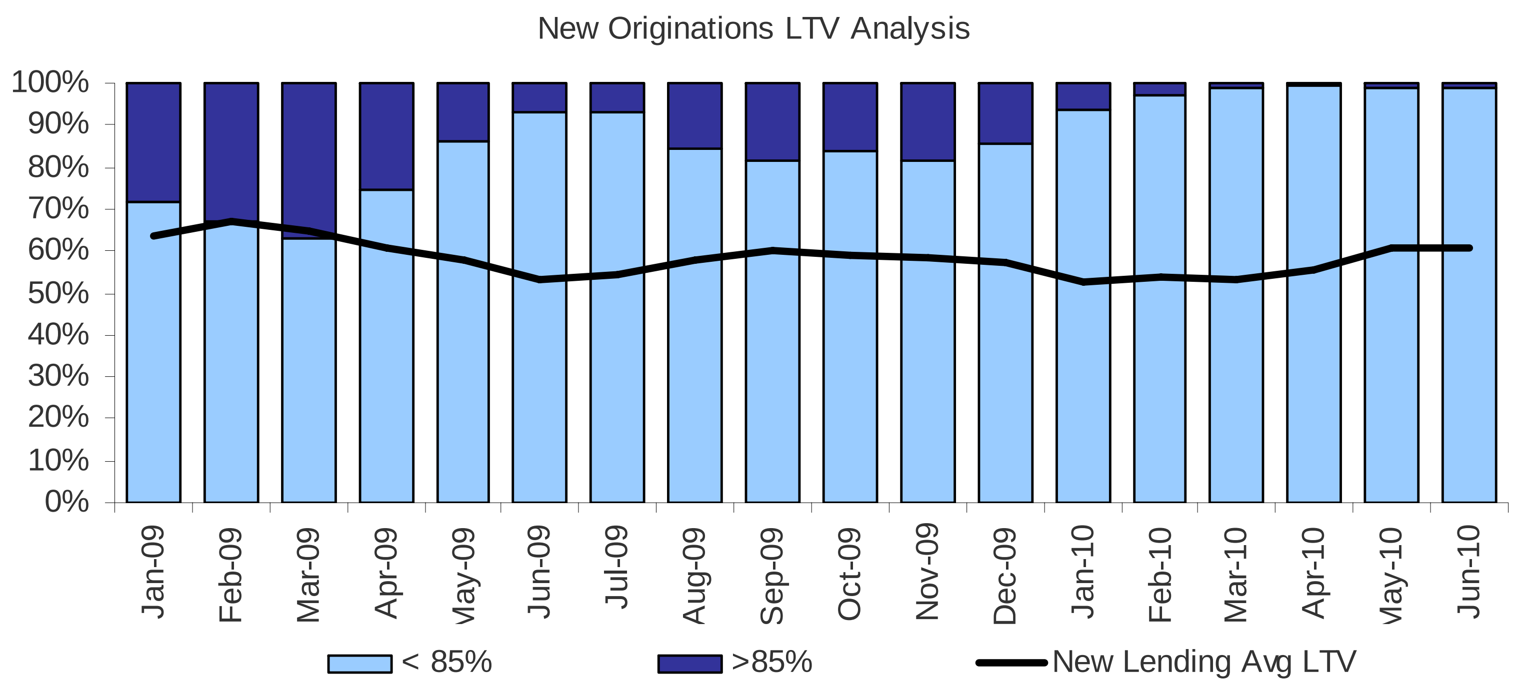
December 2009 (£m)



Low risk new mortgage lending

Focus on lower LTV business - of 2010 new lending:

- 75% was < 75% LTV
- 98% was < 85% LTV



Reducing residential arrears

Profitability | **Asset quality** | Capital | Liquidity

Well managed arrears, with ongoing actions

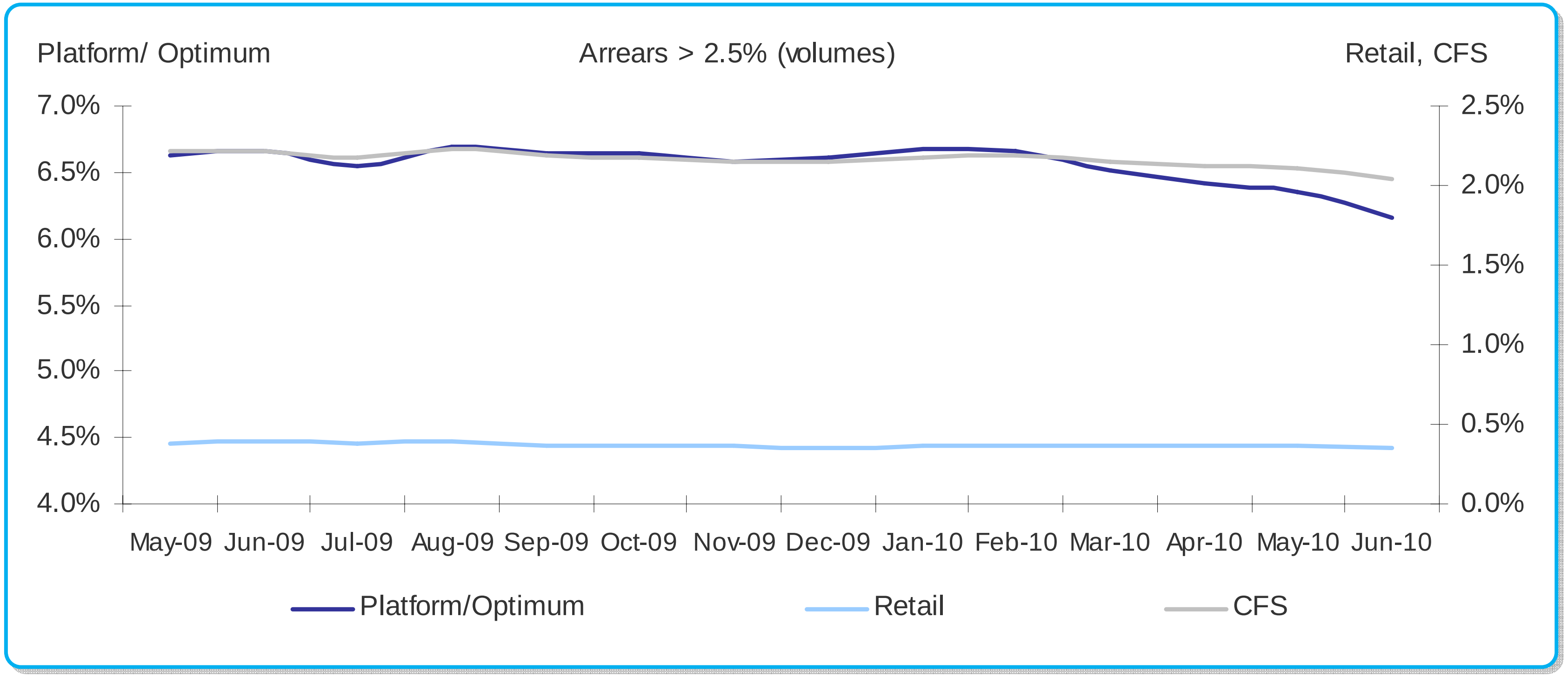
- enhanced management structure and additional resource in place
- increased use of LPA receivers to improve cash collected on BTL book
- improved outbound & inbound technology to improve contact rates
- pre-arrears mailings to support customers in early financial difficulties

	Jun-10		Dec-09
	No of accounts	>=2.5% arrears	>=2.5% arrears
Prime	197,453	0.5%	0.5%
BTL	23,078	0.6%	0.8%
Self Cert	16,245	3.7%	3.7%
Non Conforming	29,304	12.8%	13.5%
Total	**266,080**	**2.04%**	**2.15%**

Profitability | **Asset quality**
Capital | Liquidity

Reducing residential arrears

- Residential arrears (overall arrears) lowest since August 2008
- >2.5% arrears peaked in May 2009

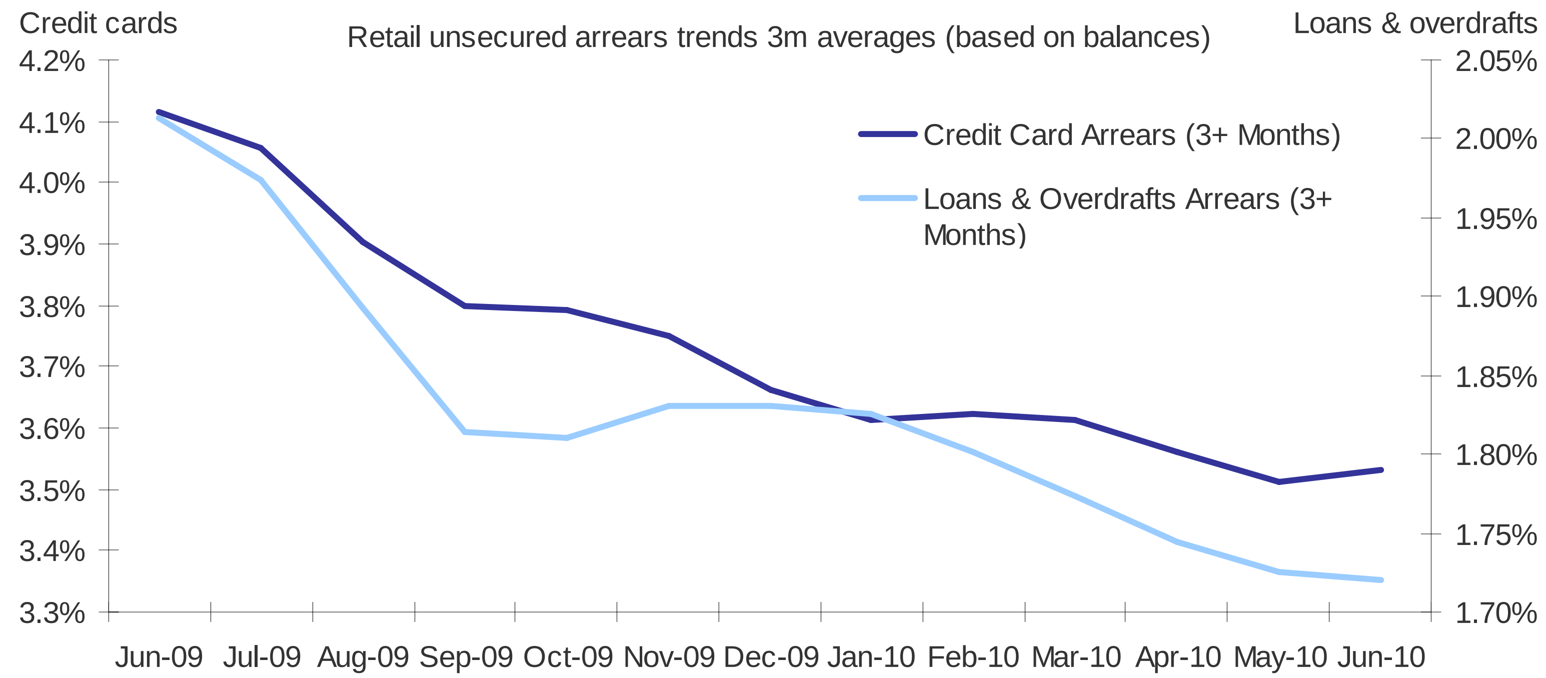


Strong unsecured portfolio

Profitability | Asset quality | Capital | Liquidity

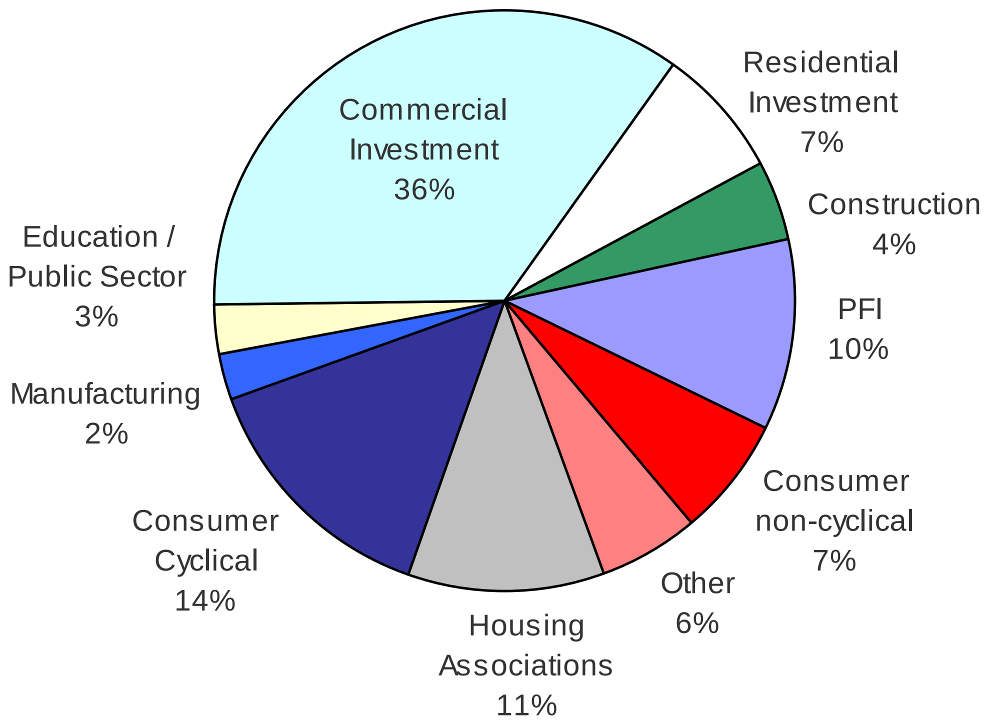
Low risk book of £1.6bn

- despite challenging market conditions, continued reduction in bad debt charge; H1 2010 c. 20% lower than H2 2009 (like-for-like basis)
- downwards trend in arrears balances

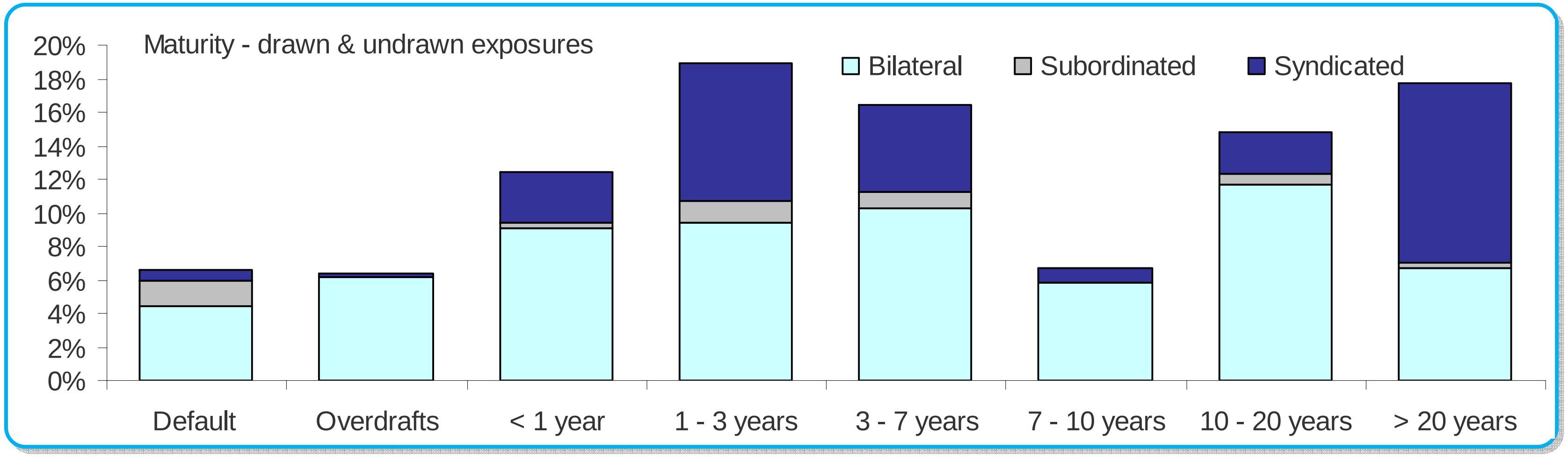


Diversified corporate portfolio

- £8.7 bn portfolio (£10.2 bn drawn and undrawn)
- Risk appetite: comprehensive structure of portfolio limits
- Centralised underwriting provides strong control & governance

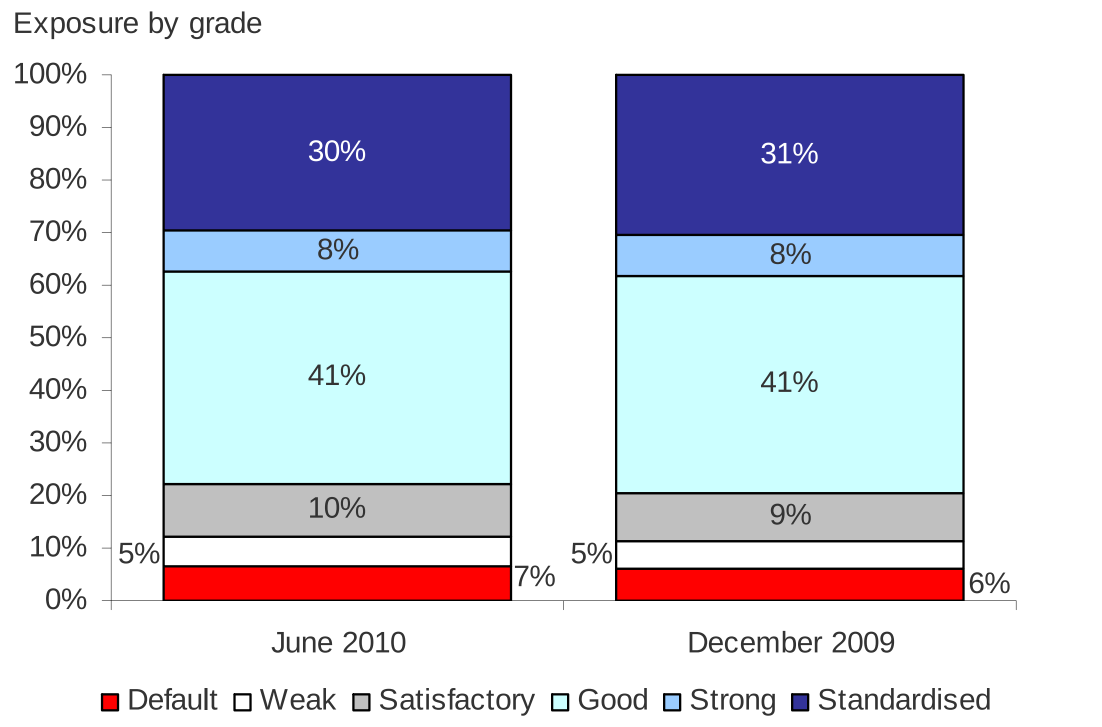


Diversified corporate portfolio



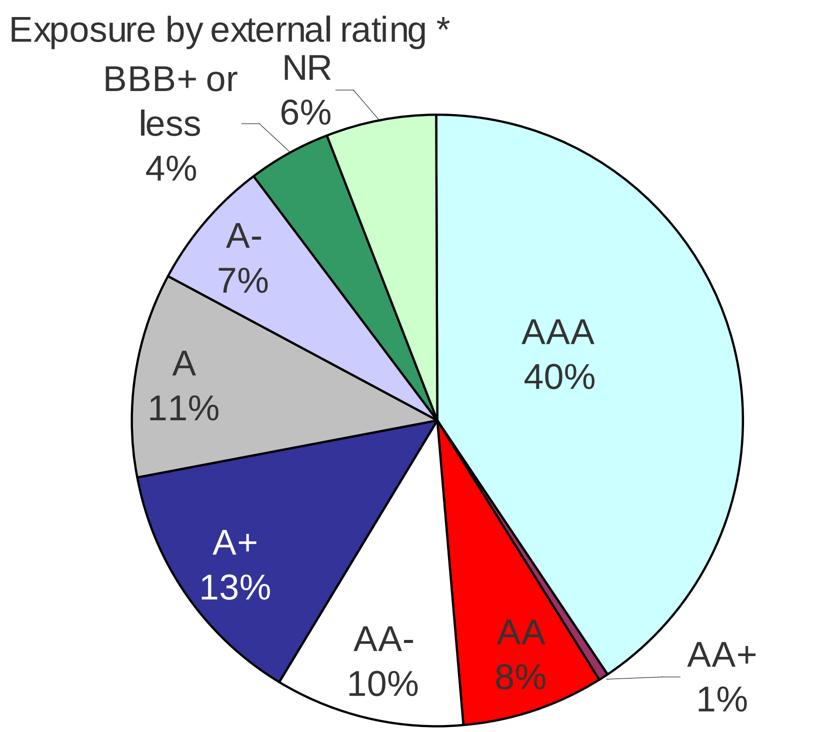
Well managed corporate portfolio

- Risk profile stable
- Of assets in default:
  - 88% already provided for, protected via FVA or secured by collateral
  - remainder largely expected to perform with minimal at-risk element



High quality treasury assets

- Higher risk Eurozone exposures closely monitored (Portugal, Ireland, Italy, Greece, Spain)
  - prudent reduction of exposures & limits over the last 24 months
  - no exposure to Greek counterparties
  - reduced term & absolute exposure with the remaining countries
- No further longer term exposure currently being undertaken
  - still active in short term (< 3m) money markets, albeit with caution and to a smaller number of higher rated counterparts



* total treasury assets excluding cash; as valued for credit risk purposes

Continued robust CFS capital

Stable CFS capital

- CFS significant capital surplus > £1.6bn against absolute regulatory minimum
- reduction due to planned investment in change programme and planned dividends to group

CFS capital (excluding H1 2010 profits)	Jun-10	Dec-09
Bank surplus over Pillar 1	1,007	1,046
Other Shareholder Capital	182	230
GI *	129	91
General Reserve	317	317
Total CFS Capital	**1,635**	**1,684**

* excess over MCR

Profitability | Asset quality | Capital | Liquidity

Continued robust Bank capital

- Stable bank surplus, ahead of prudent internal forecast
- Full year forecast anticipates continued weak economic backdrop
- Rigorous stress testing via ICAAP reviewed by FSA
- Potential enhancement of Bank capital from other CFS reserves

£m	Jun-10	Dec-09
Core Tier 1 Capital	1,833	1,738
Preference Shares	60	60
PSBs	259	257
Lower T2 sub debt	617	614
Less: capital deductions / other	(206)	(109)
Capital Resources	**2,563**	**2,560**
RWEA	19,451	18,926
Pillar 1 Capital Requirement	**1,556**	**1,514**
Capital Buffer over Pillar 1	**1,007**	**1,046**
Solvency Ratio	13.2%	13.5%
T1 Ratio (incl PSBs)	10.4%	10.4%
T1 Ratio (excl PSBs)	9.0%	9.0%
Core T1 Ratio	8.7%	8.7%

Excellent customer funding

Profitability | Asset quality | Capital | **Liquidity**

- Strong growth in liability balances to fund asset growth:
  - customer deposits up by £1.4bn *, particularly fixed rate/term deposits
  - customer funding over customer loans excess of 110% **
- Retail: £0.5bn growth in deposits
  - customer behaviour shift due to low rate environment:
    - from demand to term
    - lower spend reflected in higher current accounts
  - competitive advantage from mutuality and ethical stance
  - best ISA season since 2002 (£3.5bn invested, 97% retained)
  - multi channel distribution (e.g. direct sales, web, branch network)
- Corporate (including business services): £0.8bn growth in deposits

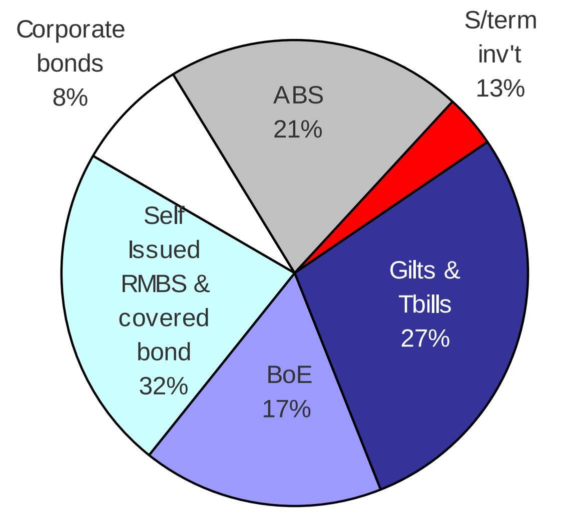
* includes additional growth for Treasury and Unity Trust Bank

** excluding securitised loans

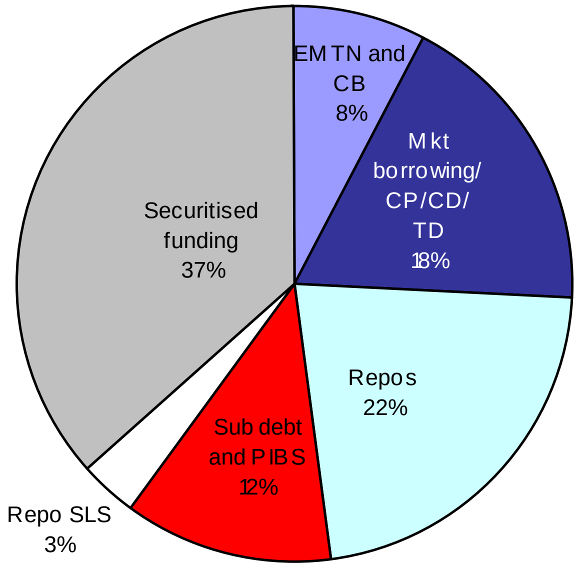
Deep liquidity, excellent funding

- High quality liquid assets
  - liquid asset ratio* 9.2% (Dec 09: 5.9%)
  - £9.7bn unencumbered assets
- Strong wholesale funding
  - Silk road securitisation completed

Unencumbered Assets



Diversified funding sources



External funding maturity

(excl perpetual debt, ST money market)

£bn	2011	2012	2013	2014	>2015
MTN	0.6		0.1		
Securitised funding	1.1	0.6			1.4
Subordinated debt	0.2			0.2	0.4
Total	1.9	0.6	0.1	0.2	1.8

* Cash + gilts as a proportion of total liabilities

Strong risk management strategy

- Clear risk appetite
- Key risks identified and stress tested as part of strategic planning
- Risk tolerance and triggers for mitigating actions set
- Robust Risk Governance structure including independent Chief Risk Officer and Board Risk Committee
- Internal and external monitoring identifies changing risk profiles

Three year transformation under way

- Planned investment > £700m:
  - replacement of core banking system
  - integration of CFS and Britannia
  - ‘business as usual’ change
- Defined outcomes mapped across our balanced scorecard
  - reflects business goals over three year corporate plan
  - measures success in four areas: financial, customer, people, process
- Change managed to ensure operations not jeopardised
- Customer advocacy/employee engagement remains very high
- Credibility in industry underpinned by awards, culminating in FT recognition as World’s Most Sustainable Bank

Open for business

- Retail mortgage applications up: over 18,000 new applications in H1 2010
  - 10% increase in volume
  - 31% increase in value
  - consistent coverage in best buy tables and market leading 90% mortgage range
- Platform applications up from £0.4bn in H2 2009 to £0.6bn in H1 2010
- Retail savings book grew by £0.5bn adding extra 142,000 new savings accounts (2% growth)
- Corporate (including business services) deposits increased by £0.8bn in H1 2010 (24% growth)

Building a platform for growth…

- Integration programme on track – excellent progress
  - forecast synergies for 2010 are ahead of target and expected to achieve c. £40m by December 2010
  - Co-operative current accounts on sale in all heritage Britannia branches
  - combined membership reward payment being developed
  - organisation redesign virtually complete (excellent engagement from trades unions, focus on redeployment)
  - integration of three mortgage origination processes into one underway
  - property strategy agreed, and rationalisation in progress
- New banking systems begin to deliver customer benefits
  - phased rollout of new on-line banking solution to 34,000 business (SME) and 1,200 corporate customers from June 2010
  - very positive early customer feedback re speed & intuitive, modern layout

...and transformation

Future outcomes of transformation plan:

- all customers see us as a single consistent company, supported by modern flexible systems and processes
  - merging the heritage networks
  - reviewing our brand strategy
- all staff feel that they work for one business
  - implementing a single employee proposition
  - organisation design work complete, all roles filled
  - single processes for common activities
  - simplified, resilient, modern and supported IT
- rationalisation and consolidation of 'head office' premises complete, including exiting, refurbishing and new builds

Economic outlook

- Overall assumption: slow recovery for UK economy
- Planning assumptions for 2011 – 2013:
  - muted GDP growth
  - base rate remaining low initially, but then increasing
  - moderate HPI growth
  - unemployment to peak in 2011

Well placed for future success

- Strong financial performance
  - profitability improved despite impact of low interest rates
  - underlying profit up to £85m from £21m in H2 2009
  - rigorous cost control
  - like-for-like impairments down 39% from H2 2009
- Balance sheet reflects underlying strength
  - well-managed asset quality
  - continuing, strong capital position
  - excellent liquidity and funding profile
- Building a platform for growth and transformation
  - integration on track
  - moving towards integrated customer proposition

Appendices

Overview of the business

- Merger created a unique financial mutual able to offer customers a strong, ethical alternative to High Street Banks

Merger given formal regulatory approval in July 2009, effective 1 August

Uniquely diversified amongst UK mutuals, offering retail & corporate customers a full range of products (banking, savings, investment, insurance and mortgages)

The co-operative financial services

Britannia BUILDING SOCIETY

Created a customer-owned business with £70bn of assets (CFS), 9m customers, 12,000 employees, over 300 branches and 20 corporate banking centres

Integration expected to take around 3 years and will create a strong brand presence within the UK financial services landscape

Products delivered through a truly multi-channel offering, including expanded branch network, UK-based call centres and significant web presence

Strategic statements

Purpose
To be a pioneering business delivering sustainable financial services for members and society

Givens

- We champion co-operative values and principles and ethics
- We are financially prudent and strong
- We share profits with members
- We only do business consistent with our values and principles

Values

- As a co-operative, we put our 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

Vision
To be the UK's most admired financial services business

Statutory – like-for-like CFS P&L

- More meaningful comparison of business performance
- Compares 2010 performance against second half of 2009
- Reflects a comparable 26 week period for 2009

	£m	£m	%
Operating result on a statutory basis - H1 2010 v2 H1 2009	**130**	88	47.5%
Full year 2009 statutory operating profit (excluding strategic projects £15.8m)		193	
Operating result on a statutory basis - H1 2010 vs H2 2009	**130**	105	24.4%
Up-lift H2 from 23 weeks to a 26 week period	**-**	9	
Britannia operating result for July (H2 prior to merger)	**-**	(5)	
Fair value merger adjustments	**(46)**	(88)	48.1%
Like-for-like operating result - H1 2010 vs H2 2009	**85**	21	299.1%

Statutory – like-for-like Bank P&L

Statutory PL	H1 2010 £m	H1 2009 £m	Change %
Net interest income	**308**	202	52%
Non interest income	**95**	94	2%
Total income	**403**	296	36%
Costs - Steady State	**(266)**	(176)	(51%)
Impairment	**(43)**	(73)	41%
Operating result (before change	**95**	47	101%
Significant items & change costs	**(34)**	(20)	(68%)
FSCS levy	**(3)**	(2)	(50%)
Profit before tax, FVA & distribution	**58**	25	134%
Fair value amortisation	**(23)**	-	-
Dividend	**(7)**	-	-
Profit before taxation	**29**	25	16%

Like for like PL	H1 2010 £m	H2 2009 £m	Change %
Net interest income	**308**	317	(3%)
Non interest income	**95**	104	(8%)
Income	**403**	421	(4%)
Costs - Steady State	**(266)**	(280)	5%
Impairment	**(89)**	(149)	40%
Underlying operating result before change	**49**	(8)	730%
Significant items & change costs	**(34)**	(40)	17%
Sub debt buy back	**-**	58	
Other	**(3)**	-	
Profit before tax & distributions	**12**	10	26%

For further information please contact cfsinvestorrelations@cfs.coop