The Co-operative Bank plc
Annual Report and Accounts
2015

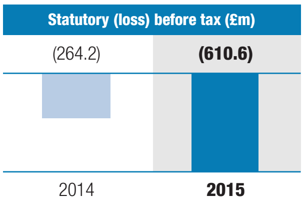
2015 The Co-operative Bank Plc Annual Report and Accounts

Contents

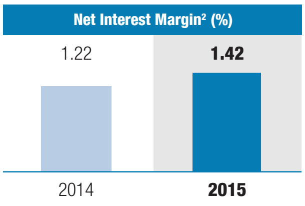
Key Performance Indicators

The Key Performance Indicators presented below[1] reflect the way in which the performance of the Bank was measured in 2015. As the Bank implements its turnaround, management will continue to review these measures.

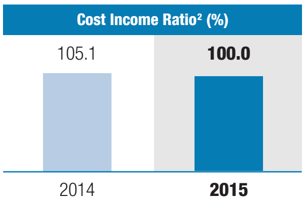
Total Bank[4]



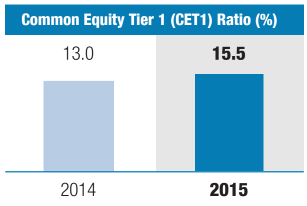
Higher statutory loss before tax due to reduced income in Non-core from deleveraging, losses on asset sales and higher conduct and legal risk charges



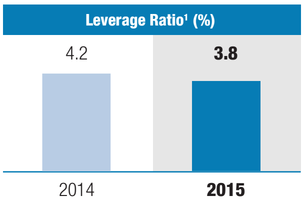
The increase in net interest margin reflects deposit repricing, reduction in deposit levels and mix change



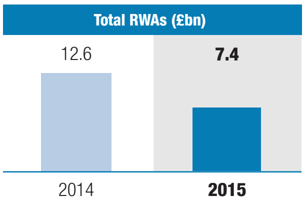
The decrease in the cost income ratio reflects cost reductions from outsourcing, branch closures and management of third party costs



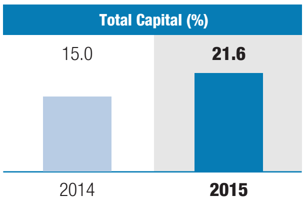
Improved CET1 ratio as RWA (Risk Weighted Assets) reduction from Non-core deleverage outweighed losses during the year



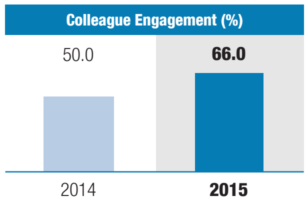
Statutory losses have reduced Tier 1 Capital at a greater rate than the balance sheet has been deleveraged



Total RWAs have reduced in line with Non-core deleverage

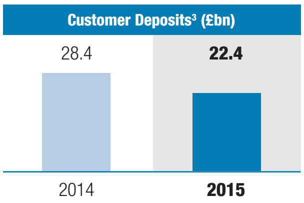


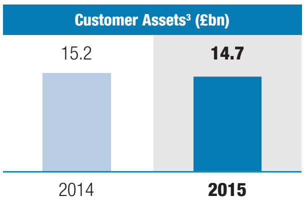
The Bank's total capital ratio has increased following the reduction in RWAs and Tier 2 issuance of £250m

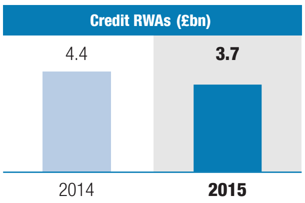


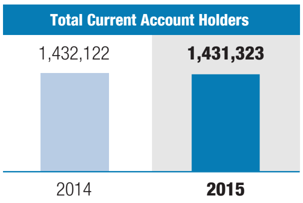
Increased colleague engagement gives some indication that the cultural change programme is gaining traction

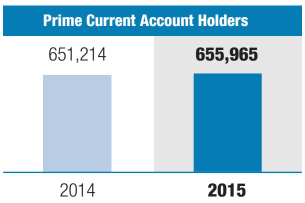
Core Bank

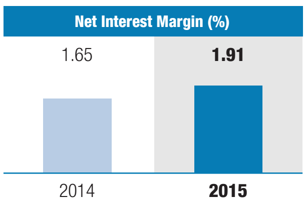




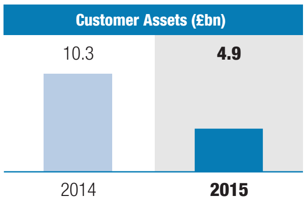


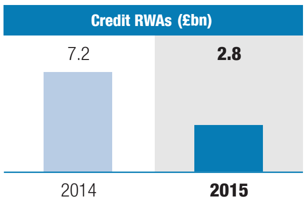






Non-core Bank





Please see 'Key Performance Indicators' on page 29 for explanations of why these metrics are important and how they are calculated.

1. KPIs are calculated on a management accounts basis as this is how we manage our business.
2. Excludes provision for customer redress.
3. This excludes Unity Trust Bank.
4. 2014 comparatives have been re-presented to reflect the change in management reporting. Please see the detailed financial review for further details.

Bank performance

Key highlights and outlook

In 2015 further significant steps were taken to implement the Bank's turnaround

- Successfully completed three transactions which improved the capital resilience of the Bank. In 2015 we completed two whole structure securitisations representing £3.1bn of the Non-core Optimum residential mortgage portfolio and a £250m Tier 2 notes offering.
- Capital position of the Bank strengthened – Common Equity Tier 1 (CET1) ratio of 15.5% at 31 December 2015 (13.0% at 31 December 2014) as the reduction in capital supporting RWAs outweighed losses during the period.
- As a result of active management the net interest margin has increased year on year by 0.20% to 1.42% largely driven by the reduced cost of funding.
- Continued brand investment, following the launch of the expanded Ethical Policy announced in January 2015, is building greater customer engagement, current account stability and restoring trust in the brand.
- Progress continues in improving day to day management, and embedding cultural change across the organisation.
- Progress has been made in delivering the IT transformation required to address the historic under investment in systems and processes. Work continued on the cornerstone IBM Enterprise Services Outsourcing (ESO) programme.
- The mortgage outsourcing agreement came into effect in August 2015.

Statutory loss before taxation of £610.6m as the issues that came to light during 2013 and 2014 continue to dominate the financial performance of the business

- Compares to a loss of £264.2m in 2014 driven primarily by: reduction in net interest income in the Non-core Bank of £37.7m as a result of deleverage; reduction in non-interest income of £45.2m; losses on asset sales of £121.4m; and reduced impairment gains in Non-core.
- In addition, conduct and legal risk charges increased by £92.5m to £193.7m due to additional provisions relating to Payment Protection Insurance (PPI) and Consumer Credit Act (CCA).
- Remediation and strategic project costs remained high in 2015 at £224.2m (2014: £206.1m) as the Bank delivers the transformation required to address the historic under investment in systems and processes.
- Fair value amortisation associated with the merger with the Britannia Building Society increased in 2015 to £120.4m (2014: £83.9m).

Simplifying of the business and reducing underlying costs continues

- Total operating costs reduced by £76.5m to £491.9m (2014: £568.4m (current basis), refer to page 21 for details), mainly due to head-count reduction, branch closures, rationalisation of the ATM network and improved management and control of third party costs.
- Operating staff costs have decreased year on year by £32.8m to £217.8m (2014: £250.6m). Permanent FTEs has fallen by 1,012 to 4,470 (2014: 5,482) and direct pay has fallen by £19.6m.
- 58 branch closures conducted in 2015.
- 54 further branches are to be closed in 2016 as a result of the observed 29% year on year reduction in branch transactions.

Rebuild of the Core Bank franchise is gaining traction

- Improved Core Bank operating result of £14.9m loss in 2015 (2014: £78.6m loss), as higher net interest income and reduced costs offset the lower level of non-interest income.
- Mortgage completions increased to £2.8bn in 2015 (2014: £1.1bn), with completions through the Bank's intermediary channel accounting for 88% of total retail mortgage completions as the Bank's offering becomes more competitive in this segment.
- Alongside this increase in inflows, mortgage redemptions (excluding contractual repayments) have fallen to £2.3bn (2014: £2.4bn).
- Rebalancing the savings portfolio as Non-core deleveraged and bringing pricing of deposits in line with the market has enabled the Bank to develop a more sustainable cost of funding. Retail customer liabilities reduced by £5.8bn to £19.7bn as a result.
- Prime current account holders have increased in 2015 to 655,965 (2014: 651,214), as work continues to re-establish the Bank's position in a very competitive market. Total current account numbers saw a marginal decrease.
- Customer relationship metrics across the Bank remain strong with the Bank still ranked #3 in current account Net Promoter Scores (NPS) and customer satisfaction ratings. Encouragingly, non-customer consideration scores have also increased, further indicating the strengthening of the brand.
- The Bank was YouGov brand index most improved UK brand of 2015.

New initiatives launched and customer propositions being developed, building on the expanded Ethical Policy

- Expanded customer-led Ethical Policy launched in January 2015.
- New overdraft proposition minimising fees and charges, based on customers' feedback, launched in April 2015.
- Further to the fixed rate credit card introduced in November 2014, a new balance transfer credit card introduced in November 2015, which does not penalise the cardholder by withdrawing their zero percent offer for small mistakes on their account.
- New rewards based current account proposition launched in January 2016.

Focus for 2016 continues to be on derisking the Bank and rebuilding the Core Bank

- Continue reduction of RWAs primarily through further Corporate CoAM deleverage.
- Deliver the necessary IT resilience and transformation projects across the Bank, including ESO and continue work on the mortgage processing outsourcing project.
- Continue investment in the brand and development of products and services which reflect the customer-led Ethical Policy.
- Further improvement in processes, cost control and asset generation in the Retail business.
- Continue to embed the Risk Management Framework and strengthen the culture of the Bank.
- Continue improvement in quality of service.

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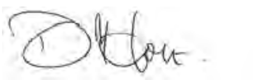
Strategic report

Strategic report

The Directors present their Strategic report for the Bank for the year ended 31 December 2015 as required by the Companies Act 2006. During 2013 the UK Government issued a new requirement for all companies to produce a Strategic report, with specific requirements for quoted companies with listed ordinary shares. Although the Bank's ordinary shares are not listed, the Bank has adopted these requirements which include a review of strategy and business model and the Principal risks and uncertainties of the Bank. The Strategic report includes the following:

This Strategic report for the Bank has been drawn up and presented in accordance with, and in reliance upon, the Companies Act 2006. The liabilities of Directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

Approved by the Board of Directors and signed on behalf of the Board.



Dennis Holt
Chairman
31 March 2016

Chairman's statement

"There remains much to be done, but we are encouraged by the progress made towards building a sustainably profitable Bank that will meet the expectations of all of our stakeholders"

In 2015, The Co-operative Bank made further significant progress in the turnaround of the Bank from the low point of the recapitalisations in late 2013 and early 2014. Following these events, we embarked on a five year plan to materially de-risk the Bank and to rebuild a viable, profitable, customer focussed Core Bank, distinguished by values and ethics, serving personal and small and medium sized business customers in the UK. To date, we have made real progress in meeting most of those demanding targets, although we continue to feel the impact of macroeconomic headwinds and some of the legacy conduct issues which, in common with the rest of the industry, are taking longer to work through than originally anticipated.

When looking at the key elements of our five year plan, the first task was to improve capital resilience and capital has been further strengthened with a CET1 ratio of 15.5% at the end of 2015, compared with 13.0% at the end of 2014. During the year we also raised £250m of Tier 2 capital in volatile market conditions. The disposal of over half of the Optimum portfolio of Non-Core residential mortgages, at robust pricing levels, means we have exceeded the 2015 targets agreed with the regulator for CET1 ratio and RWAs which improves our resilience to a severe economic stress.

Our continued success in disposing of Non-core customer assets, from £11.5bn in June 2014 to £4.9bn at end of 2015, has contributed to a significant reduction in total RWAs, which are now almost half the level seen in 2013. Encouragingly, impairment provisions put in place in 2013 have proved to be robust, although the level of impairment gains is unsurprisingly lower in 2015 than 2014. Continued low interest rates and lower defaults are also having a positive impact on the level of new credit impairments.

Our liquidity has been proactively managed and improved as we have successfully deleveraged Non-core assets and the improved strength of the franchise has meant we are less reliant on highly priced retail deposits. As a result, primary liquidity has been managed down to £4.5bn at the end of 2015 which is materially less than the £7.6bn held at the end of June 2014.

The Core Bank has delivered change and improvements around brand, products, distribution channels, customer focus and service excellence. Having relaunched our expanded ethical policy at the beginning of 2015, we continue to place values and ethics at the heart of the business. We have introduced a number of new products driven by our ethical policy, developed with our customers, and we have seen our net promoter score rise during the course of the year. Although there has been a slight reduction in income, the net interest margin continues to widen and costs continue to fall such that the Core Bank's operating result has improved and is much closer to break-even. This creates a strong base on which to build further.

Underlying this, good progress has been achieved in addressing previous under-investment in IT and Operations in order to transform our capabilities. Key milestones were successfully met in 2015, in particular relating to the outsourcing of our IT infrastructure and mortgage servicing although further major deliveries lie ahead in 2016. We continue to build colleague capability to ensure that we deliver consistently on our customer promises and we have seen clear evidence of improving colleague engagement.

However, legacy conduct issues are not yet fully resolved. Some of these are driven by industry-wide issues, particularly in respect of PPI. Others such as our CCA redress programme are impacted by the need for robust data to enable us to meet our obligations. The additional costs arising from these are significant and have had a clear impact on our full year statutory loss. They continue to receive close Board and Executive attention.

During the year, the investigations by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) into what went wrong at the Bank in the period up to 2013 were concluded. The Board has taken the findings and the size of the potential fine extremely seriously and, on behalf of the Bank, I would like to apologise again to customers for these past failings and reassure them that the Bank is a significantly stronger organisation today.

Our restructuring and renewal of the Board has progressed substantially. We continued to strengthen the Board during 2015 with the appointments of Charles Bralver as a Non-Executive Director and Aidan Birkett as our new Senior Independent Director. In addition, Derek Weir has now been appointed as the new Chairman of the Risk Committee and I would like to place on record my sincere thanks to the outgoing Chairman, Graeme Hardie, for the significant contribution he has made to the Board, first helping to navigate the Bank through its recapitalisation and secondly in overseeing the early years of the turnaround of the Bank. Graeme will step down from the Board with our best wishes at the AGM. Your Board is committed to continuous improvement in oversight and governance and we have recently completed an externally assessed Board Effectiveness review which both endorses the progress made since Sir Christopher Kelly's 2014 report and makes recommendations for further development.

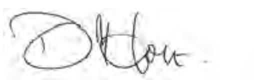
Outlook

We remain optimistic about the viability of the Core Bank franchise. The next two years will see further significant investment in the transformation of the Bank and the unwinding of further fair value adjustments so the Bank as a whole will report a loss before tax in 2016 and 2017. However, we expect both the level of investment and the impact of historic issues to materially reduce in subsequent years and it is becoming evident that there is a viable Core Bank with a solid franchise emerging which we expect to return to operating profitability before the end of 2017.

In addition, having significantly reduced the size of the Optimum portfolio and reflecting market conditions which would drive a significant loss on sale, the Board has recently reassessed the quality and income generated from the remaining portfolio and has decided to retain it for the life of the Bank's Updated Plan, which runs from 2016 to 2020, a position which has been accepted by the PRA. We will continue to reassess the position going forward in line with emerging market conditions.

However despite our success to date, the impact of legacy conduct charges on our 2015 statutory loss, as well as the headwinds created by forecasted lower interest rates, means that the journey to the level of capital resilience expected by the regulator will take one year longer than previously anticipated, with sustainable ICG compliance achieved in 2019 and PRA Buffer compliance achieved in 2020.

The transformation required to rebuild The Co-operative Bank as a viable alternative to other UK banks is not an easy task. On behalf of the Board I would like to thank our colleagues for the excellent service they provide to our customers, to our customers for their continued loyalty and to our investors for their support. There remains much to be done, but we are encouraged by the progress made towards building a sustainably profitable Bank that will meet the expectations of all of our stakeholders.



Dennis Holt

Chairman
31 March 2016

Our two business areas:

Core and Non-core

As at the end of 2015, as part of the Bank's plan to build resilience, de-risk and reshape its business and to address the underlying issues which it faces, the Core and Non-core business areas were managed as set out below:

	Core Business	Non-core Business (Co-operative Asset Management/CoAM)
Definition	• Consistent with the Bank's strategy and risk appetite **Includes:** • Retail banking (Retail) – which trades as The Co-operative Bank, Britannia and **smile**, together with the Bank's intermediary mortgage brand, Platform, and includes Retail secured and unsecured lending • Business and Commercial Banking (BaCB) – which services small and medium sized businesses (SMEs) which will typically: (i) have a turnover of less than £25m; (ii) have borrowing requirements of less than £10m; and (iii) otherwise meet the Bank's risk appetite (including charities, social businesses and co-operatives) • Treasury	• Inconsistent with the Core business strategy and risk appetite • Cannot be supported by Core business IT Retail platform • Non-core assets are typically non-performing, defaulted, unprofitable and/or capital intensive products **Includes[1]:** • Corporates – which typically have a turnover of over £25m or otherwise do not meet the Bank's risk appetite • Commercial Real Estate • Project Finance • Housing Associations • Local Authorities • Large scale Renewable Energy and Asset Finance • Optimum[2] (a closed book of predominantly interest-only, intermediary and acquired mortgage book assets) • Unity Trust Bank[3] (UTB) – Reduced shareholding from December 2015
Focus	• Retail and SME customers • Values and ethics that both underpin our business and distinguish us in the marketplace • Relationship-based banking • Where we have strong market credentials, relationships and expertise • Investment into digital channels • Offering customers products that are easy to understand and use	• Managing these businesses to achieve deleverage that does not materially reduce the CET1 ratio of the Bank as a whole
Customer Assets/Credit RWAs	**£14.7bn/£3.7bn**	**£4.9bn/£2.8bn**

1. Includes certain performing assets which have been re-evaluated and will be transferred into the Core business as the Bank expects to retain them going forward.
2. The remainder of the Optimum portfolio has been re-evaluated and the Bank expects to retain this going forward.
3. UTB operates in the social economy and commercial banking sectors and was previously consolidated into the Bank's results on the basis of control. As of December 2015, the Bank's residual holding of Unity Trust Bank's shares reduced to 6.7%. This will be treated as Non-core business.

Our strategy

Bank strategy

The Bank is focused on implementing its strategy of becoming, over the next three to four years, a smaller, sustainable and efficient bank, distinguished by its values and ethics, that is focused on retail and SME customers.

Our strategy remains unchanged with enhanced focus on our Core business strategy.

In December 2014, the Bank submitted a Revised Plan to the PRA following the results of the Bank of England stress tests. This aimed to deliver the level of resilience required for a bank of its planned future size and business model by the end of the planning period. This Plan was accepted by the PRA and focused on accelerating the reduction of the Optimum portfolio, a closed book of residential mortgages, which was particularly susceptible to a severe economic stress. Having deleveraged more than half of the Optimum portfolio and taking into account current market conditions, the Bank has decided to retain the remainder of the Optimum portfolio for the period of the Updated Plan (2016-2020) but will continue to re-assess this position going forward in line with market conditions.

Overarching strategy

Build Resilience
Capital, liquidity, IT and day-to-day business

Rebuild Core Bank
Profitable, with a growing balance sheet, leveraging brand strength and high levels of customer satisfaction

Run off Non-core
Reducing Risk Weighted Assets

To become an efficient and financially sustainable UK Retail and SME Bank that is distinguished by its values and ethics

Core business strategy

Simplify and focus on Retail and SME customers
Enhance returns
Improve cost income ratio
Invest in digital channels

Key actions for the Core business

- Streamline Retail and SME product offering
- Deepen customer relationships
- Invest in our brand
- Re-price to market/exit uneconomic products
- Re-engineering of IT platform
- Improved internet and mobile banking functionality leading to increased self-service

Non-core business strategy

Actively manage to achieve the most appropriate value for each portfolio or target for run down or exit
Taking into consideration liquidity and capital requirements

Key actions for the Non-core business

- Active management of assets
- Single asset and portfolio sales
- Optimisation of borrowers' funding structures
- Re-banking of Non-core customers
- Run down or close business over the longer term

Key actions for both the Core and Non-core business

- Reduce costs and simplify business processes
- Establish an effective and efficient operational and governance structure
- Continue to embed the Risk Management Framework and strengthen our culture
- Manage reputational and conduct risk
- Data remediation

A strategy which drives value for all stakeholders

i) Delivers a resilient, standalone bank which can prosper in its own right distinguished in the market place by adherence to values and ethics
ii) Reduces the risk of resolution and minimises the likelihood of any taxpayer support
iii) Creates value for customers, shareholders, employees and the communities we serve whilst meeting regulatory requirements

Business model

Core

As at 31 December 2015, the Bank has approximately 4.0 million Retail Banking customers (with an additional 44,000 Platform customers). There are also around 0.1 million SME customers. The Bank distributes its retail and small business products through branches, call centres and via the internet and mobile banking channels.

Non-core

The Non-core assets are a mixture of revolving credit facilities and stage drawdown facilities primarily in the Corporates, Asset Finance, Private Finance Initiative (PFI) and Commercial Real Estate (CRE) portfolios as well as the remainder of the Optimum mortgage portfolio.

In 2016, certain performing assets will be transferred from Non-core to Core and will be retained.

How we make money

The table below summarises the business activities performed by the Bank and the associated impact across the balance sheet, income statement and risk.

Business Activity	Balance Sheet Impact	Income Statement Impact	Principal Risks
We lend money to customers	Loans create assets in our balance sheet that will generate future income	We earn interest income, fees and may incur credit impairment charges	• Credit risk • Market risk • Operational risk • Liquidity and funding risk • Conduct risk
We collect deposits from customers	Deposits are a source of funding for the Bank (liabilities) which often incur interest expense	We may pay interest on deposits	• Liquidity and funding risk • Market risk • Operational risk • Conduct risk
We source funding from other banks and the capital markets	Wholesale funding is a liability for the Bank on which we incur interest expense	We pay interest on wholesale funding	• Liquidity and funding risk • Market risk • Operational risk
We provide transactional banking facilities	Minimal	We earn net fee and commission revenue	• Operational risk • Conduct risk
We invest in people in order to implement our strategy and deliver service to our customers	Minimal	Staff costs	• Operational risk • Conduct risk • People risk • Pension risk
We invest in our operations (IT and infrastructure) to deliver service to our customers while managing costs	Property, plant and equipment, Intangible assets	Other operating costs	• Operational risk • Strategic and business risk

Chief Executive's review

"Over the course of 2015, we have continued to make real progress in implementing our plan to turnaround the Bank. Our work to improve resilience, reduce cost and strengthen the performance of the Core Bank continues to deliver positive results notwithstanding the headline numbers and we remain cautiously optimistic this will continue into 2016"

Over the course of 2015, we have continued to make real progress in implementing our plan to turnaround the Bank. Our work to improve resilience, reduce cost and strengthen the performance of the Core Bank continues to deliver positive results notwithstanding the headline numbers and we remain cautiously optimistic this will continue into 2016 and beyond. I would like to thank colleagues for their hard work and determination as we continue to tackle and address the problems of the past and create a sustainable business around our personal and SME business customers.

Whilst the headline losses are significant, they were driven by legacy issues including fair value unwind, losses on the disposal of Non-core assets, transformation project spend and conduct charges. With the exception of the latter, these were all anticipated at the beginning of the year and the increase in conduct charges has to some extent been driven by factors impacting all banks, in particular PPI. They do not reflect the considerable progress in the Bank, on which I will elaborate below, and importantly have no major impact on the Core Bank which produced a close to break even result.

Since the Bank of England stress tests in December 2014, we have taken steps to significantly improve resilience in the event of a severe economic downturn. The reduction of more than half of our Non-core assets since the end of 2014, including two whole structure securitisations of £3.1bn of the Optimum residential mortgages portfolio, alongside the issuance of £250m of Tier 2 notes, means we have met our CET1 ratio and RWA commitments to the Regulator in 2015.

The performance of the Core Bank continues to improve. We have seen clear stability in our current account numbers with the overall number of prime current accounts increasing by 4,751 in 2015. Strong customer relationship metrics across the Bank reflect the excellent levels of service being delivered in our branches and contact centres and we have continued to invest in the brand which has been recognised as the most improved by YouGov in 2015. The level of mortgage completions more than doubled year on year, representing the highest value of new lending delivered by the Bank since 2010. In addition, the total Bank net interest margin improved by 20bps throughout 2015. Reassuringly, colleague engagement also increased by 16 percentage points giving some indication that our cultural change programme is gaining traction.

We continue to make good progress on cost reduction and as we enter 2016, the outsourcing of our IT infrastructure to IBM is on track.

The Bank remains exposed to external macroeconomic conditions and some of the legacy issues from the past. Although we have made steady progress in tackling remediation, we continue to be exposed to the impact of historic conduct issues such as CCA and PPI and we have increased our provisions which has impacted our statutory loss in 2015. In the case of CCA, this remains very difficult and detailed work. On PPI, in line with the rest of the industry, we have seen complaints from claims management companies continue at higher levels than previously anticipated. We now expect to receive complaints until at least 2018 when the proposed time bar may come into effect.

In today's challenging market conditions, further disposals of the Optimum portfolio would create a significant loss on sale. We have therefore adapted our plan (the Updated Plan 2016-2020) and now envisage keeping the remainder of Optimum for the life of our plan and we have agreed this with the PRA. This will protect income generation without unduly impacting the risk profile of the Bank as the average Loan to Value of the portfolio has improved significantly over the last two years and we have significantly reduced the size of the portfolio through the whole structure securitisations undertaken in 2015. We will continue to reassess this position going forward in line with market conditions as there may be opportunities to take advantage of acceptable pricing to make earlier disposals.

The Bank continues to face a number of headwinds including the expectation that interest rates are forecast to remain lower for longer. The impact of this which leads to slower revenue generation and the loss incurred in 2015, means that we now expect to reach sustainable compliance with our Individual Capital Guidance (ICG) by 2019 and the Regulator's PRA buffer by 2020 and the PRA has accepted this.

None of this should diminish the progress we have made in the turnaround of the Bank without the need for financial support at the expense of the taxpayer. We remain positive that we are developing a more resilient bank, underpinned and differentiated by values and ethics, and that a profitable Core Bank will emerge from the turnaround creating further value for all our stakeholders.

Performance Review

The Bank has made significant progress against its Revised Plan, perhaps most notably through the two whole structure securitisations of the Optimum residential mortgages portfolio (Warwick Finance One and Warwick Finance Two). With the successful completion of the second transaction in September, the Bank securitised almost half of the Optimum portfolio (£3.1bn) within six months. The significant reduction in RWAs from the deleverage of Optimum and other parts of the Non-core business has contributed to the improvement of the Bank's CET1 ratio, which now stands at 15.5% up 2.5% from 13.0% at the end of 2014. The Bank has also benefited from the proposed sale of Visa Europe and has recognised a £51.2m gross revaluation gain in relation to this transaction which has resulted in an increase in the Bank's available for sale reserve and has also increased CET1 capital by the same amount.

The Bank's overall net interest margin increased by 20bps from 1.22% in 2014 to 1.42% in 2015. This was largely driven by a reduction in the underlying costs of deposits and lower funding requirements as a result of the Non-core deleverage during the year. Although the Non-core deleverage reduced asset balances so that total Bank net interest income declined year on year, there was an improvement in Core Bank net interest income of £15.8m, totalling £460.6m for 2015. However, Core Bank non-interest income has reduced significantly year on year by £38.0m, to £52.4m in 2015. This was primarily due to lower Link commission fees following the disposal of the majority of the ATM estate, as well as a market wide reduction in card interchange rates and reduced overdraft fees on the back of improvements we made for customers on our overdraft product.

Operational costs reduced from £568.4m to £491.9m, driven mainly by rationalisation of the branch network, reduction in the ATM estate, reduction in the number of permanent employees and reduced reliance on contractors.

As we have said before, legacy issues continue to impact the financial position of the business and there are still significant challenges ahead. The statutory loss before taxation widened from a £264.2m loss in 2014 to £610.6m in 2015, most of which was anticipated with the exception of increased conduct risk charges. The main drivers were: our deleverage strategy leading to higher losses on asset sales of £121.4m in 2015 against £14.4m in 2014; increased conduct and legal risk charges of £193.7m against £101.2m in 2014; fair value accounting unwinds of Leek notes, which created a loss of £120.4m in 2015 compared to £83.9m in 2014 and increased remediation and strategic project costs needed to deliver the transformation required at £224.2m in 2015 against £206.1m in 2014.

The conduct risk charge primarily relates to CCA, PPI and packaged accounts. There was a £98.7m charge caused partly by slower than expected progress in the remediation of the previously identified breaches of the technical provisions of the CCA and partly by the discovery of new cohorts of customers requiring remediation. Although the new cohorts were identified as a result of more advanced data scrutiny, importantly, no major new failings were uncovered. The monthly amount of interest forgone has reduced significantly during the year. The increase in the existing provisions for PPI by £71.8m was due to a sustained higher level of inbound PPI complaints than previously anticipated. We now expect a higher level of complaints to continue with the announcement by the FCA that a time bar and associated marketing is likely to be applied to PPI complaints. The charge also comprises a £16.8m increase in provision required for historic mis-selling of packaged accounts due to an increase in the number of inbound complaints. However, it is important to note that these increased charges all relate to legacy issues with no new significant categories of conduct risk having been identified in 2015.

Increased capital and IT resilience

As agreed with the PRA in December 2014, the focus for 2015 was to de-risk the Bank and increase its capital resilience. Central to this was the active reduction of RWAs, with a focus on the Optimum residential mortgage portfolio. This portfolio was particularly susceptible to stress in the Bank of England's 2014 stress test scenario. The Non-core and Treasury team, in conjunction with other colleagues across the Bank, have deployed their considerable experience and skill to manage the deleveraging activity effectively, securitising £3.1bn of the Optimum portfolio, which, coupled with a natural portfolio run-off, resulted in the overall reduction of Optimum assets from £6.8bn in 2014 to £3.2bn in 2015. This reduction has substantially de-risked the impact of these assets on capital in a severe economic stress scenario. The recent economic environment has led to an improvement in the underlying credit quality of the assets due to a significant reduction in the portfolio's Loan to Value and a reduction in the proportion of the book in arrears.

Given the reduction in risk which has already taken place, current market conditions and the loss on sale that would be created, we do not believe that further disposals of Optimum, which would also reduce income and erode capital, are appropriate. We therefore now expect to hold the remainder of the Optimum portfolio for the life of the Updated Plan although we will continue to reassess this position in line with market conditions and pricing.

Continued asset sales within CoAM contributed heavily to a reduction of other Non-core assets from £3.9bn to £2.0bn. This has led to an overall reduction of Non-core RWAs from £7.2bn in 2014 to £2.8bn in 2015 which is better than expected. Nonetheless, we still have work to do to ensure sustainable compliance with our ICG by 2019 and PRA buffer by 2020. While there are currently no regulatory mandatory requirements for MREL issuance, the PRA and Bank of England have expressed a strong preference for earlier issuance of MREL than the later part of our Plan which is the Board's current view of the earliest time such issuance is feasible. To the extent that the Bank can achieve an earlier issuance, it will do so but this could further delay ICG and PRA buffer compliance and possibly the return to operating profitability of the Core Bank. The PRA and Bank of England are aware of these potential consequences and that further delay of compliance would need to be accepted. Whilst the Bank of England will have powers to mandate MREL compliance when the regulations regarding MREL are put in place, it has stated that it will consult with the Bank before setting binding requirements to mandate MREL issuance.

The work to separate our IT infrastructure from The Co-operative Group and migrate it to IBM (Enterprise Services Outsourcing), which will improve the resilience of our IT platform, is progressing with significant deliverables due in 2016. The build out of the primary and back-up data centres is complete. Bank data and applications have been copied onto the new technical infrastructure and an extensive programme of testing has commenced. Migration of the Bank's critical systems is progressing in 2016.

Finally, we have continued the work to improve the Risk Management Framework. Refreshed risk appetite statements and measures have been agreed as part of the Bank's plan and adherence to the framework is being formally monitored; we still have further work to do to embed this to our own and the Regulators' satisfaction. We have also made progress in implementing the Senior Managers Regime, which came into effect in March 2016, and we are currently ensuring this is embedded effectively.

Liquidity

Liquidity continues to reduce from the levels seen in 2013 and 2014 and primary liquidity has reduced by £2.0bn during 2015 to £4.5bn at December 2015. The main changes in the liquidity position are due to the rebalancing of the savings portfolio by repricing certain retail deposits in line with the market, resulting in a more sustainable cost of funding and improved net interest margins. The liquidity reduction driven by savings rebalancing also reflected the reduced funding requirements following the deleverage of Non-core assets. In addition, following regulatory guidance in 2015, both the Regulator and the Bank are comfortable in relaxing the Bank's required liquidity levels in stressed situations, and the Bank's Liquidity Risk Appetite has been updated accordingly. Nevertheless, as we remain predominantly retail deposit funded, our appetite is to hold comparatively higher overall levels of liquidity.

Core Bank

The Core Bank continued to make steady progress throughout 2015, with the focus placed firmly on investing in our products, the brand and our service. We are engaging with customers who, like us, believe values and ethics have an important role to play in banking. Our current account Net Promoter Score (NPS) increased from 15 to 24 and we were recognised as the most improved brand of the year by YouGov.

Alongside the excellent work of our customer facing colleagues, we have continued our efforts to strengthen our customers' trust in us by investing in our brand. Our television adverts and the focus on our donation on behalf of our customers to one of seven charities enabled us to reinforce our status as the ethical alternative to other high street banks. Encouragingly, both NPS and non-customer consideration scores have increased year on year, further indicating the returning strength of the brand.

Mortgage originations continued to improve throughout the year, with total completions for 2015 above expectation at £2.8bn compared with £1.1bn in 2014. This is the highest level of new mortgage lending since 2010. In addition, we have started to see early signs of a reduction in mortgage redemptions with redemptions falling from £2.4bn in 2014 to £2.3bn in 2015. The reinvigoration of our mortgage pipeline through our intermediary business played an important part in this success and we were pleased to see our Platform business was awarded the Intermediary Mortgage Lender of The Year by Your Mortgage. It is important to note that whilst the Core lending book remains broadly stable, we remain cautious and acknowledge that there is increased pressure on margins due to strong competition in the mortgage market which will continue in 2016 and possibly beyond. The outsourcing of our mortgage processing to Capita (which came into effect in August 2015) is progressing and will, over time, improve the Bank's ability to process mortgage applications, help to improve retention and reduce costs.

2015 represented a year of stability for our overall current account base. We have seen an increase in current account credit balances of £0.3bn to £3.8bn and Prime current accounts have increased by 4,751. Whilst the total current account base decreased in 2015, the net outflow was only 799 and showed a marked improvement from the net outflow of 66,340 in 2014. The launch in January 2016 of our Everyday Rewards current account means we now have a competitive current account proposition, which has generated a positive response from the media.

Following the introduction of a three year fixed rate credit card in November 2014, which was positively received by customers, we have also applied the principles of simplicity, transparency and fairness to our balance transfer card which was launched in November 2015. The card not only offers zero percent interest on balance transfers for 24 months, but does not penalise customers for late or missed payments by the withdrawal of the zero percent offer unlike many other lenders. This is an example of developing our products in a way which reflects our values and ethics.

In line with the commitments of our expanded Ethical Policy, we have taken steps to involve customers and incorporate their views in developing other products. Our revised overdraft policy, launched in April 2015, was the first of our products to be created together with customers. The consumer group Which? were also engaged throughout the proposition development and have provided positive feedback around the Bank's approach of listening to customers and making products that work for them. The Bank also received praise for making a 'positive move' towards transparency, living up to its values and ethics and delivering a much fairer overdraft tariff. Perhaps the most significant indication of the increased transparency was a 77% reduction in complaints related to overdrafts comparing the three months before and after the changes were made. We are proud to be at the forefront of a market offering products that are simpler for consumers to understand.

We are also committed to making banking as easy as possible for our customers. Throughout 2015, we have continued to make improvements to our digital channels, reflecting customers' changing preferences for how they do their day-to-day banking. These improvements have resulted in a 22% increase in online banking payments and a 110% increase in mobile banking payments. More and more customers are opting to use our digital services with around 749,000 customers regularly using our improved online and mobile banking services. 55% of these customers receive paperless statements only. Further digital improvements are planned in 2016.

It is particularly pleasing to note that the Bank received a number of awards for customer service in 2015, which is welcome recognition of the excellent service being delivered by colleagues in our contact centres and branches. Most notably, our call centre service was recognised as the Best Large Call Centre and the Most Improved Call Centre for customer service by ICMI. Our current account was awarded a 5 star rating by Moneyfacts and we remain one of the top 3 banks for customer satisfaction and current account NPS.

Over time it seems customers increasingly want frictionless transaction services from the Bank. These are best delivered digitally and using straight through processing. This has benefits for both the Bank and the customer. In almost direct contradiction to this, however, when something goes wrong, customers want a real person to talk to. We have made significant strides in dealing with complaints with the overall level of complaints falling by 19%. Based on industry data provided by GfK FRS, we are one of the leading banks for resolving complaints to customers' satisfaction.

Finally, the Bank is in the process of reclassifying some performing Non-core assets into the Core Bank as these are less risky than previously thought or, due to cheaper funding, now deliver acceptable returns on capital.

Cost reduction

Our efforts to reshape the Bank into a smaller, simpler organisation have maintained the focus on reducing the underlying costs of the Bank and we have delivered positive results in this regard. Operations and central costs have been reduced by £43.7m (from £355.6m in 2014 to £311.9m in 2015) which includes the progress we have made in selective outsourcing and improving our own processes. Operating staff costs have decreased year on year by £32.8m to £217.8m with a corresponding reduction of 1,264 permanent and contractor FTE which includes staff transferred as part of outsourcing. At times, this means we have had to make difficult people-related decisions but this is critical to delivering a cost base which supports a sustainable Core Bank.

We continue to provide branches where we know they are well used whilst at the same time adjusting our estate to reflect customers' changing preferences for how they do their day-to-day banking. Accordingly, there were 58 branch closures in 2015 and although we are now nearing the end of our plan for significant branch closures, we will continue to optimise the location of our branches in line with our customers' changing requirements (where we have seen a 29% year on year reduction in branch transactions) and we therefore announced the closure of 54 additional branches in January 2016.

Values and Ethics

Allied to the brand work and in an effort to sustain our differentiation from others in the marketplace, in 2015 we took some key steps towards demonstrating our values and ethics in action. We are proud to be the only high street bank with a customer-led Ethical Policy and in January 2015, we relaunched our expanded Ethical Policy which was well received by customers, colleagues and stakeholders. We kept all of the existing policy commitments and expanded the policy in new areas voted for by customers. In October 2015 we announced a £1m investment and partnership with Co-operatives UK to support the development of the UK Co-operative and social enterprise sector. This will see us providing tools and resources over the next three years to help new and existing Co-operatives grow. It was also heartening to see the Bank returning to its campaigning heritage by working with Refuge to reveal the scale of financial abuse in the UK where, unfortunately, a particularly high number of victims are women. Since the launch, we have been working with the British Bankers' Association and Citizens Advice Bureau to drive real, valuable change for those who experience this type of abuse.

Culture and People

We are now seeing clear signs of cultural change within the organisation. Continued focus on the rollout of revised workplace values has led to increased emphasis on delivering at pace, implementing effectively and taking accountability. This is particularly evident in the improvements made in complaint management for example. In addition, we were pleased to see a marked increase in overall colleague engagement since November 2014, with measures increasing across the Board. Finally, recognising that many of the Executive team came on board to deal with the crisis the Bank faced in 2013, we have started work on succession planning which is critical to the future health of the business and reflective of the increasing emphasis on the Core Bank and BAU processes. This should ensure we are recruiting talented executives with the skillset to take the Core business forward in the coming years.

Outlook

In 2015, we have continued to take some important steps to build resilience and rebuild the Core Bank. Whilst there is still much work to do, we are heading in the right direction and are on track to build a differentiated, resilient bank with an appropriate cost base.

There are still some headwinds in the Updated Plan: a lower for longer base rate environment, the scale of the transformation required and continuing conduct risk provisions are all considerable challenges facing the Bank. In addition, the PRA and Bank of England's strong preference to raise MREL earlier than we believe is feasible will also present challenges in today's market. Nonetheless, the performance of the Core Bank is improving and we are focused on providing simple, transparent products and superior service levels in our contact centres and branches and to support customers who increasingly want to use our digital channels. Whilst the Bank will report a loss before tax in 2016 and 2017, we now expect the Core Bank to return to operating profitability before the end of 2017.

In 2016, we will continue to invest in the brand, improve our digital offering and engage with customers to provide products that reflect our values and ethics and that best meet their future needs. The focus will largely remain on rebuilding the Core Bank, reducing our Non-core business, building capital and operational resilience and in particular migrating our IT infrastructure to IBM.

Delivering these fundamentals will maximise the value we can create for customers, shareholders, colleagues and the communities we serve. It will also bring the Bank in line with regulatory requirements and reduce any potential burden on the taxpayer. Whilst the Bank is a Going Concern and stronger than it was, there remain material issues to address in terms of improving resilience and bringing aspects of our business back within our risk appetite. We also continue to rely on the ongoing support of our regulators as we implement the Updated Plan which will deliver regulatory compliance. Although there is still considerable work to do to tackle the headwinds, the actions we have taken to strengthen the Bank in 2015 represent good progress and continue to align with the strategic alternatives that exist. I am grateful for the support of colleagues, customers and shareholders as we continue to execute against our Updated Plan to reshape our business around our personal and SME business customers.

Niall Booker
Chief Executive Officer
31 March 2016

Detailed financial review

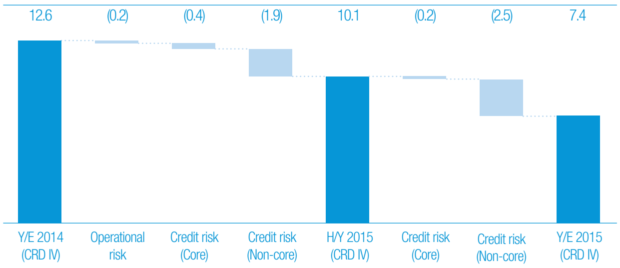
Capital

During 2015, the Bank has continued to deliver against the key objectives of its Revised Plan. The Bank has securitised £3.1bn of Non-core residential mortgages within the Optimum portfolio, and reduced its exposures within Corporate CoAM following rebanking of certain clients, proactive asset sales and non-performing asset workouts. These activities have resulted in a £4.4bn reduction in Non-core RWAs. The deleverage activity carried out has also significantly improved the Bank's stress resiliency, which was a key objective of the Bank's Revised Plan accepted by the PRA, as the assets that have been deleveraged are those that are most risk intensive in a stress scenario.

On 2 November 2015, Visa Inc. announced the proposed acquisition of Visa Europe Limited (VE) to create a single global payment business under the Visa brand. The Bank is a member and shareholder of VE. The Bank's share of the sale proceeds will comprise a mix of: cash, Class A equivalent preferred stock (the preferred stock) and contingent earn-out consideration (the earn-out). The preferred stock will be convertible into Class A common stock in Visa Inc. or its equivalent upon the occurrence of certain events. The preferred stock will be reduced (by making a downward adjustment to the conversion rate) by an amount equal to any covered losses arising from certain litigation, relating primarily to the setting of interchange fees within VE's territory. It is not possible to estimate the value of the earnout with certainty at this time. No amounts will be payable to the Bank until completion takes place. Completion is subject to regulatory approvals and is not expected to occur before 1 April 2016. The Bank has recognised a £51.2m equity investment in its 2015 accounts in relation to this transaction, which has resulted in an increase in the Bank's available for sale reserve and has increased CET1 capital. This is considered a non-significant investment and is weighted at 100% within capital requirements.

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

Risk Weighted Assets (£bn)



Overall RWAs have decreased by £5.2bn since last year end. Non-core assets have reduced in line with strategy and this is reflected in the £4.4bn reduction in Non-core RWAs. The securitisation of £3.1bn residential mortgages coupled with the natural run-off of the book (£1.8bn) and a reduction in the Optimum temporary adjustment (£0.7bn), has resulted in a £2.5bn reduction in RWAs. A further £1.8bn RWA reduction has been seen in Corporate CoAM, driven by on-going asset sales and deleveraging activity.

Operational RWAs have decreased by £0.2bn following the annual recalculation of the Pillar 1 operational risk requirement subsequent to the 2014 year end results.

The Bank is seeking to enhance its credit modelling capability in a number of key portfolios and is in discussion with the PRA with regards to the approval and implementation of these enhancements during 2016.

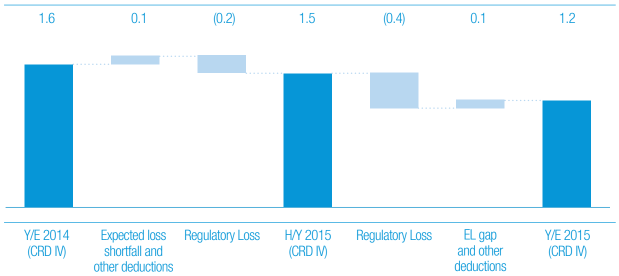
A major element of these enhancements relates to how the Bank determines Loss Given Default (LGD) for retail secured mortgages.

In June 2013 the Bank initially assessed the impact of potential enhancements which drove a £1.0bn increase in the underlying RWAs calculated using the current models. The increase predominantly related to the Optimum portfolio and the £1.0bn adjustment had been included within the Optimum RWAs. This is referred to as a temporary adjustment.

Following the significant deleverage of the Optimum balances within 2015, the Bank has judged it appropriate to reduce the temporary adjustment from £1.0bn to £0.3bn, in order to ensure that the Optimum risk weighted assets are more reflective of the underlying credit quality of the portfolio. The PRA has not objected to this change.

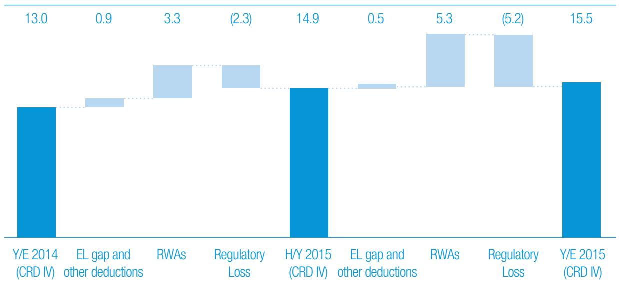
When the new LGD model is fully implemented, the remaining £0.3bn of the temporary adjustment is expected to be removed in full with the new model directly calculating the appropriate LGD and corresponding RWAs for all the Bank's secured portfolios.

Common Equity Tier 1 (£bn)



The Bank's CET1 resources have decreased by £0.4bn to £1.2bn, primarily as a result of the £622.8m statutory loss for the year.

Common Equity Tier 1 ratio (%)



The movements outlined above are the primary factors resulting in the Bank's CRD IV CET1 ratio increasing by 2.5% from 13.0% to 15.5%.

CRD IV capital position

	As at 31 December 2015	As at 31 December 2014	Change
Capital ratio			
CET1 ratio	**15.5%**	13.0%	2.5%
Total capital	**21.6%**	15.0%	6.6%
RWAs (£bn)	**7.4**	12.6	(5.2)
Leverage ratio	**3.8%**	4.2%	(0.4%)

The Bank's leverage ratio is 3.8%, down 0.4% from 2014; the on-going balance sheet deleveraging activity has been more than offset by the reduction in Tier 1 capital generated by the statutory loss in the period.

MREL & Tier 2 capital issuance

The banking industry is required to meet a minimum requirement for each of their own funds and eligible liabilities (MREL) to enable national resolution authorities (the Bank of England within the UK) to resolve firms in the event of a firm failing, as part of the European Recovery and Resolution Directive. MREL requirements can be met through holding regulatory capital or MREL compliant debt. The Bank is mindful of the capital implications of the Bank of England's minimum requirement for own funds and eligible liabilities (MREL) regime and the increased debt issuance this will drive, for the banking industry in general but also for the Bank.

The Bank's Updated Plan (2016-2020) incorporates MREL qualifying issuance commencing in 2018 which is the Board's current view of the earliest time when such issuance may be feasible. The PRA and the Bank of England have indicated their strong preference that the Bank incorporates an earlier profile of MREL issuance than currently contemplated by the Bank's Updated Plan. Such expectations have been confirmed by the regulators as not intended yet to represent the formal setting of a required MREL issuance plan and the Bank of England has stated that it will consult with the Bank before setting binding requirements, which it will be able to do at any point following publication of its MREL policy (expected to be sometime in 2016).

The Bank issued £250m of MREL eligible Tier 2 capital notes, in 2015, increasing the level of bail-in-able capital and further improving the Bank's capital resiliency.

This, along with the £5.2bn reduction in RWAs, has resulted in a 6.6% increase in the total capital ratio.

ICG compliance

As at 31 December 2015, the Bank was compliant with its Individual Capital Guidance (ICG), being the PRA's statement as to the regulatory capital (Pillar 2a) it expects the Bank to hold above Pillar 1, where Pillar 1 is the minimum required under the Capital Requirements Regulation (CRR). However, due to the Bank's on-going losses it is not forecast to remain compliant with ICG requirements for most of the planning period.

The PRA has engaged with the Bank throughout 2015 regarding its overall compliance with CRR and its Credit risk modelling capability. Subsequently, the PRA has set the Bank an additional CRR related Pillar 2a capital requirement in the form of a fixed add on in order to cover potential risk in this area. This Pillar 2a capital requirement was not included within the Bank's ICG requirements at 31 December 2015, however, it will be included within the requirements going forward. It is the Bank's intention, subject to model output, to have the add on removed by the end of 2017 at the latest.

As at 31 December 2015, the Bank's Pillar 2a requirement was set at 9.7% of RWAs or £723m, of which 5.5% must be met by CET1.

The Bank's Updated Plan anticipates that the Bank will meet a 7% CET1 ratio throughout the planning period and will have sustainably met ICG by 2019.

The Bank's Updated Plan aims to build a sustainable Core Bank and is designed to create a surplus to the PRA buffer by 2020.

The Bank anticipates that its leverage ratio will be sustainably above 3.0% by the end of the Plan however it is expected to reduce in the intervening period.

Liquidity

Overview

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

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

- reduce retail deposits to match the reduction of balance sheet assets and reduce the cost of the liability base;
- ensure the liquid asset buffer predominantly comprises of highly liquid securities, allowing for limited reliance on short dated secured funding sources;
- maintain the availability of mortgage collateral to support the secondary liquidity position; and
- repay wholesale funding to manage the balance sheet and the Bank's liquidity position.

Credit rating

On 31 July 2015, Moody's announced that the Bank's senior unsecured rating remains unchanged at Caa2 but now has a positive outlook. Moody's upgraded the Bank's Baseline Credit Assessment (BCA) from Ca to Caa2. However, Moody's removed any government support assumption leaving the overall rating unchanged at Caa2. Fitch confirmed the Bank's ratings at B in November 2015, but revised the outlook to stable from negative. The current ratings are:

	Long term	Short term
Moody's	Caa2	NP
Fitch	B	B

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

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

Liquidity portfolio

The Bank's liquidity resources, as at 31 December 2015, were £11.4bn compared to £12.1bn as at 31 December 2014. As at 31 December 2015 the liquid asset ratio was 15.6% (2014: 17.4%). The table below analyses the Bank's liquidity portfolio by product and by liquidity value. Primary liquidity consists of liquid assets that are eligible under EBA regulations (HQLA) and secondary liquidity consists of all other liquid assets (including self-issued retained securitisations and whole loans).

Primary liquidity has decreased over the period by £2.0bn and secondary liquidity has increased by £1.3bn.

	2015 £m	2014 £m	Change £m
Operational balances with central banks	**2,329.3**	4,487.4	(2,158.1)
Gilts	**1,450.2**	1,246.7	203.5
Central government and multilateral development bank bonds	**760.2**	819.5	(59.3)
Total primary liquidity	**4,539.7**	6,553.6	(2,013.9)
Total secondary liquidity	**6,863.1**	5,566.8	1,296.3
Total liquidity	**11,402.8**	12,120.4	(717.6)

Retail and Commercial funding

The majority of the Bank's funding comes from Retail and Commercial accounts. As at 31 December 2015, customer deposits were £22.8bn compared to £29.9bn as at 31 December 2014.

Retail deposits reduced over the period by £5.8bn. This forms part of the Bank's strategy to reduce its retail deposits to match the reduction in the balance sheet and to reduce the cost of liabilities; £3.4bn of the reduction relates to retail term deposits.

The total amount of corporate deposits reduced by £0.5bn over the year. This was due to the planned reduction in Non-core liability balances.

	2015 £m	2014 £m	Change £m
Current accounts			
Retail	**3,808.3**	3,479.3	329.0
Corporate	**2,106.6**	2,346.1	(239.5)
Total current accounts	**5,914.9**	5,825.4	89.5
Instant access savings accounts			
Retail	**6,580.6**	7,936.9	(1,356.3)
Corporate	**486.1**	584.0	(97.9)
Total instant access saving accounts	**7,066.7**	8,520.9	(1,454.2)
Term deposits and bonds			
Retail	**4,277.3**	7,675.6	(3,398.3)
Corporate	**281.4**	431.6	(150.2)
Total term deposits and bonds	**4,558.7**	8,107.2	(3,548.5)
Individual savings accounts (ISA)			
Retail – ISA Fixed	**2,355.9**	3,557.4	(1,201.5)
Retail – ISA Demand	**2,622.6**	2,745.9	(123.3)
Total ISA accounts	**4,978.5**	6,303.3	(1,324.8)
Other deposits	**290.6**	1,121.0	(830.4)
Total customer deposits	**22,809.4**	29,877.8	(7,068.4)

Wholesale funding

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

In March 2015 the Bank optionally redeemed the Silk Road Finance Number One securitisation with an outstanding note balance of £1.1bn, of which £0.4bn was held by external investors. The Bank issued £250m of Tier 2 notes and repaid £443.4m (€550.0m) of Euro Medium Term notes at maturity during the year.

In addition, the Bank redeemed the fully retained Leek 20, 21 and 22 and Cambric 1 securitisations in the period, which unencumbered the underlying Non-core mortgages. In accordance with IAS 39 no funding liability is shown for retained notes and these amounts are therefore excluded from the table below.

	2015 £m	2014 £m	Change £m
Preference shares, PSBs and subordinated debt	**457.0**	196.4	260.6
Secured funding	**2,091.0**	2,521.8	(430.8)
Repos	**671.3**	500.6	170.7
Market borrowing	**10.9**	46.0	(35.1)
MTNs	**404.9**	832.9	(428.0)
Total wholesale funding	**3,635.1**	4,097.7	(462.6)

The table does not include the Funding for Lending Scheme (FLS). Funding provided by the FLS at the end of the period was £150.7m. £198.6m of outstanding FLS funding was repaid in December 2015, as part of the Bank's continuing management of its funding profile. The remaining balance was repaid in January 2016.

Figures are based on nominal values and accrued interest as at 31 December 2015 and 31 December 2014.

The table below analyses contractual maturities (as opposed to internally expected repayment dates), with the Leek notes being disclosed based on call dates:

	2015 £m	2014 £m	Change £m
Repayable in less than 1 month	**522.5**	84.8	437.7
Repayable between 1 and 3 months	**159.7**	334.4	(174.7)
Repayable between 3 and 6 months	**352.4**	–	352.4
Repayable between 6 and 9 months	**243.3**	–	243.3
Repayable between 9 and 12 months	**433.0**	389.8	43.2
Repayable between 1 and 2 years	**746.9**	1,028.1	(281.2)
Repayable between 2 and 5 years	**259.0**	942.1	(683.1)
Repayable in more than 5 years	**918.3**	1,318.5	(400.2)
Total external funding	**3,635.1**	4,097.7	(462.6)

Deleveraging the Non-core Optimum business

The Bank's Revised Plan accepted by the PRA in December 2014, required a reduction in Non-core assets, which were particularly vulnerable to the Bank of England's hypothetical severe stress. The reduction in the size of the Optimum portfolio has significantly improved the Bank's resilience to a severe economic downturn.

On 6 May 2015 the Bank successfully closed its inaugural whole structure securitisation of part of its Non-core Optimum residential mortgages portfolio through the issuance of notes and residual certificates by Warwick Finance Residential Mortgages Number One plc (Warwick Finance One). On 25 September 2015 the Bank completed a further whole structure securitisation of Warwick Finance Residential Mortgages Number Two plc (Warwick Finance Two).

Warwick Finance One and Warwick Finance Two comprised portfolios totalling £3.1bn, of residential mortgages, issuing rated Residential Mortgage Backed Securities (RMBS) and residual certificates to investors. In addition, the Bank retained 65% of the Class A Notes on settlement of Warwick Finance One and 80% on the settlement of Warwick Finance Two. The Class A Note retention is the only position retained by the Bank within the Warwick Finance One and Warwick Finance Two capital structures. These assets are classified as available for sale. The net funding proceeds to the Bank for the publicly placed notes was £1.3bn.

The successful completion of the transactions formed a key component of the Bank's Revised Plan to accelerate the deleveraging of its Non-core assets, which includes Optimum.

Overall impact of the Warwick Finance One and Warwick Finance Two transactions

The table below shows the effect of the Warwick Finance One and Warwick Finance Two transactions on Optimum's balance sheet:

Optimum balance sheet

	31 December 2014[1] £m	Contractual repayments £m	Redemptions £m	Possession sales £m	Allowance for losses[2] £m	Fair value amortisation £m	Fair value accounting reclassification £m	Other £m	**Pre-Warwick 31 December 2015 £m**	Impact of Warwick Finance 1 & 2 transactions £m	**31 December 2015[1] £m**
Optimum Balance Sheet											
Gross customer balances	6,450.1	(51.4)	(346.1)	(21.4)	–	–	–	–	**6,031.2**	(3,144.5)	**2,886.7**
Allowance for losses	(21.9)	–	–	–	21.0	–	(48.0)	–	**(48.9)**	35.7	**(13.2)**
Fair value adjustments	(76.3)	–	–	–	–	2.8	48.0	0.1	**(25.4)**	9.8	**(15.6)**
Other accounting adjustments	4.3	–	–	–	–	–	–	(0.9)	**3.4**	–	**3.4**
Net carrying value	6,356.2	(51.4)	(346.1)	(21.4)	21.0	2.8	–	(0.8)	**5,960.3**	(3,099.0)	**2,861.3**

1. Refer to Risk Management section for further information on loans and advances to customers.
2. £21m decrease in allowance for losses, including parameter refresh and improvement in underlying asset quality.

The cash proceeds from Warwick Finance One and Warwick Finance Two were £3.1bn (after £78.7m creation of the general reserves), giving rise to a £68.5m loss on disposal of £3.1bn gross loans and advances before the associated release of credit risk provisions, fair value reserves and transaction costs. Incorporating these elements, the overall net loss was £34.6m.

The table below shows the combined effect of the two Warwick Finance transactions on the Bank's income statement:

Warwick transactions – Bank income statement

	Loss on disposal of assets £m	Release of allowance for losses £m	Release of conduct risk provision[1] £m	Release of merger fair value £m	Transaction costs £m	**31 December 2015 £m**
(Losses)/gains on asset sales[2]	(68.5)	35.7	(8.8)	–	(11.6)	**(53.2)**
Operating (expense)/income	(68.5)	35.7	(8.8)	–	(11.6)	**(53.2)**
Impairment losses on loans and advances[3]	–	–	–	(7.6)	–	**(7.6)**
Operating result	(68.5)	35.7	(8.8)	(7.6)	(11.6)	**(60.8)**
Conduct/legal release	–	–	8.8	–	–	**8.8**
Fair value amortisation release	–	–	–	17.4	–	**17.4**
Profit/(loss) before taxation	(68.5)	35.7	–	9.8	(11.6)	**(34.6)**

1. £8.8m conduct risk provision was transferred to Warwick Finance One and Warwick Finance Two as part of the transaction. This is excluded from the loss recognised on transfer date in note 41.
2. £53.2m total loss on asset sale is reflected in Non-core (losses)/gains on asset sales.
3. £7.6m impairment losses on loans and advances is reflected in Non-core impairment gains/(losses) on loans and advances.

Impact on regulatory capital

The table below shows the effect of the Warwick Finance One and Warwick Finance Two transactions on the Bank's credit RWAs:

Capital

	31 December 2014 £m	Disposal of Optimum assets £m	Warwick Finance 1 & 2 Class A Notes £m	Other Movements £m	**31 December 2015 £m**
Optimum credit RWAs	3,526.0	(1,712.4)	–	(837.6)	**976.0**
Warwick Finance One & Two RMBS credit RWAs[1]	–	–	101.2	–	**101.2**
Total	3,526.0	(1,712.4)	101.2	(837.6)	**1,077.2**

1. Warwick Finance One and Warwick Finance Two RMBS are held within the Bank's Treasury business unit.

On completion, Warwick Finance One and Warwick Finance Two transactions contributed a net £1.6bn reduction in credit RWAs together with a net £17.2m reduction in CET1 as a result of the net loss of £34.6m on the disposal of assets, which was partially offset by the reduction of £17.4m in Expected Loss (EL) Gap.

Fair value of the Optimum portfolio

Within the Optimum portfolio, the majority of assets and liabilities are measured at amortised cost in accordance with the Bank's accounting policies as outlined in note 1 of the Bank's Financial Statements. The carrying value represents the gross customer balances less any allowance for losses and merger fair value adjustments, the value as at 31 December 2015 was £2.9bn (31 December 2014: £6.4bn).

The fair value of these Optimum assets and liabilities are as per note 39. This has been calculated using the future lifetime income approach. Under this approach, fair value is measured by determining discounted expected cash flows, derived using expected redemption profiles of the portfolio, and discounting these cash flows at current market rates for products with similar characteristics and risk profiles. The current market rate used is assumed to encompass the time value of money plus a risk premium to account for the inherent uncertainty in the timing and amount of future cash flows arising from a book of mortgage assets.

Fair value

	31 December 2015		31 December 2014	
	Carrying Value £m	**Fair Value £m**	Carrying Value £m	Fair Value £m
Optimum				
Loans and advances to customers	**2,861.3**	**2,556.6**	6,356.2	5,113.1

The table above shows that the fair value of the Optimum portfolio is £304.7m lower than the carrying value as at 31 December 2015 reflecting the adopted approach to determining fair value as outlined above.

However, this fair value is not intended to represent the value which could be achieved as part of a structured disposal, as the valuation method is applied to the individual assets in the Optimum portfolio. The Bank sold the future portfolio purchase call to the residual noteholders in the Warwick Finance One and Warwick Finance Two transactions. If the notes are called, there may be potential for the residual noteholders to extract further value from the portfolio through alternative mortgage servicing arrangements.

Furthermore, the nature of the Warwick Finance One and Warwick Finance Two transactions, being a whole structure securitisation, enabled the Bank to achieve favourable pricing through stratification of the portfolio which allowed the Bank to better position the risk profile of the underlying mortgage assets to the purchasers' risk appetite. Additionally, other market conditions which could impact pricing in any such transaction include the market appetite for similar securities along with the available and anticipated supply.

In summary, the fair values reported in note 39 under International Financial Reporting Standards (IFRS) may not represent the value achievable in a structured disposal. The value achieved may be impacted by the market conditions prevailing at that time and thus may not be achievable in any future transactions.

Optimum stress resiliency

The underlying stressed resiliency of the Optimum portfolio has improved since the 2014 Bank of England stress testing exercise. Improvements in the economic environment have resulted in an improvement in the underlying credit quality of the Optimum assets through reductions in the average Loan to Value of the portfolio and a reduction in the proportion of the book in arrears. The portfolio is therefore considered to be more resilient to a severe economic stress than at the time of the 2014 stress testing exercise.

Furthermore in the current market, the Bank believes it may not achieve similar pricing to that of the Warwick Finance One and Warwick Finance Two on future securitisations and thus any further deleverage in the near term would be capital destructive. The Bank's strategy is therefore to continue to hold these assets for the foreseeable future, in order to mitigate any further losses resulting from the sale of the assets and protect income and CET1 capital in a lower for longer base rate environment. However the bank will reassess this position, considering market conditions over time.

Revised basis of preparation

The results presented here are on a management accounts basis and are representative of how the Bank was managed in 2015.

The basis of preparation of the Bank's management and Board reporting has changed in 2015. The Income Statement breakdown has been revised to provide management with a more appropriate divisional split of underlying business unit profitability. This has allowed increased focus on the Core Bank and will enable a more informed comparison of the underlying operating performance drivers, following completion of the Bank's turnaround.

Legacy issues and the associated costs are now presented below the line, as these are not considered to comprise a material part of the go forward Core Bank operating result.

The following changes have been applied to the prior basis of operating expenditure, project expenditure and Financial Services Compensation Scheme (FSCS) levy.

The FSCS levy was previously reported as an exceptional item but is now included in operating expenditure as it is considered an on-going cost of operating the Core Bank.

Projects are split into three categories; Operational projects, Remediation projects and Strategic projects. Previously all project expenditure was included within the operating result and all depreciation and amortisation was included within operating expenditure. Under the revised basis of preparation, depreciation and amortisation of any capital spend associated with Strategic and Remediation projects are presented below the operating result. They are not considered to be recurring in the long term and will significantly reduce following the completion of the turnaround. Operating projects and the associated depreciation and amortisation continue to be included within the operating result.

Operating expenditure continues to be split into direct operating expenses, relating to each business unit, and head office overheads. The latter is included within the Core Bank result as these costs will be fully absorbed into the Core Bank upon completion of the Bank's Updated Plan.

Fair value accounting unwinds relating to the merger with Britannia Building Society, primarily the Leek notes are excluded from the operating result and included in the Non-core result.

Conduct and legal risk charges that relate to legacy issues are still excluded from the operating result.

2015

	Prior Basis £m	Reclass project depreciation £m	Reclass FSCS Levy £m	**Current Basis £m**
Total direct costs	(191.0)	11.0	–	**(180.0)**
Operations and Head Office overheads	(315.7)	22.7	(18.9)	**(311.9)**
Total operating costs	(506.7)	33.7	(18.9)	**(491.9)**
Operating projects	(27.0)	(22.7)	–	**(49.7)**
Remediation projects	(121.0)	(3.5)	–	**(124.5)**
Strategic projects	(92.2)	(7.5)	–	**(99.7)**
Total project expenditure	(240.2)	(33.7)	–	**(273.9)**
FSCS Levy	(18.9)	–	18.9	**–**
Total Costs	(765.8)	–	–	**(765.8)**

2014

	Prior Basis £m	Reclass project depreciation £m	Reclass FSCS Levy £m	Current Basis £m
Total direct costs	(225.6)	12.8	–	(212.8)
Operations and Head Office overheads	(369.0)	37.8	(24.4)	(355.6)
Total operating costs	(594.6)	50.6	(24.4)	(568.4)
Operating projects	(37.2)	(33.8)	–	(71.0)
Remediation projects	(140.1)	(5.5)	–	(145.6)
Strategic projects	(49.2)	(11.3)	–	(60.5)
Total project expenditure	(226.5)	(50.6)	–	(277.1)
FSCS Levy	(24.4)	–	24.4	–
Total Costs	(845.5)	–	–	(845.5)

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Total Bank financial performance

Bank performance

	2015 £m	Re-presented[2] 2014 £m	Change £m
Net interest income	**471.5**	493.4	(21.9)
Losses on asset sales	**(121.4)**	(14.4)	(107.0)
Non-interest income	**69.9**	115.1	(45.2)
Operating income	**420.0**	594.1	(174.1)
Operating expenditure	**(491.9)**	(568.4)	76.5
Operational project expenditure	**(49.7)**	(71.0)	21.3
Impairment gains on loans and advances	**48.6**	171.7	(123.1)
Operating result	**(73.0)**	126.4	(199.4)
Remediation project expenditure	**(124.5)**	(145.6)	21.1
Strategic project expenditure	**(99.7)**	(60.5)	(39.2)
Share of post tax profits from joint ventures	**0.7**	0.6	0.1
Conduct/legal risk	**(193.7)**	(101.2)	(92.5)
Fair value amortisation	**(120.4)**	(83.9)	(36.5)
Loss before taxation	**(610.6)**	(264.2)	(346.4)
Net interest margin	**1.42%**	1.22%	0.20%
Cost income ratio[1]	**100.0%**	105.1%	(5.1%)

1. Operating expenditure and operating projects (including associated depreciation and amortisation) divided by operating income excluding (losses)/gains on asset sales.
2. As a result of a change in accounting policy in the year, there has been a re-classification of income from net interest income to non-interest income. See Bank Income Statement for additional information.

The 2015 financial results reflect the positive progress made in delivering against the primary areas of focus outlined in the Bank's Revised Plan.

The Bank has achieved significant deleverage in its Non-core portfolios in 2015. The whole structure securitisations of Warwick Finance One and Warwick Finance Two totalled £3.1bn and reduced the Optimum book to almost half the size of the 2014 position. Corporate CoAM assets were also significantly reduced via a combination of formal trade sales, proactive rebanking of Corporate CoAM clients and the natural run off of the loans within the book.

In addition, the Bank issued £250m of Tier 2 capital notes, in 2015, which further increased capital resiliency.

Despite the significant asset deleverage the Bank has continued to improve its net interest margin delivering a 20bps improvement, to 1.42%. This improvement was largely driven by changes in deposit pricing within the Core Bank term and variable savings portfolios. The Bank has proactively managed down the higher levels of liquidity built up across 2014 as the overall funding requirement has reduced, following the deleveraging of Non-core assets.

This has resulted in a reduction in the Bank's underlying funding costs which has helped to protect net interest income, in light of the reduction in asset balances compared to 2014.

Non-interest income has reduced year on year, predominantly within the Retail business, driven by: a significant reduction in Link commission fees following the disposal of the majority of the ATM estate, industry-wide reductions in card interchange fees and lower overdraft fees following the launch of the new overdraft proposition in April 2015.

The Bank has delivered a significant reduction in operating expenditure which was down £76.5m in 2015 reflecting the progress of cost reduction initiatives. The reductions in costs are as a result of improved efficiency and simplification of Bank processes, reflecting management actions taken to address the Bank's cost base. Primarily attributable to the reduced ATM estate and cost reduction initiatives including: branch rationalisation, FTE (full time equivalents) reductions, third party procurement savings, supplier contract management and the fraud recovery process. The Bank has made a significant investment, with expenditure of £273.9m in 2015 to progress the transformation of IT resilience and remediation of systems and processes, in transforming the business into a stable retail and SME Bank with efficient processes and simplified products. The Bank has invested heavily in digital channels, through the upgrade of the mobile banking app, delivery of the paperless statements functionality, and digital product offerings.

Losses on asset sales have increased year on year to £121.4m, following increased amounts of Non-core deleverage in 2015 to improve stress capital resilience. The Bank has continued to invest across all project categories, continued to transform the Core Bank's operations and rebuild the Core Bank. Despite the progress made, significant challenges remain in creating a resilient Bank.

The Bank's financial performance continued to be impacted by legacy issues, particularly the anticipated fair value unwind related primarily to the merger with Britannia Building Society of £120.4m, and continued conduct legal risk charges totalling £193.7m in 2015, an increase of £92.5m from 2014.

The Bank's statutory loss before taxation for 2015 is £610.6m.

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

Operating expenditure

	2015 £m	Re-presented 2014 £m	Change £m
Core direct costs	**(165.2)**	(188.6)	23.4
Non-core direct costs	**(14.8)**	(24.2)	9.4
Total direct costs	**(180.0)**	(212.8)	32.8
Operations and Head Office overheads	**(311.9)**	(355.6)	43.7
Total operating costs	**(491.9)**	(568.4)	76.5
Of which: staff costs	**(217.8)**	(250.6)	32.8

Total operating expenditure reduced by £76.5m to £491.9m. Following the change in the basis of preparation, operating expenditure now includes charges in respect of the FSCS levy. For more detail on the basis of preparation see page 21.

In line with the Core Bank strategy cost savings result from a channel shift to Digital for new and existing customers and a simpler product set. In 2015, this has been delivered through a rationalisation of branches and contact centres delivering savings of £8.7m. In addition Full time equivalents reductions driven by efficiencies, process simplification and the outsourcing of mortgage servicing to Capita in August 2015 delivered savings of £14.5m and the active management of supplier contracts delivered savings of £6.6m. These cost savings were partially offset by an increase in marketing expenditure of £6.4m relating to the continued promotion of the brand and an increase in Digital marketing, following the launch of new products.

The deleveraging of the Non-core portfolio has driven a significant reduction in the number of specialist contractors and lower consultancy fees (£5.4m) and reduced third party costs (£2.1m).

Cost reductions in Operations and Head Office overheads have been primarily driven through the rationalisation of the ATM estate (£30.3m); reduction in staff and 3rd party costs of £8.9m due to Capita outsourcing and other efficiencies and process simplifications and £5.4m reduction in the FSCS Levy. There were also one off non-recurring savings of £5.9m relating to property disposals and provision releases in the Operations and Head Office area. These savings have been partially offset by the Capita outsourcing costs of £7.1m.

At a total Bank level, Operating staff costs have decreased year on year by £32.8m to £217.8m. Permanent staff numbers (full time equivalents) have fallen by 1,012 to 4,470 and direct pay has fallen by £19.6m. In addition, the number of short to medium term specialist contractors has significantly reduced by 252 to 234 and as a result non direct pay has fallen by £13.3m. Note these exclude any FTE and associated expense relating to the Bank's project expenditure.

Project expenditure

	2015 £m	Re-presented 2014 £m	Change £m
Operational projects expenditure	**(27.0)**	(37.2)	10.2
Operational projects depreciation	**(22.7)**	(33.8)	11.1
Operational projects	**(49.7)**	(71.0)	21.3
Remediation projects expenditure	**(121.0)**	(140.1)	19.1
Remediation projects depreciation	**(3.5)**	(5.5)	2.0
Remediation projects	**(124.5)**	(145.6)	21.1
Strategic projects expenditure	**(92.2)**	(49.2)	(43.0)
Strategic projects depreciation	**(7.5)**	(11.3)	3.8
Strategic projects	**(99.7)**	(60.5)	(39.2)

Operational projects

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

The charge for the year of £49.7m (2014: £71.0m) of which £22.7m (2014: £33.8m) relates to depreciation of previous investments. Key current projects include: Regulatory Reporting Programme (£6.4m); Bank Corporate Simplification (£2.6m); cheque imaging (£1.1m) and (£16.9m) on other smaller projects, ensuring regulatory and mandatory requirements of the Bank are met.

Depreciation has reduced by £11.1m due to the transfer of shared assets to The Co-operative Group as part of separation. The depreciation charge has now been replaced with a management recharge which is included in operating expenses.

Remediation projects

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

The 2015 cost of £124.5m (2014: £145.6m) includes depreciation of £3.5m (2014: £5.5m). Key projects include: Enterprise Services Outsourcing and separation from The Co-operative Group £44.4m, in 2015 and £50.8m utilisation of 2014 provision; finance transformation programme of £14.1m; ongoing IT remediation of £10.6m of other issues identified and outlined by the PRA.

Strategic projects

Strategic projects relate to those projects that are transformational in nature and deliver significant cost or income benefits to the business. Project costs of £99.7m (2014: £60.5m), including depreciation of £7.5m (2014: £11.3m), reflect continued investment to enhance capability across the organisation. Projects included: further branch transformation, with closure of an additional 58 branches in 2015 (£15.6m), mortgage outsourcing (£33.1m), and digital (£16.0m), along with severance associated with organisational design changes (£8.0m).

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

Capital expenditure

	2015 £m	Re-presented 2014 £m	Change £m
Operational projects	**6.5**	(3.0)	9.5
Remediation projects	**9.1**	(2.5)	11.6
Strategic projects	**45.5**	26.0	19.5
Total project capital expenditure	**61.1**	20.5	40.6

Operational projects capital expenditure in 2015 relates mainly to cheque imaging. The 2014 position includes impairments of £5.8m with £3.4m relating to mobile banking.

Remediation capital expenditure in 2015 is driven by Enterprise License Agreement (ELA) (£7.8m) as part of Enterprise Services Outsourcing (ESO) project and finance transformation software license spend (£1.7m). 2014 included impairments of £5.8m for IT branch infrastructure.

Strategic capital expenditure in 2015 includes the digital programme costs of £22.8m (2014: £21.0m); additional capital spend relating to Mortgage outsourcing of £21.0m.

Impairment gains and losses

	2015 £m	2014 £m	Change £m
Core impairments	**(0.3)**	3.5	(3.8)
Non-core impairments	**48.9**	168.2	(119.3)
Net impairment gains on loans and advances	**48.6**	171.7	(123.1)

Net impairment write-backs of £48.6m in 2015 are much lower in comparison to 2014.

Non-core assets have been disposed of at favourable prices compared to the provision levels of impairment held against them, and together with a number of loan restructures, have resulted in the release of previously recognised impairment provisions resulting in a write-back of £65.8m in 2015 (2014: £104.6m). In addition, the Bank has benefited from revised valuations of collateral still held against assets, due to a marginal improvement in economic conditions. This has resulted in a net write-back of £5.8m (2014: £62.3m).

New defaults amounted to £43.0m in 2015, compared to £18.7m in 2014. This was driven by two specific cases moving into default, which together accounted for £33.0m of the charge. Improving economic conditions have seen the remainder of the Non-core portfolio represent a lower default rate, resulting in a collective impairment write-back of £20.4m in 2015 (2014: £33.2m).

Core Bank impairments of £0.4m, with the BaCB portfolio experiencing impairment write backs of £1.3m in the year following changes in the collective provision modelling.

A more detailed analysis of impairments is provided in the Risk Management section.

Conduct and legal risk

Conduct and legal risk charges

	2015 £m	2014 £m	Change £m
CCA Customer Redress	**(58.3)**	(40.5)	(17.8)
CCA Cost to Remediate	**(40.4)**	(22.3)	(18.1)
PPI Redress	**(44.2)**	(5.0)	(39.2)
PPI Cost to Remediate	**(27.6)**	–	(27.6)
Packaged Accounts	**(16.8)**	(17.4)	0.6
Mortgages	**(0.6)**	(17.2)	16.6
Mis-sold	**6.4**	10.0	(3.6)
Other	**(12.2)**	(8.8)	(3.4)
Total	**(193.7)**	(101.2)	(92.5)

The 2015 charges relating to conduct and legal risk were £193.7m (2014: £101.2m) driven by increases in existing provisions with no new material categories of conduct risk being identified. The conduct and legal risk charges predominantly relate to legacy issues that have continued to be recognised across the industry.

The £193.7m charge in the year primarily comprised of increases for PPI (including Plevin) of £71.8m, CCA unsecured unenforceable interest of £58.3m and £40.4m relating to the cost to redress customers.

The Bank completed its PPI proactive business review activity in 2015, with minimal amounts of redress to be paid in 2016. However there was an increase in the underlying provision of £71.8m, driven by the level of inbound complaints not declining as originally anticipated and the proposed FCA led marketing campaign regarding the regulatory time barring on PPI complaints.

Following the recent FCA statement on Plevin, which outlined the proposed rules and guidance regarding the rules around redress that Banks likely to have to follow, the Bank has reassessed its exposure based on the information available currently and has recognised an incremental PPI provision of £1.3m.

The Bank also incurred a £58.3m cost in 2015 relating to unenforceable interest which it cannot charge on accounts while they are not compliant with CCA. Whilst the Bank has made significant progress in redressing and remediating open non-compliant accounts in 2015, it has revised assumptions regarding total remediation based on the actual redress paid out in 2015, coupled with an increase in the expected delivery costs to complete the remediation programme, which has resulted in a £98.7m increase in the CCA conduct provision.

At the start of 2015, the Bank experienced an increased level of inbound packaged account complaints which resulted in the Bank raising a £16.8m provision.

In addition, the Bank released £8.8m of provisions in relation to mortgages within the Optimum portfolio as a result of Warwick Finance One and Warwick Finance Two transactions. This is discussed in more detail on page 19.

Business segment financial performance

	2015 £m	Re-presented 2014 £m	Change £m
Retail contribution	**323.1**	348.5	(25.4)
BaCB contribution	**45.5**	48.0	(2.5)
Core contribution excluding Treasury/other	**368.6**	396.5	(27.9)
Treasury/other contribution	**(21.9)**	(48.5)	26.6
Core contribution result	**346.7**	348.0	(1.3)
Non-core contribution result	**(58.1)**	205.0	(263.1)
Head Office overheads	**(311.9)**	(355.6)	43.7
Operational project costs	**(49.7)**	(71.0)	21.3
Operating result	**(73.0)**	126.4	(199.4)

Contribution is defined as net income after impairment and direct costs. Head office overheads (costs incurred in central functions) are not allocated to a business segment.

Core contribution excluding Treasury/other contribution is down on prior year at £368.6m (2014: £396.5m) as a result of a reduction in non-interest income, partially offset by lower direct costs.

Treasury/other loss improved by £26.6m primarily due to an increase in net interest income, which is a result of secured wholesale funding transactions being called in 2015.

Non-core contribution generated a loss of £58.1m (2014: profit of £205.0m). The primary driver of this deterioration is the accelerated deleverage strategy resulting in an underlying reduction in net interest income and increased loss on sale.

These are discussed in more detail in the following sections.

Internal transfer pricing policy

The Bank operates an internal transfer pricing policy. Liability balances receive an internal cost of funds as they provide the funding to support the Bank's assets. This is reflected within the business unit net interest income. The Bank's assets are charged an internal cost of funds to account for this. The internal cost of funds paid and received, varies by asset and liability type and is included within the business unit net interest income.

The internal cost of funds for Core Bank assets and liabilities is refreshed each year to reflect the Bank's underlying cost of funding. The underlying funding cost has reduced in 2015 compared to 2014 following the re-pricing of the Bank's relatively more expensive liabilities. Core assets have therefore been charged lower internal cost of funding and Core liabilities have received a reduced funding income. The internal interest rates for Non-core assets and liabilities do not change annually.

This has reduced the net interest income since 2014 of the Retail and BaCB business units as they have a net liability position.

Core

Core contribution

	2015 £m	Re-presented 2014 £m	Change £m
Net interest income	**460.6**	444.8	15.8
Losses on asset sales	**(0.8)**	(2.1)	1.3
Non-interest income	**52.4**	90.4	(38.0)
Net income	**512.2**	533.1	(20.9)
Direct costs	**(165.2)**	(188.6)	23.4
Impairment gains/(losses) on loans and advances	**(0.3)**	3.5	(3.8)
Contribution result	**346.7**	348.0	(1.3)
Head office Overheads	**(311.9)**	(355.6)	43.7
Operational projects	**(49.7)**	(71.0)	21.3
Operating result	**(14.9)**	(78.6)	63.7
Net interest margin[1]	**1.91%**	1.65%	0.26%
Assets	**22,819.0**	25,476.2	(2,657.2)
Liabilities	**25,674.6**	33,391.0	(7,716.4)

1. Total Core Asset and Liability net interest income divided by average asset balances.

Core Bank contribution, comprising of Retail, BaCB and Treasury/other, reduced by £1.3m.

Retail contribution reduced by £25.4m as a result of a reduction in non-interest income, partially offset by direct cost savings.

BacB contribution reduced by £2.5m as a result of a reduction in net interest income, driven by a reduction in internal cost of funding.

Treasury/other contribution increased by £26.6m similarly as a result of an increase in net interest income primarily due to secured wholesale funding transactions being called during the year.

These are discussed in more detail in the following sections.

Core Bank net interest margin has continued to improve year on year up 26 basis points (bps) on prior year to 1.91%, largely driven by the reduction in interest expense on liabilities following proactive repricing.

Core Bank assets have reduced by £2.7bn to £22.8bn mainly attributable to a £2.2bn reduction in Treasury/other assets including the removal of £0.5bn of Unity Trust Bank assets that were previously consolidated into the Bank's balance sheet.

Core Bank liabilities have reduced by £7.7bn during the year from £33.4bn at 31 December 2014 to £25.7bn at 31 December 2015 as the Bank has proactively managed liability run-off to meet reduced funding and liquidity requirements.

Retail contribution

	2015 £m	Re-presented 2014 £m	Change £m
Net interest income	**421.7**	396.3	25.4
Non-interest income	**43.2**	105.2	(62.0)
Net income	**464.9**	501.5	(36.6)
Direct costs	**(138.1)**	(154.8)	16.7
Impairment gains/(losses) on loans and advances	**(3.7)**	1.8	(5.5)
Contribution result	**323.1**	348.5	(25.4)
Net interest margin[1]	**2.93%**	2.52%	0.41%
Customer assets	**14,219.3**	14,611.4	(392.1)
Customer liabilities	**19,725.2**	25,562.3	(5,837.1)

1. For each individual Business segment the Net interest margin calculation adds net interest earned on both assets and liabilities together and divides by average asset balances, this is not adjusted to reflect any balance sheet mismatch at Business segment level.

Retail contribution has reduced by £25.4m to £323.1m (2014: £348.5m), as higher net interest income and reduced direct operating expenses have been more than offset by a £62.0m reduction in non-interest income.

The Retail business continues to benefit from the increased new business origination activities in the year. This renewed focus has helped drive an increase in mortgage completions to £2.8bn in 2015 compared to £1.1bn in 2014. The Bank's intermediary channel accounted for 88% or £2.5bn of total mortgage completions in 2015 (2014: £0.9bn), with £1.5bn in the second half of 2015 as the Bank's offering becomes more competitive in this segment. Total mortgage redemptions decreased in 2015 to £2.3bn down slightly from £2.4bn in 2014. The mortgage portfolio had a net reduction of £0.2bn in the year (£1.9bn reduction in 2014).

The completion of mortgage processing outsourcing should further improve the Bank's ability to process mortgage applications and introduce enhanced retention capability.

The Bank's current account volumes have stabilised, compared with a 4.0% reduction in 2014. This is primarily as a result of the Bank's increased presence within the marketplace following investment in an improvement in the brand positioning, and significant improvements in the Bank's Net Promoter Score (NPS) for Current Accounts.

Net interest income has increased by £25.4m to £421.7m in 2015.

The large scale deleveraging of Non-core assets has reduced the Bank's overall funding requirements, as the Retail portfolio was the largest source of funding for these Non-core assets. As a result, the Bank has been able to proactively manage a reduction in high priced deposits and rebalance the savings portfolio, through the reduction in pricing for term and variable deposits. This has resulted in a reduction in the average interest expense on deposits and a more sustainable cost of funding. This activity has seen Retail customer liabilities reduce by £5.8bn to £19.7bn (2014: £25.6bn).

Retail net interest income has reduced in 2015 as a result of the changes in the internal cost of funding as outlined on page 24 in the internal transfer pricing policy section. Net interest income has also fallen as a result of the reduction in Retail liabilities, on which the internal cost of funding has been paid.

The reduction in net interest income from these impacts has however been more than offset by the reduction in level of interest expense paid for Retail customer deposits following the repricing activity within the year.

Despite a significant reduction in the volume of liabilities, driven by a reduction in the Bank's funding requirements and the reduction in the internal cost of funding, the Retail portfolio has seen an increase in net interest income and net interest margin.

Retail non-interest income reduced to £43.2m (2014: £105.2m), primarily due to a reduction in income from Link commission as a result of the sale of part of the ATM estate. In addition, industry-wide impacts of revised card interchange have reduced the Bank's card transaction fee income. Overdraft fees have decreased following the launch of the new overdraft proposition in April 2015.

The impairment charge for Retail was £3.7m; this was predominantly within the unsecured portfolio, with overall write-backs in the secured portfolio following improvements in the underlying impairment model parameters in 2015.

Business and Commercial Banking (BaCB)

Business and Commercial Banking contribution

	2015 £m	Re-presented 2014 £m	Change £m
Net interest income	**41.9**	46.1	(4.2)
Non-interest income	**11.6**	14.9	(3.3)
Net income	**53.5**	61.0	(7.5)
Direct costs	**(9.3)**	(14.6)	5.3
Impairment gains on loans and advances	**1.3**	1.6	(0.3)
Contribution result	**45.5**	48.0	(2.5)
Net interest margin[1]	**7.35%**	6.29%	1.06%
Customer assets	**520.9**	620.0	(99.1)
Customer liabilities	**2,682.0**	2,837.0	(155.0)

1. For each individual Business segment the Net interest margin calculation adds net interest earned on both assets and liabilities together and divides by average asset balances, this is not adjusted to reflect any balance sheet mismatch at Business segment level.

2015 BaCB business contribution of £45.5m (2014: £48.0m) represents a £2.5m reduction on prior year.

Customer liabilities have fallen to £2.7bn, mostly driven by the run off on the fixed savings book. Customer assets decreased from £620.0m to £520.9m, largely due to customer outflows due to our competitive position within the market place.

Net interest income reduced to £41.9m in 2015 down £4.2m from 2014. BaCB generates the majority of its net interest income from its liability balances and as outlined on page 24 changes in the internal transfer pricing policy in 2015 have reduced the internal cost of funding received by liabilities, reducing the overall net interest income.

The net liability position of the BaCB portfolio results in the net interest margin being sensitive to changes in asset balances.

The 106bps improvement in Net interest margin is driven by the proportionally higher impact of the reduction in asset balances in 2015 compared to the reduction in Net interest income for BaCB.

BaCB reported a net impairment write back of £1.3m driven by changes in the collective provision methodology.

Treasury/other

Treasury/other business contribution

	2015 £m	Re-presented 2014 £m	Change £m
Net interest income	**(3.0)**	2.4	(5.4)
Losses on asset sales	**(0.8)**	(2.1)	1.3
Non-interest income	**(2.4)**	(29.7)	27.3
Net Income	**(6.2)**	(29.4)	23.2
Direct costs	**(17.8)**	(19.2)	1.4
Impairment gains on loans and advances	**2.1**	0.1	2.0
Contribution result	**(21.9)**	(48.5)	26.6
Assets	**8,078.8**	10 ,244.8	(2,166.0)
Liabilities	**3,267.4**	4,991.7	(1,724.3)

Treasury/other contributed a loss of £21.9m in 2015 compared to the prior period loss of £48.5m.

Net interest income decreased by £5.4m, the positive impact of the lower wholesale funding was more than offset by lower interest income on reduced balances supporting the Bank's liquidity buffer which consists of highly liquid eligible assets such as cash, gilts and multi-lateral development bonds. These balances reduced by £2.0bn when compared to 2014 reflecting the lower liquidity requirements of the Bank. In addition to this, the balance sheet deleveraging of the Non-core portfolio resulted in lower internal funding income charged to the rest of the business. Balance sheet reduction and a change in product mix has also had a positive impact on Treasury income through hedging.

The disposal of Western Mortgage Services (WMS) to Capita, completed in August 2015, as part of the mortgage processing outsourcing agreement generated a gain on sale of £4.3m in 2015.

In December 2015, the Bank reduced its share in Unity Trust Bank, to 6.7%. Prior to the sale Unity Trust Bank results were fully consolidated into the Bank's results. The Bank received £5.9m of cash proceeds from Unity Trust Bank following the sale of £3.3m Class A Shares. The overall loss on sale was £5.0m.

Non-interest income improved due to significant positive hedge ineffectiveness on cross currency swaps. This was primarily due to the weakening of the euro against sterling. In addition to this the FLS facility was partially repaid resulting in lower fees paid.

The Bank purchased £1.6bn of the Warwick Finance One and Warwick Finance Two RMBS senior tranche as part of the Optimum asset disposal programme. In addition to this a £250m Tier 2 subordinated debt issuance was successfully completed while senior unsecured debt of (£443.4m) €550.0m was repaid in 2015.

Non-core

Non-core balance sheet

	2015 £m	2014 £m	Change £m
Corporate CoAM	1,998.0	3,930.1	(1,932.1)
Optimum	3,155.9	6,822.9	(3,667.0)
Assets	5,153.9	10,753.0	(5,599.1)
Corporate CoAM	211.3	557.4	(346.1)
Liabilities	211.3	557.4	(346.1)
Customer assets	4,894.5	10,253.1	(5,358.6)
Customer liabilities	211.3	557.4	(346.1)

Non-core total assets decreased by £5.4bn to £4.9bn. The Bank's Revised Plan required an acceleration of the reduction in Optimum assets. Optimum was particularly vulnerable to the 2014 Bank of England's hypothetical severe stress. The accelerated reduction of the Optimum portfolio significantly improved the Bank's resilience to a severe economic downturn. Current market conditions mean it is not capital accretive to further deleverage the Optimum Portfolio in the near term.

The Bank's Non-core residential mortgage portfolio reduced by £3.7bn to £3.2bn primarily driven by the two whole structure securitisations of Warwick Finance One and Warwick Finance Two.

Deleveraging of Corporate CoAM assets continued in 2015, with a net reduction of £1.9bn across 2015. This reduction is mainly driven by the sale of loans to third parties and the re-banking of customers. This included the sale of the renewable energy portfolio of £264.0m and PFI sales of £445.7m.

Non-core liabilities have reduced by £346.1m to £211.3m in line with expectations. As the Bank continues its Non-core deleveraging strategy, customers have naturally migrated their accounts to their new financial institutions.

Non-core contribution

	2015 £m	Re-presented 2014 £m	Change £m
Net interest income	10.9	48.6	(37.7)
Losses on asset sales	(120.6)	(12.3)	(108.3)
Non-interest income	17.5	24.7	(7.2)
Net income	(92.2)	61.0	(153.2)
Direct costs	(14.8)	(24.2)	9.4
Impairment gains on loans and advances	48.9	168.2	(119.3)
Contribution result	(58.1)	205.0	(263.1)

Non-core contributed a loss of £58.1m in 2015, which is a significant but expected reduction from the positive contribution of £205.0m in 2014.

Non-core net interest income has decreased by £37.7m, following the significant reduction in interest generating assets as the book has been deleveraged.

The reduction in Non-core contribution is further impacted by lower net impairment write-backs on loans and advances in the year of £48.9m down from £168.2m in 2014. These are associated with assets being disposed of at favourable prices to the net book value resulting in the write back of previously recognised impairment provisions. In addition, the Bank has revised valuations of assets still held. The specialist team continues to focus on distressed-asset workout and turnaround capability and this approach, together with the improving economic environment, has resulted in a write-back of previously recognised impairment of assets on disposal.

The Non-core loss on sale has increased by £108.3m from 2014. This is predominantly driven by the losses on sale from the Corporate CoAM portfolio of £67.5m of which £30.6m relates to £445.7m of PFI, £14.9m relates to £56.4m of mortgage backed securities and £14.2m relates to a portfolio of £81.8m of Corporate assets, and also the Optimum mortgage securitisations.

Non-core non-interest income is down on prior year as a result of lower asset balances across the business and will continue to fall as the Bank continues to deleverage the asset base.

Direct costs reduced by £9.4m to £14.8m in 2015, primarily as a result of a reduction in staff costs with fewer staff being required as the book is deleveraged. Coupled with the non-recurring costs of operating the Illius portfolio and the Non-core portfolio set up fees which both existed in 2014.

The Bank's Updated Plan

The Bank has made steady progress in 2015 against the objectives of the Revised Plan, however throughout 2015 a number of systemic and idiosyncratic opportunities and challenges have driven deviations to the assumptions included within the Revised Plan.

These deviations have impacted the Bank's 2015 actual performance and driven revised expectations across the planning horizon.

These include lower for longer market interest rates, improved Core Bank origination, prevailing market pricing for Non-core deleverage, systemic capital market volatility, increased 2015 provisions for conduct risk and further clarity around future Regulatory Capital requirements, including MREL.

Consequently, the Bank has undertaken a strategic review in order to assess a number of options open to management that enable the Bank to mitigate some of the impacts of these changes. This has resulted in the creation of the Bank's Updated Plan which has been approved by the Bank's Board and accepted by the PRA.

The key strategic change in the Bank's Updated Plan compared to the Revised Plan relates to the Bank ceasing any further planned deleverage of the Non-core Optimum portfolio although management will retain this as a management action that can be redeployed if required.

The underlying stressed resiliency of the Optimum portfolio has improved since the 2014 Bank of England stress testing exercise. Improvements in the economic environment have resulted in an improvement in the underlying credit quality of the Optimum assets through reductions in the average Loan to Value of the portfolio and a reduction in the proportion of the book within arrears. The portfolio is therefore considered to be more resilient to a severe economic stress than at the time of the 2014 stress testing exercise and is significantly smaller in size.

Furthermore, given current market volatility, the Bank believes that it may not achieve similar pricing to that of the Warwick Finance One and Warwick Finance Two on future securitisations and thus any further deleveage in the near term would unnecessarily be capital destructive. The Bank's strategy is therefore to continue to hold these assets for the foreseeable future, in order to mitigate any further losses resulting from the sale of the assets and protect income and CET1 capital in a lower for longer base rate environment. The Bank will continue to assess this strategy in light of emerging market conditions periodically.

There are still significant risks within the Bank's Updated Plan. Legacy conduct risk issues continue to impact the industry whilst, along with all financial institutions, the Bank is significantly sensitive to changes in the macroeconomic environment.

The required remediation and transformation investment along with the continued unwind of the fair value reserves recognised following the merger with the Britannia Building Society is expected to drive further losses in the Bank in 2016. As a result the Bank's CET1 ratio is expected to reduce in the medium term, before it improves again.

Key Performance Indicators[1]

The key performance indicators presented below reflect the way in which the performance of the Bank has been measured during 2015. Management continue to review these measures on an ongoing basis.

Capital KPIs

	Definition	Why it is important to the business and management	
CET1 Ratio	Capital requirements are part of the regulatory framework governing how banks and depository institutions are measured. Capital ratios express the Bank's capital as a percentage of its RWAs as defined by the Regulatory authorities. CET1 is broadly equivalent to tangible shareholders' funds less certain capital deductions.	The Bank is required to maintain minimum regulatory capital and capital ratios at all times. The CET1 ratio is important for the Bank's ability to withstand any future market wide or individual stresses.	**2015: 15.5%** 2014: 13.0%
Total Capital Ratio	The ratio of total capital resources to the Bank's total RWAs.	The Bank is required to maintain minimum regulatory capital and capital ratios at all times. The total capital ratio is important for the Bank's ability to withstand any future market wide or individual stresses.	**2015: 21.6%** 2014: 15.0%
Leverage Ratio	A ratio calculated by reference to CRD IV fully-loaded Tier 1 capital (after deductions) divided by adjusted balance sheet exposure.	UK banks are required to disclose this ratio from 2015. It is expected that the ratio must be maintained at 3% or above with effect from 1 January 2018. This is currently under review by the PRA for Banks with retail deposits under £50bn. The Bank anticipates its leverage ratio will be above 3.0% by the end of the Plan.	**2015: 3.8%** 2014: 4.2%
Total RWAs	RWAs are required to be calculated for the Bank to provide for three types of risk: i Credit risk ii Market risk iii Operational risk The Bank considers market risk within credit risk. The Bank's capital ratios are calculated from the sum of the three RWA categories.	The Bank is required to maintain minimum regulatory capital and capital ratios at all times Calculation of total RWAs is part of the calculation of these ratios.	**2015: £7.4bn** 2014: £12.6bn

Returns KPIs

	Definition	Why it is important to the business and management	
Statutory profit/(loss) before tax	This represents operating profit/(loss) less intangible asset impairment, the cost of customer redress, levies, taxes and various non-recurring items.	This is a primary profitability measure used by management to assess performance.	**2015: (£610.6m)** 2014: (£264.2m)
Net interest margin[2]	Net interest income (the difference between interest received from loans/other assets and interest paid out on deposits/other liabilities) divided by average total assets.	The net interest margin is the key measure of the Bank's ability to generate revenue.	**2015: 1.42%** 2014: 1.22%
Cost income ratio[3]	The proportion of the Bank's revenue which is used to fund its operating costs, calculated by dividing operating costs plus operating projects (including the associated depreciation) by net interest income and non-interest income.	A principal measure of the efficiency of the Bank's overall operations.	**2015: 100.0%** 2014: 105.1%

By its nature, achieving a target involves risks and uncertainties because it is a forward looking statement that relates to, and depends on, circumstances that may or may not occur, in the future. A target is not a guarantee of future performance. The Bank's actual results may differ significantly from those suggested by a target. Please see Going Concern, Principal risks and uncertainties and Risk management for information on factors that may mean any targets may not be achieved when planned for, or at all.

1. KPIs are calculated on a management accounts basis as this is how we manage our business. Therefore these measures do not include several items which are reported in the statutory loss. This may render these metrics difficult to reconcile on a statutory basis.
2. Net interest margin is calculated on a management accounts basis and excludes a number of items which are reported in the statutory loss for the year. These include relevant conduct and legal provisions and fair value unwinds. This may render these metrics difficult to reconcile on a statutory basis.
3. Cost income ratio is calculated on a management accounts basis.

HR Key Performance Indicators

	Definition	Why it is important to the business and management	
Colleague engagement	The Bank measures the engagement level of its employees based on responses to questions covering five areas. Colleague Engagement is a measure of colleague sentiment towards The Co-operative Bank plc based on their advocacy, confidence, commitment, pride and their willingness to give discretionary effort that supports productivity and performance. For 2015, the Employee Engagement index was 66% (October 2015 survey). This represents an increase of 16% points on survey results from November 2014, reflecting the Bank's focus over the past 12 months to listen to colleague feedback, act on it and communicate local and Bank-wide activities.	Our people are vital to our success. Given the challenges the Bank has faced, it is essential that colleagues continue to feel engaged and committed to delivering the Updated Plan. The Bank continues to focus on improving our colleagues' experience at work, which underpins the successful execution of the Bank's turnaround.	**2015: 66%** 2014: 50%

Gender diversity

YE 2015	Female No.	Female %	Male No.	Male %
Board[1]	2	18%	9	82%
Executive Management Team[2]	2	22%	7	78%
Other Employees[3]	3,078	61%	1,988	39%
Grand Total	3,082	61%	2,004	39%

YE 2014 Re-presented[4]	Female No.	Female %	Male No.	Male %
Board	2	22%	7	78%
Executive Management Team	2	29%	5	71%
Other Employees	3,897	63%	2,299	37%
Grand Total	3,901	63%	2,311	37%

The definitions used for reporting in this section have been updated to ensure consistency of approach across Bank reporting. The 2015 categories are in line with ICSA: The Governance Institute guidance for the content of an annual report for UK companies.

1. Board: Includes Executive and Non-Executive Directors.
2. Executive Management Team: Includes senior managers who have responsibility for planning, directing or controlling the activities of the Company.
3. Other Employees: Includes all other permanent employees.
4. The colleague categories have been redefined for the 2015 report. The 2014 figures (using the new definitions) are therefore included in this report to enable comparison.

Detailed Key Performance Indicators

Core Bank KPIs

The Core business represents lines of activity that are consistent with the Bank's strategy and risk appetite and includes Retail, BaCB and Treasury & Other.

	Definition	Why it is important to the business and management	
Net interest margin	Net interest income (the difference between interest received from loans and other assets and interest paid out on deposits and other liabilities) divided by average total assets.	The net interest margin is the key measure of the Core Bank's ability to generate revenue.	**2015: 1.91%** 2014: 1.65%
Customer deposits	The amount of money customers hold in their accounts with the Bank, also known as customer liabilities.	The Core Bank needs customers to deposit money with the Bank so that it is able to fund loans to other customers.	**2015: £22.4bn** 2014: £28.4bn
Customer assets	The amount of money the Bank has lent to customers as loans.	The interest received on loans is the Core Bank's primary source of revenue.	**2015: £14.7bn** 2014: £15.2bn
Primary current account holders	Customers holding an account with the Bank who on average pay in £800 or more per month.	A measure of the size of the Core Bank's active customer base.	**2015: 655,965** 2014: 651,214
Credit RWAs	Total assets adjusted by different risk weightings for different types of assets (to reflect their inherent potential for default) with the aim of more accurately reflecting the Bank's exposure to potential losses.	Asset types which attract high risk weightings require the Core Bank to hold more equity capital to absorb potential losses.	**2015: £3.7bn** 2014: £4.4bn
Total current account holders	The total number of open current accounts the Bank has.	Current accounts are the cornerstone of the Bank's relationship strategy.	**2015: 1,431,323** 2014: 1,432,122

Non-core Bank KPIs

The Non-core business consists of those asset classes which are not consistent with the Bank's Core strategy and are managed to achieve the most appropriate asset value on an individual portfolio basis or are targeted for run down or exit.

	Definition	Why it is important to the business and management	
Customer Assets	The amount of money the Bank has lent to customers as loans.	The interest received on loans is the Bank's primary source of revenue; conversely, impairments on those loans create losses which reduce capital.	**2015: £4.9bn** 2014: £10.3bn
Credit RWAs	Total assets adjusted by different risk weightings for different types of assets (to reflect their inherent potential for default) with the aim of more accurately reflecting the Bank's exposure to potential losses.	Asset types which attract high risk weightings require the Bank to hold more equity capital to absorb potential losses. Reducing RWAs in Non-core will, all other things being equal, increase the Bank's CET1 ratio.	**2015: £2.8bn** 2014: £7.2bn

Principal risks and uncertainties

Background

The Bank faced an extremely difficult and unprecedented situation following its June 2013 announcement of a significant shortfall in CET1 of £1.5bn. Since then elements of the uncertainty around the Bank's capital position have been removed with the successful completion of several capital raising exercises, including the Liability Management Exercise (LME) in December 2013, the equity capital raising in May 2014, the receipt of the Co-operative Group's £333m capital contribution in 2014 and the issuance of £250m subordinated Tier 2 notes in June 2015.

In December 2014, following the Bank's failure of the Bank of England stress tests, the PRA accepted a Revised Plan for the period 2015-2019 under which one of the key priorities was to commit to an earlier deleverage of the Non-core Optimum portfolio, being a significant part of the Bank's Non-core business that is particularly vulnerable to the hypothetical stress tests. During 2015, the Bank successfully completed the Warwick Finance One and Warwick Finance Two RMBS securitisations with the effect of contributing a combined £1.6bn reduction in credit RWAs.

Overall, there remain significant challenges in the execution of the turnaround, although much progress has been made over the past 24 months. The Bank has a large number of remediation and redress programmes to implement (most notably a very large and complex project with respect to the Bank's IT infrastructure) along with substantial re-engineering of its operating model. A failure to successfully implement or a delay in implementing the Bank's strategy and plans may adversely impact the Bank's business, operating results, financial condition, prospects, regulatory capital position and its ability to comply with its regulatory requirements both in respect of capital and more generally (see below for more information).

The Bank's ability to implement a turnaround is heavily influenced by external factors which may mean underpinning internal assumptions relating to economic or market conditions may be incorrect and negatively impact the Updated Plan (for example interest rates may not rise in accordance with assumptions underpinning the plan). Many of these are similar to those faced by other financial institutions, for example, deterioration in general economic conditions, instability of global financial markets (including the effect of macro political conditions in Europe, such as Brexit), the management of credit risk, interest rate risk, currency risk and market risk, as well as risks stemming from regulatory change and an increasing regulatory enforcement and an increasingly litigious environment. A number of such factors have required the Bank to adapt its Revised Plan and replace it with the Updated Plan as discussed below.

The Bank's Updated Plan and Rationale for retaining Optimum

Throughout 2015, a number of external and idiosyncratic opportunities and challenges faced by the Bank have driven material changes to the assumptions that were included in the Revised Plan accepted by the PRA in December 2014. These changes have impacted the Bank's 2015 performance and resulted in revised assumptions and expectations across the Bank's planning horizon. This has resulted in an Updated Plan, for the period 2016-2020, which has been approved by the Bank's Board and accepted by the PRA.

The key changes to assumptions include lower for longer Bank of England interest rates, improved Core Bank origination, prevailing market pricing for Non-core deleverage, systemic capital markets volatility, increased 2015 provisions for conduct risks and further clarity around future regulatory capital requirements, including expectations concerning MREL.

Consequently, the Bank has undertaken a strategic review to assess the options available to mitigate some of the impacts of these changes. The key strategic change made in the Bank's Updated Plan relates to the suspension of any further planned deleverage of the Non-core Optimum portfolio in 2016 until such time as market conditions improve, at which point Management may consider opportunities at the time. Given current market volatility, the Bank believes it may not achieve similar pricing benefits to that of the Warwick Finance One and Warwick Finance Two transactions and thus any further deleverage of Optimum in the near term would be capital destructive.

Additionally, the underlying stressed resiliency of the Optimum portfolio has increased since the 2014 Bank of England stress testing exercise and the economic environment has contributed to an improvement in the underlying credit quality of the Optimum assets. These are due to reductions in the average loan to value ratio and a reduction in the proportion of the book within arrears. The size of the portfolio materially reduced and the remaining portfolio is considered to be more resilient to a severe economic stress than at the time of the 2014 stress testing exercise and pose less of a risk than previously thought.

The Bank's strategy is therefore to continue to hold the remainder of the Optimum portfolio assets for the foreseeable future in order to mitigate any further losses that may result from the sale of the assets and accordingly protect the Bank's income and CET1 capital in a lower for longer interest rate environment. The Bank will continue to assess this strategy in light of emerging market conditions periodically. There remain significant risks within the Bank's Updated Plan although much progress has been made over the past 24 months.

Optimum portfolio Risk Weighted Assets temporary adjustment

The Bank is seeking to enhance its credit modelling capability in a number of key portfolios and is in discussion with the PRA with regards to the approval and implementation of these enhancements during 2016. A major element of these enhancements relate to how the Bank determines LGD for retail secured mortgages.

In June 2013 the Bank initially assessed the impact of potential enhancements which drove a £1.0bn increase in the underlying RWAs calculated from the current models. The increase predominantly related to the Optimum portfolio and the £1.0bn adjustment had been included within the Optimum RWAs. This is referred to as a temporary adjustment.

Following the significant deleverage of the Optimum balances within 2015, the Bank has judged it appropriate to reduce the temporary adjustment from £1.0bn to £0.3bn in line with the balance reduction in order to ensure that the Optimum RWAs are more reflective of the underlying credit quality of the reduced size of the portfolio. The PRA has not objected to this change.

When the new LGD model is fully implemented, the remaining £0.3bn of the temporary adjustment is expected to be removed in full if agreed by the PRA with the new model directly calculating the appropriate LGD and corresponding RWAs for all the Bank's secured portfolios.

Regulatory Position

The following section summarises the Bank's position in relation to deficiencies against regulatory requirements and expectations. These deficiencies have existed for some time and will continue for some years to come while the Bank implements its Updated Plan. As part of the successful implementation of the Updated Plan, the Bank will need the ongoing support of all its Regulators regarding any continuing and intervening deficiencies to required regulatory standards.

Capital

The Bank continues to meet its Pillar 1 capital requirements under normal economic conditions. This is the minimum required under the CRR. The PRA provides Individual Capital Guidance (ICG) for each bank. This represents guidance on the capital (Pillar 2a) a firm should hold in excess of Pillar 1.

As at 31 December 2015, the Bank was compliant with the ICG for total capital set by the PRA, however it is not forecast to remain compliant with ICG requirements for most of the planning period. The Bank is not expected to be sustainably ICG compliant until 2019.

The Bank does not currently have sufficient capital resources to withstand a severe stress scenario under its current in force PRA Buffer. The Bank's Updated Plan has been accepted by the PRA subject to ongoing review and the Bank expects to remediate this position by 2020. This is driven by further reductions in Non-core RWAs, the implementation of cost reduction initiatives and profit generation in the later stages of the Plan.

The Bank is mindful of the capital implications of the Bank of England's minimum requirement for own funds and eligible liabilities (MREL) regime and the increased debt issuance this will drive, for the banking industry in general but also for the Bank.

The Bank of England published a consultation paper in December 2015 proposing a methodology for setting a firm's individual MREL requirement at a minimum of 2 x (Pillar 1 + Pillar 2a).

The Bank's Updated Plan (2016-2020) incorporates MREL qualifying issuance commencing in 2018 which is the Board's current view of the earliest time when such issuance may be feasible. The PRA and the Bank of England have indicated their strong preference that the Bank incorporates an earlier profile of MREL issuance than currently contemplated by the Bank's Updated Plan. Such expectations have been confirmed by the regulators as not intended yet to represent the formal setting of a required MREL issuance plan and the Bank of England has stated that it will consult with the Bank before setting binding requirements, which it will be able to do at any point following publication of its MREL policy (expected to be sometime in 2016).

Should the Bank be able to issue MREL earlier than currently considered feasible, then it would do so, which might further delay ICG and PRA buffer compliance and Core Bank operating profitability. The PRA and Bank of England are aware of these possible outcomes. If in due course the Bank becomes subject to a binding requirement to issue MREL and it is unable to do so when required, the Bank's regulators can agree to accept the Bank's original issuance plan, a revised issuance plan, require some other action on the part of the Bank or in the absence of any of these the Bank of England may exercise its powers under the Banking Act 2009[1]. In considering the viability the Board has taken note of the contents of PRA consultation paper (CP 44/15) and the Board believes that resolution is less likely than the other outcomes while the Bank is executing its plan as accepted by the PRA and continuing to de-risk the Bank.[2]

Both regulators acknowledge and recognise that any change to the Bank's current planning assumptions for MREL would have to be subject to the overall feasibility of the Bank being able to issue MREL which would need to take into account multiple factors including (without limitation): market conditions, investor appetite, pricing, the Bank's financial performance and plans, and its then existing capital position.

This issue will be kept under close review by the Board, the Bank of England and the PRA periodically over the life of the plan period.

There is no guarantee that the Bank's regulators will not enforce stricter regulatory capital requirements on the Bank (whether specifically applicable to the Bank or to banks more generally) or that the Bank will not be required to issue additional capital to satisfy MREL.

Capital Requirements Regulations (CRR)

The Bank is currently not compliant with CRR provisions related to the use of an Internal Ratings Based (IRB) approach to modelling its credit risk capital requirements. A review by the Regulator took place during 2015 and identified areas of non-compliance and inadequate procedures relating to use of an IRB approach requiring improvement and a remediation plan to rectify this under supervisory guidance. These areas include the redesign of model risk policy and model inventory and the strengthening of the overall control environment and governance relating to IRB approach.

Subsequently, the PRA has set the Bank an additional CRR-related Pillar 2a capital requirement in the form of a fixed add-on in order to cover any potential risk in this area. This Pillar 2a capital requirement was not included within the Bank's ICG requirements at 31 December 2015 however it will be included within the Bank's requirements going forward. It is the Bank's intention, subject to model output, to have the add on removed by the end of 2017 at the latest.

A failure to address Model Risk non-compliance could potentially result in further regulatory action such that the Bank's permission to use an IRB approach could be removed, resulting in the use of a standardised approach to modelling credit risk. This could expose the Bank to a material increase in the calculation of its RWAs with a consequent requirement to hold additional capital, the creation of an additional ICG deficit and a reduction in the Bank's CET1 ratio.

1. Details of how the Bank of England's resolution powers operate under the Banking Act 2009 generally operate can be found set out in a document "The Bank of England's approach to resolution, October 2014" which can be found on its website at http://www.bankofengland.co.uk/financialstability/Documents/resolution/apr231014.pdf.

2. PRA CP 44/15 "The minimum requirements for own funds and eligible liabilities (MREL) Buffer and Threshold Conditions" was published on 11 December 2015 and sets out that PRA processes to adopt a policy that if a firm is in breach of its MREL requirement, it would not automatically mean that the PRA will consider the firm is failing, or likely to fail, to satisfy Threshold Conditions.

Liquidity Coverage Ratio (LCR)

The Bank is not currently compliant with all requirements to report its liquidity coverage ratio which came into force in October 2015. Specifically, the Bank is unable to report its LCR and Additional Liquidity Monitoring Metrics (ALMM) on a stand-alone Bank only basis due to a lack of data and systems capability at a subsidiary level to separate the Bank from a consolidated reporting level. The Bank expects to continue to report its LCR and ALMM on a consolidated level while it seeks to improve data and systems architecture to enable it to report on a stand-alone basis during 2016.

Technology

As reported previously, the Bank's IT infrastructure is in need of an upgrade in numerous respects. Previously, the Bank has reported many shortcomings in its ability to recover its systems in the event of failure in the technical infrastructure. Significant progress was made in 2015 to address these issues (95% of components have now been successfully proven), resulting in a material reduction in exposure to component-level failure of the IT infrastructure.

The migration of IT Infrastructure to an IBM platform (announced in January 2015) is expected, in time, to deliver proven disaster recovery capability for all critical business processes. In Q1 2015 the Bank received written confirmation from the FCA that the lack of proven end-to-end disaster recovery capability constituted a breach of the FCA's Threshold Conditions (Threshold Conditions [1]).

The FCA continues to closely supervise the Bank as it works towards the remediation of the historic deficiencies in its IT systems including, notably the disaster recovery capability mentioned above, and thereby restoring compliance with the appropriate resources (non financial resources) Threshold Conditions. The FCA is not currently proposing further immediate supervisory intervention or the immediate exercise of any additional regulatory powers as a result of this previous assessment. The assessment took place prior to the improvements that have been made during 2015. The FCA reserves the right to take action in the future in relation to this breach. The PRA's general policy is not to communicate its assessment of its position in relation to the PRA's Threshold Conditions. However, both the PRA and FCA are closely monitoring the position of the Bank and it remains in continual dialogue with both Regulators.

Risk Management Framework (RMF)

A supervisory review of the Bank's Risk Management Framework (RMF) was conducted during 2015 and concluded that further work is required to fully embed it across the Bank. While the Bank's systems of control have improved since 2014 and steps have been taken during 2015 to enhance the RMF, significant further strengthening is required in order to fully and effectively embed the RMF to a consistent standard across the Bank. There remain challenges to finalising the implementation of the RMF including the capability of systems to effectively report risks on an end-to-end basis and the ability to attract and retain staff with the requisite skills and knowledge into the first and second line Risk functions.

This continues to be a priority for the Bank in 2016 and the Regulators will continue to closely review the Bank's progress during 2016. A failure to implement an RMF that addresses any remaining material deficiencies could potentially result in the Regulators taking further action.

1. These threshold conditions are set out in Schedule 6 of the Financial Services and Markets Act 2000 as amended by the Financial Services and Markets Act 2000 (Threshold Conditions) Order 2013. Threshold Conditions set out the minimum standards to be met relating to financial and non-financial resources, including capital, risk management, liquidity, and technology. The Threshold Conditions differ depending on whether a firm is PRA-regulated or not.

Principal risks and uncertainties continued

The table below outlines the key financial and non-financial risks to which the Bank is exposed. The crystallisation of any of these risks could result in an adverse effect on the Bank's business, operating results, financial condition, reputation and prospects.

The Bank's Risk Management Framework (RMF) categorises these risks and comprises the Board approved segmentation of the risks that the Bank faces. During 2015, the Bank refined and enhanced its risk appetite statements under the RMF against each risk to provide further clarity. These are more fully described in the risk management section of this report. The table below highlights ten principal risks, all of which are included in the RMF and allow the Bank to identify, assess, manage, monitor and report on its risks across the business. Details of how these risks are managed can be found in the Risk Management Section. Please refer to the Performance Evaluation section of the Corporate Governance section of this report for a fuller discussion of the RMF.

Many of these risks are not unique to the Bank but are common across all banks. Detail on the risks that are more idiosyncratic to the Bank can be found below:

	Principal Risks – Definition	Why this is important and how it is managed
1.	**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 borrower's failure to perform as agreed.	**Managing this risk is a fundamental part of what a bank does.** The Bank's exposure to this risk is reducing as the higher risk lending is deleveraged, however along with all other banks the Bank remains exposed to macroeconomic, market-wide risks such as issues with the housing market and interest rate changes.
2.	**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). Should additional liquidity be required during a time of stress this is likely to result in higher than anticipated funding costs which will negatively impact on retained earnings and therefore capital resources.	**The Bank is reliant on its retail deposit base as a major source of funding** and given the relative size of the Bank's retail deposit base as compared with other sources of funding, the Bank is particularly exposed to liquidity risks as a loss of confidence by customers may result in the loss of a high proportion of the Bank's funding.
3.	**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 which is managed and hedged in line with the market risk policy to minimise earnings volatility.	**The treasury team manages interest rate risk.** More information can be found in the risk management disclosures. The Bank's deleverage strategy is particularly susceptible to market risk and has impacted the Bank's ability to continue to deleverage all of the Optimum portfolio.
4.	**Operational risk (including legal 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. Legal risk including litigation is also managed within this risk type.	**The Bank is subject to a number of specific issues in this area due to a lack of investment in systems and processes which has led to increased operational risk.** **In particular:** **The Bank's IT system has been underinvested in for a considerable period of time.** The Bank needs to urgently and significantly improve and re-engineer its existing IT platform as the existing infrastructure is unsuitable and inherently fragile. There are also concerns about its resilience as the Bank's IT disaster recovery plan is not proven for a significant and prolonged data centre outage. Whilst there has been a material improvement in the Bank's resilience to failure of individual components of its IT infrastructure, the Bank's ability to recover from a significant data centre outage remains unproven. In January 2015, the Bank entered into an Enterprise Services (ES) contract with IBM in order to address this risk, however until that work is completed the Bank is exposed to a higher risk of an IT failure causing material disruption to the Bank's products and services. There are considerable execution risks in a project of this scale and complexity, including the risk that costs and timescales may exceed those originally contemplated. The Bank's regulators are fully aware of the steps the Bank is taking to address these operational risks. **Many of the Bank's business, operational, reporting and financial processes rely on significant manual intervention** which is inefficient and increases the risk of errors in the Bank's data and financial reporting. The Bank is subject to high levels of model risk which occurs as a direct result of weaknesses in the design or use of a model.

	Principal Risks – Definition	Why this is important and how it is managed
4.		In 2015 the Bank commenced implementation of new financial systems which will be utilised to deliver the 2015 year end financial results. This, together with other process improvements has improved the control environment to some extent. This investment will continue in 2016 to mitigate inefficiencies and automate, where possible, certain of the Bank's financial processes as well as significantly improve the control environment. **The Bank's systems of control have been weak** and although the foundations of more robust controls, including enhancements to the RMF in 2015 have been laid, this is taking more time than anticipated and significant work is still required to embed across the organisation. These include the need to enhance general IT controls, including logical access and controls over the management of financial and customer data. Poor systems and manual processes, many of which have not been integrated following the Bank's merger with the Britannia in 2009 exacerbate this risk. Until the RMF is fully embedded there is increased risk that inadequate risk management could lead to exposures outside the Bank's risk appetite, unanticipated losses and regulatory censure. **The Bank is outsourcing key aspects of its operations** for example its mortgage processing, to enhance, modernise and ultimately make aspects of its operations more effective and cost efficient. Major outsourcing projects and contractual arrangements are complex to execute and manage and delay means costs could increase. The Bank is exposed to the risk that any major outsourcing arrangements are not properly scoped by the Bank in determining its business requirements; the Bank fails to deliver on its contractual commitments; the arrangements are not properly managed by the Bank or delivered upon as expected by the outsourced provider on an ongoing basis. In the case of the mortgage processing outsourcing this could expose the Bank to increased costs and/or disruption in its mortgage business which would impact on a major aspect of its core banking business. The Bank has engaged Capita to provide mortgage origination and servicing processing whilst retaining control over the policies to be applied by Capita. Until such time as business processing moves onto Capita systems (the testing, implementation and migration of which are subject to close supervision by the Bank), Capita shall continue to provide the services in the manner and to the same standard as performed by the Bank pre-outsourcing. The design and build of Capita systems is being worked on and until complete could lead to delays or increased costs. Business processing is expected to transfer onto Capita systems for new business on a phased basis with migration of existing business planned to take place in 2017. **The Bank is in the process of separating from The Co-operative Group.** Currently, and into the medium term, the Bank depends on The Co-operative Group to provide a number of services including critical functions such as IT (until the ES arrangement with IBM described above becomes operational), personnel, assets and to on-supply certain services, data and assets by third party suppliers. The Bank also has significant counterparty exposure to The Co-operative Group. The ongoing separation project is complex and may be more costly than currently contemplated. **The Bank faces legal, financial and reputational risk where legal proceedings are brought against it**, including as a result of the Bank's day to day business activity or encouraged by adverse findings of various investigations into events and activities at the Bank. Liability for damages may be incurred by the Bank where third parties are harmed by the conduct of the Bank's business.

Principal risks and uncertainties continued

	Principal Risks – Definition	Why this is important and how it is managed
4.		**Fraud Risk.** The Bank will continue to manage fraud risk within risk tolerances, manage losses arising and comply with all relevant legal and regulatory requirements.
5.	**Reputational risk** The risk associated with an issue which could in some way be damaging to the reputation of the Bank. Underlying issues arising as a result of: (i) the Bank's strategic decisions or business performance; (ii) an operational failure; or (iii) external perception. This may result in a requirement to hold additional liquidity in anticipation of a stress scenario, which is likely to negatively impact retained earnings over time and therefore capital resources.	**The Bank considers that its reputation as an ethically led organisation is critical to the success of the plan.** There is a risk that this reputation may be undermined. As the various investigations into past events at the Bank reach a conclusion, there is a risk that findings may adversely affect the Bank's reputation. In addition, the Bank's change in ownership structure at the end of 2013 and the necessity to make significant cost savings which will include inter alia ongoing branch closures and staff reductions increase this risk. The Bank will continue to rely on the Co-operative brand and therefore carries the risk that its brand will be damaged as a result of matters affecting The Co-operative Group. The Co-operative Bank trade mark belongs to the Bank. Please see the Branding Arrangements section of the Corporate Governance Report on page 58 for a fuller explanation of the principles governing the Bank's right to use the trade mark and the circumstances in which the Group may be able to conduct banking business. In certain circumstances the Bank's right to use the term 'Co-operative' could be challenged or removed. The Secretary of State for Business, Innovation and Skills may direct the Bank to change its registered name if, in his or her opinion, it gives so misleading an indication of the nature of its activities as to be likely to cause harm to the public. Further, the FCA has the power to prevent the use of the term 'Co-operative', 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. A loss of support from key stakeholders for the Bank's continued use of the term Co-operative may result in a risk these authorities could look to exercise their powers. Co-existence Agreement – Bank and Group have been negotiating a co-existence agreement to allocate trademarks into appropriate ownership. As the agreement is not yet finalised, there is still scope for disagreements on the use of certain shared brands. In addition, if terms cannot be agreed, the Bank may be required to make rapid changes to its IT systems, marketing materials and signage.
6.	**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 Updated Plan and desired strategy. This may result in the Bank having to hold additional capital and/or liquidity. This risk is covered by many areas of capital in Pillar 2, specifically execution, concentration and liquidity risk.	**The Bank's Updated Plan to focus on becoming a smaller Core Bank is challenging, unproven and is in the earlier stages of implementation. The Bank does not have a track record in successful execution of the large scale change simultaneously necessary. Accordingly, there is an ongoing risk that the Bank is unable to implement the turnaround. Furthermore, there is a risk that the Bank's strategy to deliver the Updated Plan may be insufficient to address all of the Bank's problems or deliver the projected benefits.** The Plan involves concurrent transformational change, with a large component relating to IT, which may result in additional investment cost and delays to the Plan. Any delay would require ongoing regulatory acceptance of these issues for a longer period of time which might not be forthcoming and could be withdrawn if the Plan is not executed in line with regulatory expectations. The Bank's Updated Plan will require the Bank to continue to deleverage Corporate CoAM assets and reduce execution risk across key transformation projects, which it may not be able to achieve.

	Principal Risks – Definition	Why this is important and how it is managed
6.		If in due course the Bank becomes subject to a binding requirement to issue MREL and it is unable to do so when required, the Bank's regulators can agree to accept the Bank's original issuance plan, a revised issuance plan, require some other action on the part of the Bank or in the absence of any of these the Bank of England may exercise its powers under the Banking Act 2009. In considering viability the Board has taken note of the contents of PRA consultation paper (CP 44/15) and the Board believes that resolution is less likely than the other outcomes while the Bank is executing its plan as accepted by the PRA and continuing to de-risk the Bank. Despite ongoing evidence of Stability in the Core Bank franchise there is a risk that this position weakens due to currently unforeseen events. The longer term consequences of the macro economy from a vote to leave the EU could have a currently unquantified impact on the Bank.
7.	**People risk** People risk is the risk associated with the recruitment, employment and management of individuals within the Bank. A significant portion of the Bank's cost base is staff costs and so managing this resource within budget is key to cost reduction and therefore to retained earnings. This risk is captured within the operational risk framework.	**The Bank continues to be subject to increased people risk.** The ability to attract and retain staff remains an issue in some specialised areas. Despite improvement, employee turnover levels still remain high, reflecting the buoyancy of the external market. This increases execution risk in the Plan and reduces historical corporate knowledge. A number of key initiatives have been undertaken during 2015 to tackle People Risk issues. The Bank's Culture Programme seeks to improve colleague engagement, reinforcing the Co-operative Bank Values and Culture, and embedding these into people policies and processes. Employee engagement levels have improved significantly throughout 2015. A number of the Bank's executive team were recruited in 2013 to deal with the capital deficit which came to light in 2013. As the turnaround progresses, succession plans are in place to replace members of the existing team with executives to lead the Bank as it moves towards business as usual operations. The Bank is exposed to the risk that current executives may not be able to be replaced in a timely fashion with appropriate and sufficiently skilled replacements, exposing the Bank to operational disruption and potential delay in essential activities necessary for the Updated 2016-20 Plan to be successfully delivered. The Bank is similarly exposed to the risk that Non-Executive Directors may not be able to be hired for its Board as Directors serve their expected terms and stand down, particularly in the wake of increasing regulatory expectations of the Senior Manager Regime. Given the requirements of the Capital Requirements Directive IV, which affect variable remuneration and came into force on 1 January 2016 and reflecting the Bank's non-compliance with its ICG and PRA buffer requirements until the latter part of the Updated Plan, the Bank is considering changes to its pay structures. There is a risk that any amended compensation approach could drive higher fixed costs or impact attraction and retention of staff.

	Principal Risks – Definition	Why this is important and how it is managed
8.	**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.	**Along with the wider banking industry, the Bank must comply with multiple regulatory changes** which may add complexity to an already difficult technology, operational and prudential change programme. There is also a risk that, both foreseen and unforeseen, changes to regulatory requirements affect the Bank's ability to successfully implement its Updated Plan or that the acceptance by regulatory authorities of the Bank's plan to address the various ways in which the Bank is currently non-compliant and which is essential for the Bank to continue to operate, is withdrawn. **The regulatory position of the Bank is described at the start of this section.** As at December 2015, the Bank met its ICG, however this is a temporary position and the Bank will not sustainably meet its ICG until 2019. The PRA has accepted the Bank's plan to remediate this position. The Bank is under intense regulatory scrutiny and expects such scrutiny to continue. The Bank is currently non-compliant with respect to certain regulatory and prudential capital requirements as described above. In summary, these areas comprise the following: being ICG non-compliant until 2019, PRA buffer non-compliance, CRR non-compliance in relation to current IRB permissions, LCR reporting requirements, FCA Threshold Conditions breach with respect to IT (non-financial resources) and insufficient embedding of the risk management framework across the Bank. On 11 August 2015 the PRA and FCA published the outcome of their enforcement investigations into certain events which occurred and processes in place in the Bank within the period from July 2009 and the end of 2013. During this period, the PRA found that the Co-operative Bank was in breach of Principle 3 (Management and Control) with respect to the Bank's control and RMF. The FCA found the Bank to have breached UK Listing Rule 1.3.3 in relation to two statements in the Bank's 2012 Annual Report and Accounts. In addition the FCA and PRA both found that, from 25 April 2012 to 9 May 2013 that the Bank breached Principle 11 by failing to notify the FCA and PRA of intended changes to two senior positions (and the reason for those changes). No fine was imposed by the PRA or FCA. However, the terms of the public censures by the PRA and FCA made clear the seriousness with which the failings were regarded and expressly stated that if any future enforcement investigation into the Bank found serious and wide ranging failures then the censures would be a relevant factor in determining the outcome. There remain a number of further investigations covering some or all of the same time period and events affecting the Bank which are either underway or still to commence (being: investigations into certain former senior individuals at the Bank; the Financial Reporting Council investigation in to the preparation, approval, and audit of the Bank's financial statements up to and including the year ended 31 December 2012 which focuses on the role of the auditors and individual accountants; and the independent investigation ordered by HMT). Therefore although no fine has been imposed by the PRA or FCA as a result of their investigations, the Bank remains exposed to increased regulatory scrutiny, significant resource drain, damages, fines and costs, adverse publicity, reputational damage and litigation claims either as result of the findings of the PRA and FCA investigations or the eventual outcome of any other investigations.

	Principal Risks – Definition	Why this is important and how it is managed
8.		**Model risk** – The Bank is currently not compliant with CRR provisions related to the use of an Internal Ratings Based (IRB) approach to modelling its credit risk capital requirements. A review by the Regulator took place during 2015 and identified areas of non-compliance and inadequate procedures relating to use of an IRB approach requiring improvement and a remediation plan to rectify this, under supervisory guidance. These areas include the redesign of model risk policy and model inventory and the strengthening of the overall control and governance environment. A failure to address model risk non-compliance would potentially result in regulatory action such that the Bank's permission to use an IRB approach could be removed, resulting in among other things the use of a standardised approach to modelling credit risk. This could expose the Bank to a material increase in the calculation of its RWAs with a consequent requirement to hold additional capital, the creation of an additional ICG deficit and a reduction in the Bank's CET1 ratio. **Money-Laundering risk** – the Bank remains fully committed to supporting international and domestic efforts to combat money laundering and the funding of terrorist and criminal activity, preventing the illicit use of the Bank's products and services and to meeting the Bank's legal and regulatory obligations in full. While a remediation programme is under way, more work is required to be done in this regard. **Competition** – the personal financial services industry is mature so growth often requires taking market share from competitors. The Bank faces risk of losing market share to other banks, building societies and insurance company competitors. In addition, the Competition and Markets Authority (the CMA) announced in November 2014 its decision to launch an in-depth market investigation review into the personal current account and SME retail banking sectors and this investigation is ongoing. Together with other significant retail and SME banks in the UK, the Bank is participating in the investigation which is being conducted by a Market Reference Group drawn from the CMA's panel of independent members. The CMA is scheduled to publish its final report and recommendations in July or August of 2016 and until such time the impact to the Bank and the wider industry as a whole is unknown and yet to be determined. The financial services industry continues to be the focus of significant legislative and regulatory change which has and could continue to impose operational restrictions on the Bank, increase the Bank's costs and/or capital requirements and/or otherwise materially adversely affect its business, operating results, financial condition and prospects.

	Principal Risks – Definition	Why this is important and how it is managed
9.	**Conduct risk** The risk that the Bank's behaviour, offerings or interactions will result in unfair outcomes for customers.	**The Bank is exposed to the inherent risks relating to the mis-selling of financial products**, acting in breach of regulatory principles or requirements and giving negligent advice or other conduct determined by the Bank or the regulators to be inappropriate, unfair or non-compliant with applicable law or regulations. Any failure to manage these risks adequately could lead to further significant provisions, costs and liabilities and/or reputational damage. The Bank's approach to provisions for historic mis-selling issues such as PPI, interest rate swaps and packaged accounts is based on the views and requirements of the Regulators. Any change in the Regulator's current approach, such as an extension of the period covered by the requirement for proactive contact with customers, or a revision of approach following the Supreme Court decision in Plevin, could have a material impact. The 2014 decision of the UK Supreme Court in Plevin held that, judged on its own facts, non-disclosure of the amount of commission payable in connection with the sale of single premium PPI to a customer could create an unfair relationship under provisions of the UK Consumer Credit Act. The Plevin decision has a potential impact on a number of the Bank's customers who may have a claim for PPI mis-selling and treatment of prior claims. Having reassessed its exposure on available information the Bank has recognised an incremental provision of £1.3m for Plevin. During 2015, the FCA proposed a time bar on PPI claims (which of itself could be subject to judicial challenge) and a dedicated marketing campaign to consumers as to their right to reclaim PPI. These new set of variables create challenges to accurately model future redress with certainty. As at December 2015, a provision of £87.0m (2014: £73.6m) has been recorded in respect of potential customer redress and costs relating to past sales of PPI. This includes a £71.8m charge in 2015 following a slower than expected rate of decline on inbound complaint volumes. Forecast future complaint volumes are difficult to predict and may increase, remain constant or decline more steadily due to the proposed time bar and FCA communications campaign. Accordingly, the time bar and advertising campaign may increase the overall level of claims that may be experienced by the Bank in 2016 and beyond. Additionally there may be further consumer, industry and/or legal challenges to the proposed FCA approach to Plevin or PPI more generally resulting in further uncertainty as to whether additional provisioning is required and whether this would be material for the Bank. The Bank is continuing its programme of a structured risk based assessment of products and provisions, of which the primary focus is the discovery and remediation of existing and new conduct and legal issues. While much work has been undertaken and progress has been made in identifying conduct issues, no assurance can be given that further issues will not be identified, or that the already identified issues may not require further provision, or that changes in regulation may give rise to further conduct risks emerging. As well as PPI, the Bank continues to monitor developments in certain product related areas, which are attracting increased focus, in some cases from both the Courts and the Financial Ombudsman Service, including loan early repayment charges, variation of certain product terms and conditions and the outcome of the judicial review of an IRHP (Interest Rate Hedging Product) loan granted by another lender and the related FCA remediation rules. Changes in the approach to any of these issues in the market could adversely affect the Bank.

	Principal Risks – Definition	Why this is important and how it is managed
9.		Where appropriate, projects to remediate these issues are underway, these however are costly, complicated and require significant data extracts and IT support to implement. Delays or failure to successfully implement redress to customers increases the costs to the Bank and may lead to regulatory sanction. The Bank has initiated a redress programme in respect of various breaches of mortgage conduct of business rules. It is also the subject of a skilled persons review into potential detriment to its mortgage customers arising from poor arrears handling. The Bank is addressing the recommendations from this review and has implemented enhanced policies and processes which are delivering improved customer outcomes. The outcome of the final review is uncertain but could potentially lead to enforcement investigations by the FCA. The Bank continues to be exposed to the risks of non-compliance with the Consumer Credit Act (CCA). While the Bank has identified certain instances where its documentation or processes have not been fully compliant with the technical requirements, there may be other instances of non-compliance which have not yet been identified. Until remediation of the issues already identified is complete, the Bank remains in breach of the technical requirements of the Act and will be unable to enforce interest charges on the affected accounts. The consequences of non-compliance with the CCA can include interest and default charges paid by a customer in prior periods being required to be refunded and the customer agreement not being enforceable by the Bank without a court order until the breach is remedied.
10.	**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 Pace scheme is not currently sectionalised and operates on a 'last man standing' basis.** The Bank's obligation to Pace would increase significantly if another large employer in the scheme were to become insolvent. There is uncertainty over how much the Bank will need to pay in the event of sectionalisation of the scheme. The defined benefit section of Pace was closed to future accrual in October 2015 and the Bank is now in consultation with The Co-operative Group and the Pace Scheme Trustees with the aim of separating its liabilities in the scheme from those of other participating employers. As a consequence of the ongoing consultations, there remains uncertainty as to the quantum of any pension liabilities which may be recorded on the Bank's balance sheet in the future in relation to Pace. **The Bank is now the Principal Employer and Sponsor of the Britannia pension scheme, which is a closed defined benefit scheme.** The Scheme's triennial actuarial valuation as at 5 April 2014 is still being finalised but is expected to report a deficit the quantum of which is not yet determined. There remains uncertainty as to the structure of the Bank's recovery and the period over which the Scheme's deficit will be funded, although the Bank is in consultation with respect to this. The Bank has been released from prior guarantees given in favour of the Scheme but is now Principal Employer and so is primarily liable.

Viability statement

In accordance with provision C2.2 of the 2014 UK Corporate Governance Code, the Board is required to assess the prospects of the Company over a period longer than the 12 months required by the Going Concern provision, separately set forth on page 50 of this Report.

When considering the viability of the Bank, the Directors have referenced appendix B of the Financial Reporting Council's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting published in September 2014 (the FRC Guidance), which explicitly covers the longer term viability statement.

For a complete understanding of this viability statement, please refer to the Principal risks and uncertainties section beginning on page 68 of this report for a detailed description of the Bank's Principal risks and uncertainties (the PRU), the Risk Management section on page 98 for a detailed analysis of how these risks are managed within the Bank's Risk Management Framework, and the Going Concern statement on page 64. All of the risks described therein are considered as qualifications to the Bank's prospects over the period of assessment described below.

Assessment of Bank prospects

The Bank's Updated Plan forecasts the Bank's performance over the next five years, covering 2016 to 2020. However given the material uncertainties referred to in the PRU section, and the inherent uncertainties involved in any longer term plan based on future macro-economic and regulatory trends, amongst other factors, the Directors concluded that the viability of the Bank would be more appropriately viewed over a period of three years.

A robust assessment has taken place considering risks that would threaten the Bank's capital position, regulatory compliance, business model, future performance, solvency or the liquidity position of the Bank, including its resilience to the threats to its viability posed by those risks in severe but plausible scenarios.

The primary focus of this assessment is the Bank's Updated Plan (2016-2020). The Bank's management considered a number of scenarios before proposing the Updated Plan which has been approved by the Bank's Board and accepted by the PRA.

The Updated Plan involved a granular build of individual business units' strategies, and the associated key assumptions, which were discussed and challenged by the Bank's Risk Framework Owners and assessed by the Bank's internal risk function. There was also an assessment of the anticipated financial impacts of the Bank's legacy issues of conduct requiring remediation and other Bank under investment, leading to the programme of investment especially in respect of IT infrastructure and conduct remediation.

The key assumptions included within the Updated Plan, and on which the Directors have made their assessment, include:

- That the anticipated future interest rate profile remains at historic lows in the short to medium term and will remain below the historic position observed within the UK pre-2008 across the initial years of the Updated Plan. However, when rates are assumed to rise in the Updated Plan, the Bank forecasts an increase in the Bank's net interest margin;
- The external market remains open for further Corporate CoAM deleverage;
- That the planned MREL issuances can be achieved at terms similar to those achieved historically. There remains a risk that the markets may be closed to the Bank or that the costs of issuance are at an unaffordable level;
- The Bank is able to deliver the significant transformation and change programme already underway without material deviation from planned timescales and costs;
- The Bank's franchise remains intact;
- The Bank's various regulators continue to accept the Bank's plan to address non-compliance which currently includes the regulatory requirements which are set out in the PRU section and include non-compliance with ICG, PRA buffer, non-financial threshold conditions and CRR;
- If in due course the Bank becomes subject to a binding requirement to issue MREL and it is unable to do so when required, the Bank's regulators can agree to accept the Bank's original issuance plan, a revised issuance plan, require some other action on the part of the Bank or in the absence of any of these the Bank of England may exercise its powers under the Banking Act 2009. In considering viability the Board has taken note of the contents of PRA consultation paper (CP 44/15[1]) and the Board believes that resolution is less likely than the other outcomes while the Bank is executing its plan as accepted by the PRA and continuing to de-risk the Bank.
- The Bank does not become exposed to significant new conduct or legal risk either due to the Bank discovering new significant conduct issues arising from legacy Bank practices or from changes in regulatory approach to previous general market practice; and
- There is no further significant regulatory change imposed on the Bank including changes that impact capital requirements

In reviewing the Bank's Updated Plan, the Board reviewed compliance with key capital and liquidity risk appetites and compared these against the Revised Plan, adopted in December 2014 and accepted by the PRA. In doing so, the Board also assessed Key Performance Indicators and the impact of the PRU to the overall performance of the Bank and its ability to continue to operate and meet its liabilities during the plan period.

Many of the Bank's risks are assessed through sensitivity analysis. This includes, amongst others, modelling the impact of changes to regulatory capital risk weightings, raising additional liquidity, variations in the Bank of England base rate, reductions in new business volumes and associated margins and the ability to raise any required form of capital. The Bank also seeks to assess the impact of one-off cost increases which may arise from overspend in the Bank's investment portfolio and operating cost base, in addition to any potential further charges in respect of conduct and legal risks.

1. PRA CP 44/15 "The minimum requirements for own funds and eligible liabilities (MREL) Buffer and Threshold Conditions" was published on 11 December 2015 and sets out that PRA proposes to adopt a policy that if a firm is in breach of its MREL requirement, it would not automatically mean that the PRA will consider the firm is failing, or likely to fail, to satisfy Threshold Conditions.

The Bank has prepared forecasts based on a number of economic scenarios including the PRA (H1 2015) stress scenario. This economic environment mirrors the 2008/2009 financial crisis and reflects a potential set of systemic risks faced by UK banks. The stress results in a reduction in the Bank's new business volumes following market contraction, lessens the Bank's ability to deleverage Corporate CoAM assets and raise wholesale funding and increases impairment across the Bank's asset portfolios.

The Bank's Updated Plan will form the basis of the Bank's ICAAP and ILAAP that will be formally submitted to the regulator for review and challenge.

Financial performance is tracked as part of the Bank's monthly Board performance reporting. These reports will include a view of the forecasted full year financial position compared against its Updated Plan. On a quarterly basis this forecast is extended to cover the planning horizon and highlight areas of significant deviation. This quarterly process considers the emerging risks and opportunities and includes appropriate sensitivity analysis.

The Updated Plan seeks to build a capital buffer sufficient to cope with a scenario akin to the PRA stress scenario and meet the PRA requirements for a PRA buffer by the end of the planning horizon i.e. 2020.

Board view of prospects

Given the material uncertainties referred to in the PRU and the inherent uncertainties involved in any longer term plan as a result of future macro-economic upheaval, such as a Brexit scenario, and regulatory trends, amongst other factors, the Directors feel that the maximum appropriate period for forecasting viability of the Bank is three years.

It is noted that the Bank has made significant progress against the Revised Plan accepted by the PRA in December 2014. The Board believes that within the next three years, the Bank will have substantially progressed its transformation programme, the Core Bank franchise rebuild and elements of further Non-core deleverage within Corporate CoAM. The Bank has already invested in the Core Bank franchise which has stabilised personal account volumes in 2015 and increased the level of mortgage origination when compared to 2014. In addition, the operating costs for the Core Bank have decreased as a result of the targeted cost reduction initiatives. The Bank has also demonstrated its ability to deliver the required level of Non-core deleverage via the delivery of two whole structure securitisations of the Optimum portfolio in 2015 together with the continued progress in its Corporate CoAM deleverage. Please refer to the detailed financial review within the Strategic Report for more detail regarding the progress made regarding the Core Bank and the progress made on Non-core deleverage.

Key to the Bank's viability is that the Bank's various regulators continue to accept the Bank's plan to address non-compliance which currently includes the regulatory requirements which are set out in the PRU section and include non-compliance with ICG, PRA buffer, non-financial threshold conditions and CRR. The Bank understands its regulators are particularly focussed on the delivery of the remediation actions in its updated plan which relate to the embedding of its Risk Management Framework, the required actions to improve internal modelling capabilities, remediation of its IT systems and disaster recovery capability and potential MREL issuances.

In addition the Bank's viability is dependent on the absence of major macro-economic or political upheaval and the absence of significant regulatory change not already foreseen.

Conclusion

The Bank's Updated Plan provides the basis on which the Directors have concluded that they have a reasonable expectation the Bank can continue to operate and meet its liabilities, as they fall due, for the next three years based on the assumptions the Directors have made set out above. However given the material uncertainties referred to in the Going Concern statement, the PRU and the above risks, uncertainties, qualifications and assumptions, the Bank is dependent on the continued acceptance of the Banks Updated Plan by its regulators. This continued acceptance includes the fact the Bank does not expect to sustainably meet its ICG and PRA buffer until beyond the viability assessment period, with sustainable compliance achieved in 2019 and 2020 respectively.

Social, community and human rights

Our Values, Ethics and community impact

In 1992, we became the first Bank to have a customer-led Ethical Policy which defined the businesses and organisations we would provide banking services to, based on our customers' ethical concerns.

The Policy has been shaped around our customers ever since and, in June 2014, over 74,000 customers, colleagues and other stakeholders shared their views on the Ethical Policy and our wider values in our Values and Ethics Poll.

As a result, in January 2015, in line with our customers' ethical concerns, as well as re-committing to the existing statements, we strengthened and expanded the Policy to cover five pillars of activity. Our Ethical Policy now provides a framework governing how the Bank operates including: our products and services, relationship with suppliers and external stakeholders, as well as our workplace culture. Customers also wanted the Bank to return to its campaigning heritage so the Policy now includes a commitment to campaign for social and economic change.

Our campaigning heritage was again demonstrated in December 2015 with a joint campaign launch alongside the charity Refuge on financial abuse in intimate relationships.

Values and ethics are central to the success of the Bank in the future and remain at the heart of our business, including being embedded in the Articles of Association of the Bank. The Articles of Association include a clause that requires us to act in line with the values associated with the co-operative movement. Values and ethics will continue to be firmly embedded in our approach as they have been since the Bank's inception over 140 years ago.

Review of the year

Our employee volunteering programme is a key pillar of our approach to community investment. Colleagues can take part in team challenges or can volunteer through a variety of individual opportunities. In 2015, the Bank provided a total of 554 opportunities for colleagues to volunteer 4,352 hours to their local communities through volunteering and fundraising activities. As part of this total, 50 team challenges were carried out over the year.

Individual volunteering opportunities included Fit 4 Finance where, in 2015, volunteers helped secondary school pupils understand the world of money management. Bank colleagues also carried out Number Partners volunteering, which involved working with primary school children to improve their numeracy skills. In total, the Bank's volunteer programme has benefited 5,578 young people.

Charity partnerships

Through our affinity card programme we raised close to £1m for our partner charities in 2015. By choosing and using these credit cards, our customers are able to support a range of charities including Oxfam, Save the Children and Amnesty International.

Supporting co-operatives

In January 2015, the Bank committed to supporting the growth of the co-operatives sector in the UK. In October 2015, we agreed to contribute £1m to a three-year partnership with Co-operatives UK to support the development and growth of the UK's co-operative and social enterprise sector. The partnership, launched formally in 2016, will seek to support the 6,796 co-operatives already operating in the UK and help others to start up. The partnership will deliver a variety of initiatives through a website giving business advice and guidance as well as peer mentoring and group training sessions on key issues such as registration, membership development and co-operative finance.

Environmental protection and greenhouse gas (GHG) reporting

Protecting the environment is one of the underpinning goals of our Ethical Policy. In pursuit of this goal, we do not lend to businesses or projects that conflict with our commitments on environmental sustainability. In November 2015 we were able to sign the Paris Pledge on not financing fossil fuels prior to the United Nations summit on Climate Change in Paris.

We also seek to minimise our own environmental impacts. We continued to source the vast majority of our electricity from renewables in 2015. We also maintained our 'beyond carbon neutral' policy for the eighth consecutive year, by offsetting our operational greenhouse gas (GHG) emissions[1] plus an extra 10% to address legacy issues. We do this by supporting carbon reduction projects, sourced through climate and development experts ClimateCare.

These projects provide additional benefits for people and the environment. For example, we supported a water filter project in Kenya that not only reduces wood burning, but also improves the health of the communities that use the filters. The Carbon For Water programme is one of the world's largest clean water interventions, in total providing over 3.5 million Kenyans with access to clean water.

We have been reporting our GHG emissions for over 16 years. We measure our direct GHG emissions in carbon dioxide equivalent (tCO_2e) using the latest UK Government guidance[2]. Our direct GHG footprint encompasses energy consumption, refrigerant leakages from major occupancies and all business travel (air, rail and road). All greenhouse gas data and related commentary is externally assured[3].

Total GHG emissions by source

Source of emissions	Total emissions (tCO_2e) 2015	2014
Fuel combustion	**2,449**	2,774
Electricity consumption[4,5]	**20,068**	24,335
Refrigerant leakages[6]	**131**	373
Business travel	**995**	1,121
Total	**23,643**	28,603
Carbon intensity (tCO_2e/FTE[7])	**4.19**	4.87

1 Remaining emissions from gas, brown electricity, business travel, and major occupancy refrigerants once green electricity supply is discounted.
2 Department for Environment, Food and Rural Affairs (DEFRA), Environmental Reporting Guidelines: including mandatory greenhouse gas emissions reporting guidance, June 2013. www.gov.uk/government/uploads/system/uploads/attachment_data/file/206392/pb13944-env-reporting-guidance.pdf. Since 2013 all UK quoted companies have been required to report on their GHG emissions as part of their Annual Report and Accounts. (The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013).
3 DNV GL has provided limited assurance of the GHG data and commentary as part of the Bank's Values and Ethics 2015 Report assurance. In that report the assurance statement sets out the scope of work and standards used to form their opinion.
4 If electricity from renewable sources is accounted as zero carbon then emissions from electricity would be 201 tCO_2e.
5. GHG emissions per unit of electricity are calculated by DEFRA and updated annually. Due to changes in the UK energy mix DEFRA decreased this metric from 0.49426 kg CO_2e/kWh for electricity purchased in 2014 to 0.46219 kg CO_2e/kWh for electricity purchased in 2015.
6 Refrigerant gas data includes major occupancy properties only.
7 Average number of full time equivalent (FTE) employees for the year.

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Corporate Governance

Biographies of the Board






1. Dennis Holt

Chairman

Dennis joined the Board in February 2014 as Senior Independent Director. He was appointed as Chairman on 27 October 2014. Dennis' experience in banking and insurance spans 45 years and includes a period as Main Board Executive Director at Lloyds TSB responsible for the Retail Bank. He has held several Non-Executive posts including Deputy Chairman of Bank of Ireland plc, Chairman of Bank of Ireland UK and Chairman of Liverpool Victoria. He is currently Non-Executive Chairman of Beazley plc, its subsidiary Beazley Furlonge Limited and Swift No.3 Ltd.

Committee membership: Nomination (Chairman), Remuneration, Values and Ethics.

2. Aidan Birkett

Senior Independent Director

Aidan joined the Board in July 2015. He built his career within the professional services sector over more than 30 years with PwC and Deloitte. He was head of Deloitte's Corporate Finance business and a member of the firm's executive committee. He has led a number of high profile strategic and commercial reviews of businesses in varying turnaround situations, in the UK and overseas. This has provided him with significant experience in the wholesale finance sector and an understanding of the retail customer segment across a number of non-financial sectors. Aidan has served as a consultant, director and advisor in various capacities and has held various Non-Executive Director roles. He is currently a Non-Executive Director with the Dubai Group.

Committee membership: Audit, Nomination.

3. John Richard Coates

Non-Executive Director

Richard joined the Board in January 2013. Richard was appointed as Interim Senior Independent Director in October 2014 and stepped down from the role in September 2015. He has over 25 years of 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 and serves as their Audit Committee Chairman.

Committee membership: Audit (Chairman), Risk.

4. Derek Weir

Non-Executive Director

Derek joined the Board in July 2014 and was appointed Chair of the Risk Committee on 26 January 2016. He has over 25 years of financial services experience, holding a range of senior positions in corporate and commercial banking. During this time he held posts, both in the UK and internationally, at Barclays Bank plc and Royal Bank of Scotland plc, including being the Managing Director responsible for Commercial Banking in the UK for Royal Bank of Scotland plc. Derek is currently a Non-Executive Director of Motherwell Football and Athletic Club Limited, Motherwell Football Club Community Trust and a Director of Kerrach Limited. Derek is also Non-Executive Director of Macklin Enterprise Partnerships Consultancy Limited and Macklin Enterprise Partnerships Limited.

Committee membership: Audit, Risk (Chairman).

5. Laura Carstensen

Non-Executive Director

Laura was appointed to the Board in May 2014. Laura is a former partner at the City law firm, Slaughter and May. Laura is a former Member and Deputy Chair of The Competition Commission (now The Competition and Markets Authority). She is currently a Non-Executive Director and Chair of the Audit Committee of Park Group PLC and is a Commissioner for the Equality & Human Rights Commission.

Committee membership: Values and Ethics (Chair), Remuneration.

6. Maureen Laurie

Non-Executive Director

Maureen joined the Board in June 2014. She brings over 30 years of experience in senior human resources (HR) roles spanning global HR strategy, policy and transformation in the financial and public sectors, including the British Council, NYSE EURONEXT, LIFFE, Barclays, Standard Chartered Bank, EBRD and Reuters. Maureen holds professional qualifications from the Chartered Institute of Personnel and Development and was appointed a Fellow of the CIPD in 1992. She is also a Pensions Management Institute qualified Trustee. From 2010 until 2015 Maureen was a Non-Executive Director, Independent Governor and Trustee of London Metropolitan University and is currently a Non-Executive Director and Trustee of Reuters Pension Fund.

Committee membership: Remuneration (Chair), Nomination, Values and Ethics.

7. Richard Graeme Barclay Hardie

Non-Executive Director

Graeme joined the Board in May 2013. He was Chair of the Risk Committee until 26 January 2016 when he stood down from that role. He was previously Managing director of NatWest retail bank and Executive Director, retail banking at Abbey National Bank plc. He was a senior advisor, retail markets at the Financial Services Authority (as it was known) and a Non-Executive Director at Metro Bank (UK) Limited and FNZ (UK) Ltd. He is currently a Director of Northpoint Consultancy Services Limited.

Committee membership: Risk, Audit, Remuneration.

8. William Thomas

Non-Executive Director

Bill joined the Board in October 2013. He is a former Senior Vice President of Hewlett Packard and was on the Executive Committee of EDS plc 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 a member of the Council, and President of the Alumni Association at Cranfield University School of Management and is on the management and Board of Leeds University Business School. Bill serves as the Chair of the Royal Navy and Royal Marines Charity. Additionally, he is a Non-Executive Director of Xchanging plc and GFI SA, and a partner in Hopton Estates.

Committee membership: Risk, Nomination, Values and Ethics.

9. Charles Bralver

Non-Executive Director

Charles joined the Board in April 2015. Charles was a founding partner of Oliver Wyman & Company where, from 1984 through to 2007, he held several positions, including Vice Chairman, Head of Europe, Head of North America, and Head of the Global Capital Markets Practice. He has over 30 years' financial services experience, including two years as a Strategic Advisor on Financial Services at Warburg Pincus LLC. He is the former Senior Associate Dean for International Business and Finance at the Fletcher School of Law and Diplomacy at Tufts University in Boston, USA. He is currently a member of Oliver Wyman's Senior Advisory Board and a Non-Executive Director of Canaccord Genuity Group and NewStar Financial and a member of the Investment Committee at Ultra Capital Partners. He also acts as a Senior Advisor on Financial Services to Silverpoint Capital, and is a member of Chatham House, London.

Committee membership: Risk.

10. 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. Niall has been a member of the committee of the Council of Glenalmond College since 2012 and its Chairman since 2013.

11. John Baines

Finance Director

John joined the Board in October 2014. John joined The Co-operative Bank in April 2013 as Chief Financial Officer and has over 25 years of experience in financial services. Prior to joining The Co-operative Bank, 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 is a qualified Chartered Accountant and has held a number of senior roles in investment banks.

Committee membership: Values and Ethics.

Directors' report

The Directors present their report and audited accounts for the year ended 31 December 2015.

General information

The Co-operative Bank plc (Registered number 990937) and its subsidiaries provide a range of banking and financial services in the United Kingdom. See page 11 for a full description of our business model and focus.

Dividends

The Directors are focussed on the Updated Plan for the Bank and as such the Directors do not expect 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. Therefore the Bank is not able to recommend payment of a dividend given the continuing losses (2014: £nil).

Business review, future developments, post balance sheet events and financial risk management objectives and policies

The business review and future developments, key performance indicators, Principal risks and uncertainties and post balance sheet events are referred to in the Strategic report starting on page 7. Financial risk management objectives and policies can be found as detailed below:

	Pages
Business review and future developments	**16**
Key performance indicators	**29**
Principal risks and uncertainties	**32**
Financial risk management objectives and policies	**98**
Post balance sheet events	**243**

Going Concern

There continues to be material uncertainty around the execution of the Bank's turnaround, and its ability to continue as a Going Concern. These are included in the Principal risk and uncertainty Section and Going Concern disclosure in Note 1.

The Bank and Company's business activities, together with its financial position, and the factors likely to affect its future development and performance, are set out in the Strategic report on pages 7 to 45. In addition, the Risk Management section includes the Bank's objectives, policies and processes for managing its risk and details of its exposure to risk. The capital management section provides information on the Bank's capital policies and capital resources including the capital raising activity which resulted in £250m of new Tier 2 capital being raised in 2015 and the significant Non-core deleveraging activity in 2015.

Consequently, after due analysis, the Directors have concluded that the risks highlighted with the Principal risks and uncertainties coupled with those set out in detail in the Basis of Preparation section of the Annual Report and Accounts, represent material uncertainty which may cast doubt upon the Bank's ability to continue as a Going Concern. 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.

Nevertheless, after making enquiries of management and considering the Bank's Updated Plan, in particular those for the 12 month period following the date of approval of the Bank's financial statements, 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 these financial statements. Therefore this set of financial statements does not include the adjustments that would result if the Bank was unable to continue as a going concern.

The Directors have considered the ongoing viability of the Bank; this can be found in the Principal risks and uncertainties section.

Political donations

It is the Bank's policy that no donations are made for political purposes.

Directors' details

Details of Directors, including appointments and resignations during the financial year, and changes since the end of the financial year are provided on page 54 of the Governance section of the report.

Details of the Directors offering themselves for election and re-election at the next Annual General Meeting are provided on page 57.

Directors' third party and pension scheme indemnity provisions

Details of insurance and indemnities in place for the benefit of the Directors are provided within the Corporate Governance report on page 77.

Significant contracts

Details of related party transactions are set out in note 36 on pages 222 to 225.

Corporate responsibility

The Bank's corporate responsibility activities are outlined on page 45.

CO_2 emissions

The Bank's greenhouse gas emissions report is detailed on page 45.

Employees

Prior to the LME certain functions were centralised and carried out by the Co-operative Group. Since the LME the Bank and Co-operative Group have separated successfully the majority of the business functions and are continuing to work towards final separation of the shared Information Technology infrastructure. These activities are further explained in the notes to the financial statements.

The Bank has committed significant investment to implement a cultural transformation programme, led by the CEO and executive team, which will embed new workplace values throughout the organisation. The roll out of this began in the second half of 2014 and continued during 2015.

The Bank remains focused on supporting performance improvement through the provision of high quality mandatory risk, conduct and performance management e-training to all colleagues. A revised Performance Management policy was implemented in 2015. As part of supporting and improving line manager capability the Bank has extended its management development programme to include masterclasses on key areas such as performance management and change management. A full modular based programme built around five core management skills is available for all our people managers.

A key focus for the Bank during the last year has been the design of a learning, leadership and development framework with programmes which support the creation of a talent pipeline aligned to future capability needs. In 2014 we recruited eight graduates to join our new Graduate Programme, and this was expanded to a further 14 graduates in 2015.

The Bank issued a colleague engagement survey in October 2015 which will provide a baseline for driving better colleague engagement and a cultural values index.

The Bank continues to consult and communicate (using a number of platforms including colleague publications, intranet, surveys, conferences and videos) with colleagues on customer, organisation and business performance issues. In addition, informal and formal consultations with both Unite and the Britannia Staff Union are regularly undertaken. The unions continue to be fully consulted where organisational change and other issues may affect colleagues.

During 2015, the Bank continued relationships with a number of diversity advisory bodies such as Inclusive Employers, Business Disability Forum, Business in the Community and Stonewall who provide the Bank with information on diversity.

In January 2015, as part of its new Ethical Policy, the Bank committed to paying colleagues no less than the living wage.

Employees with disabilities

During 2015, the Bank continued to be a holder of the 'Positive about Disabled People' symbol, a recognition given by Jobcentre Plus to employers who have agreed to meet five commitments concerning the recruitment, employment, retention and career development of disabled people. The Bank 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 Bank 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 recognises that health and wellbeing at work are vital. Wellbeing services include access to an external employee assistance programme (EAP) which provides free expert advice to colleagues and their immediate families on a wide range of matters including health and wellbeing, personal and work related concerns, money and debt, child/elder care and trauma. The Bank also provides occupational health support.

Corporate Governance report

The Corporate Governance report can be found on pages 52 to 60 and, together with this Directors' Report of which it forms part, fulfils the requirements of the Corporate Governance statement for the purpose of the Financial Conduct Authority's Disclosure and Transparency Rules (DTR).

Each of the persons who is a Director at the date of approval of this annual report confirms that:

- So far as the Director is aware, there is no relevant audit information of which the Bank and Company's auditor is unaware; and
- The Director has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Bank and Company's auditor is aware of that information.

The confirmation is given and should be interpreted in accordance with the provisions of S418 of the Companies Act 2006.

Ernst & Young LLP have expressed their willingness to continue in office as auditor and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

By order of the Board

Dennis Holt
Chairman
31 March 2016

Corporate Governance report

Chairman's Introduction

The reporting that follows my statement demonstrates the Board's approach to ensuring that there are governance structures in place to provide a robust framework to support our continuing work to implement the Bank's Plan. The Bank continues on its journey to revitalise our franchise and an important step in that journey was the further strengthening of our Board. During 2015, the Board was strengthened by the appointment of Aidan Birkett as independent Non-Executive Director and his subsequent appointment as Senior Independent Director in succession to Richard Coates, who had discharged that role in an interim capacity. Aidan built his career within the professional service sector over more than 25 years with PwC and Deloitte. The Board also welcomed Charles Bralver as a Non-Executive Director. Charles Bralver has over 30 years' financial services experience in senior and strategic roles.

In early 2016 the Board appointed Derek Weir as Chair of the Risk Committee, in succession to Graeme Hardie who has stepped down as Chair of the Committee but remains an independent Non-Executive Director until the Bank's AGM at which time he will stand down from the Board.

Our Board will develop again during the course of 2016 as we progress our search for additional Non-Executive Directors. At this year's AGM, with the exception of Graeme Hardie, all the Directors will stand for election or re-election.

During 2015 the Board again worked very closely with and was supported by the Chief Executive and the Executive Committee to further revise the Plan going forward and to address a number of key initiatives and corporate activities. The complexity of issues addressed by the Board during the year has been reflected in the time the Directors have devoted within Board and Committee meetings and in preparation for Board decisions to ensure that there is sufficient reflection on, and scrutiny, analysis, challenge and debate of, the matters presented. Our decision making during the year has included: consideration and approval of the migration of the Bank's IT infrastructure from The Co-operative Group into IBM managed data centres to improve IT infrastructure and resilience and to form the foundation for the further development of the Bank's digital offering; the securitisation of Non-core mortgage assets; and the selection and appointment of new Directors. The Board remains focused on stakeholder engagement and remains committed to holding appropriately structured and regular dialogues with shareholders.

As we expected, 2015 saw further progress towards a viable business that is sustainable in the longer term and demonstrates the values and ethics on which the Bank was founded and continues to operate its business today. There remains significant work to do.

Dennis Holt
Chairman
31 March 2016

Compliance with the UK Corporate Governance Code

The UK Corporate Governance Code, published by the Financial Reporting Council in 2014 (the Code), sets out standards of good practice in relation to Board leadership and effectiveness, remuneration, accountability and relations with shareholders.

The Directors will continue to support high standards of Corporate Governance. The Bank complied with the principles of the 2014 Code during the year.

Role and Responsibilities of the Board

The Board has collective responsibility for the long term success of the Bank. Its role is to provide leadership of the Bank within a framework of prudent and effective controls which enables risk to be assessed and managed. It sets the Bank's values and standards and ensures that its obligations to its shareholders, customers and other stakeholders 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 principal 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.

The Board has approved a schedule of Matters Reserved for the Board and authorities delegated to the Chief Executive Officer (CEO). Both the Matters Reserved for the Board and the CEO's delegated authorities have been revisited by the Board and re-adopted for 2016 with appropriate enhancements. 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 approval of the Bank's risk appetite and its Risk Management Framework.

Implementation of the strategy set by the Board and the management and day-to-day running of the Bank is delegated to the CEO, with oversight by the Board, with the exception of the Matters Reserved for the Board.

The Matters Reserved for the Board can be viewed on the Bank's website at:

www.co-operativebank.co.uk/aboutus/governance/matters-reserved-for-the-board

The Board

As reported in the Chairman's introduction to this report, there have been additional appointments to the Board during 2015 and it is expected that there will be further appointments during the course of 2016.

Composition

Details of the members of the Board, their biographies and details of length of service are set out on pages 48 to 49.

During 2015, the following Directors were appointed: Charles Bralver on 23 April 2015 and Aidan Birkett on 1 July 2015. Aidan Birkett was subsequently appointed as Senior Independent Director on 27 October 2015. At the end of 2015, the Bank's Board of Directors comprised two Executive Directors (Niall Booker and John Baines) and nine Non-Executive Directors (including the Chairman). There have been no further changes to the number of Directors since the end of 2015.

Richard Coates stood down as Interim Senior Independent Director on 27 October 2015. Aidan Birkett was appointed as Senior Independent Director on 27 October 2015.

The Bank regards Richard Coates, Graeme Hardie, William Thomas, Laura Carstensen, Maureen Laurie, Derek Weir and Aidan Birkett as Independent Non-Executive Directors. Dennis Holt has been regarded as an Independent Non-Executive Director, within the meaning of 'independent' as defined in the Code and on his appointment as Chairman on 27 October 2014. Charles Bralver was appointed to the Board following nomination by Silver Point Capital under the terms of the Shareholder Rights Agreement. For the purposes of the Code, Charles Bralver is not considered to be independent.

The Code recommends that at least half the Board of Directors (excluding the Chairman) should comprise Independent Non-Executive Directors. The 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 consider more than two thirds of the Board to be independent.

All the Independent Non-Executive Directors have considerable experience and make valuable contributions to the Bank. The Independent Non-Executive Directors constructively challenge and help develop proposals on strategy and bring strong, independent judgement, 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 Board considers that this will continue as new members are added to the Board during 2016.

Board Changes

During 2015 two Directors were appointed to the Board. Charles Bralver was appointed to the Board on 23 April 2015 following nomination by Silver Point Capital under the terms of the Shareholder Rights Agreement. Aidan Birkett was appointed to the Board of the Company on 1 July 2015, and was subsequently appointed as Senior Independent Director with effect from 27 October 2015.

Current members of the Board		Independent	Appointed
Dennis Holt	Chairman	On appointment	3 February 2014
Niall Booker	Chief Executive Officer	N/A	11 June 2013
John Baines	Finance Director	N/A	1 October 2014
Aidan Birkett	Senior Independent Director (from 27 October 2015)[1]	Independent	1 July 2015[1]
Richard Coates	Non-Executive Director (Interim Senior Independent Director to 27 October 2015)[2]	Independent	16 January 2013[2]
Graeme Hardie	Non-Executive Director	Independent	1 May 2013
William Thomas	Non-Executive Director	Independent	28 October 2013
Laura Carstensen	Non-Executive Director	Independent	27 May 2014
Maureen Laurie	Non-Executive Director	Independent	30 June 2014
Derek Weir	Non-Executive Director	Independent	25 July 2014
Charles Bralver	Non-Executive Director	Not Independent	23 April 2015

1. Aidan Birkett was appointed as Senior Independent Director on 27 October 2015.

2. Richard Coates stood down as Senior Independent Director on 27 October 2015.

Nominee Directors

For so long as the Co-operative Group Limited remains a bona fide co-operative society, the Co-operative Group Limited has the right, in certain prescribed circumstances and because of the percentage shareholding it currently holds in the Company, pursuant to the Articles of Association, Relationship Agreement and the Shareholder Rights Agreement, to appoint one representative to the Board of the Bank. The Bank's Articles of Association can be found on the Bank's website. The Co-operative Group has not utilised this right during the course of 2015. Should this appointment be made in 2016 it will not be regarded as independent for the purposes of the Code.

Under the Relationship Agreement two Non-Executive Directors were able to be nominated by certain subscribers of ordinary shares. Such Non-Executive Directors have to be independent under the Code. Derek Weir and Aidan Birkett were appointed to the Board after being nominated in this way.

Under the May 2014 capital raising two of the Company's largest shareholders (Silver Point Capital and Perry Capital) were granted the right to nominate a Non-Executive Director. Silver Point nominated Charles Bralver. Perry Capital has not yet nominated a Non-Executive Director.

The Role of the Chairman

Dennis Holt, the current Chairman of the Bank, was appointed on 27 October 2014 and for the purposes of the Code was considered independent on appointment. Details of Dennis' professional commitments are included in his biography. The Board is satisfied that these commitments do not interfere with the performance of Dennis' duties for the Bank.

The Bank's Chairman is a Non-Executive Director who leads the Board in the determination of its strategy and in the achievement of its objectives. The Chairman takes personal responsibility for organising the business of the Board, ensuring its effectiveness and setting its agenda. The Chairman has no involvement in the running of the day-to-day business of the Bank. His role is to facilitate the effective contribution of Directors and constructive relations between the Executive and Non-Executive Directors, to ensure Directors receive accurate, timely and clear information and to ensure that there is effective communication with shareholders. The division of responsibilities between the Chairman and the Chief Executive is clearly defined and was re-adopted by the Board in March 2016.

The Role of the Senior Independent Director

Richard Coates was appointed as the Interim Senior Independent Director on 1 October 2014. On 27 October 2015 Richard Coates stood down as Interim Senior Independent Director and Aidan Birkett was appointed Senior Independent Director. Details of Aidan's professional commitments are included in his biography on page 48. The Board is satisfied that these commitments do not interfere with the performance of the Senior Independent Director.

The Senior Independent Director is available to shareholders if they have concerns that the normal channels of the Chairman, Chief Executive Officer or other Executive Directors have failed to resolve, or for which such channels of communication are inappropriate.

The Senior Independent Director will meet with the other Non-Executive Directors without the Chairman present once a year and on other occasions as appropriate to appraise the Chairman's performance.

The Role of the Chief Executive Officer (CEO) and the Executive team

The CEO 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. The current CEO is Niall Booker, who was appointed to the Board on 11 June 2013.

It is the responsibility of the Executive team to implement the strategic objectives as agreed by the Board. The Executive team, under the leadership of the CEO, is responsible for the management of the Bank. John Baines is the Finance Director and a member of the Board and the Executive Committee.

The Secretary to the Board

The Secretary is responsible for advising the Board through the Chairman on all governance matters. All Directors have access to the advice and services of the Secretary. The Articles of Association provide that the appointment and removal of the Secretary is a matter for the Board, as do the Matters Reserved to the Board.

The current Secretary is Brona McKeown who is also General Counsel of the Bank.

Appointment and Reappointment of Directors

All Non-Executive Directors are appointed to the Board for an initial term of three years but, under the terms of their appointment, are required to submit themselves for annual re-election at the Bank's Annual General Meeting (AGM). All current Directors, with the exception of Graeme Hardie, will offer themselves for election or re-election at the AGM in 2016. The terms of appointment of the Non-Executive Directors are available for inspection on request to the Secretary.

The biographical details of all Directors are discussed on pages 48 to 49 and can also be found on our website at:

www.co-operativebank.co.uk/aboutus/governance/Directors

How the Board operates

Meetings and attendance

The Board usually meets on a monthly basis and there were 13 business as usual scheduled meetings in 2015 (11 monthly meetings, two strategy meetings). The Chairman and Board members also receive updates from the CEO and members of the Executive team between meetings.

During 2015, 13 additional ad hoc Board meetings or meetings of a Committee of the Board were held. The Board agreed the arrangements for those meetings, and agreed, where it was appropriate to do so, the identity or the number of Directors required to attend meetings. Accordingly not all Directors were required to attend all those additional meetings. All Directors had notice of the meetings being held and access to the materials to be discussed and the opportunity to provide their comments on the business to be considered in advance to the Chairman, other members of the Board or the Secretary.

The Board is scheduled to hold 10 Board meetings and two strategy meetings in 2016. The strategy meetings will be attended by Senior Executives and will consider performance and longer term planning. If necessary, the Chairman and Non-Executive Directors meet in the absence of Executive Directors as required. Members of the wider Executive and senior management team 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.

Information to Directors

Directors and usual attendees of Board and Committee meetings use a Board portal and an electronic tablet as their primary method for the receipt of papers. The electronic tablet provides access to additional materials to support Directors in their preparations for Board and corporate activity including constitutional documents and the materials from previous meetings.

In the ordinary course of scheduled Board and Board Committee meetings the aim is to provide the Directors with access to Board and Committee papers seven days before a meeting.

Attendance

The following table sets out the attendance at scheduled Board meetings:

Name	Appointed date	Resigned date	Board Meetings attended[1] (entitled to attend)[2]	Audit Committee attended[1] (entitled to attend)[2]	Risk Committee attended[1] (entitled to attend)[2]	Values and Ethics Committee attended[1] (entitled to attend)[2]	Remuneration Committee attended[1] (entitled to attend)[2]	Nomination Committee attended[1] (entitled to end)[2]
Dennis Holt			13 (13)	–	–	5 (6)	9 (9)	5 (5)
Richard Coates			13 (13)	10 (10)	9 (10)	–	–	–
Graeme Hardie			13 (13)	10 (10)	10 (10)	–	9 (9)	–
William Thomas			12 (13)	–	9 (10)	6 (6)	–	5 (5)
Laura Carstensen			11 (13)	–	–	6 (6)	8 (9)	–
Maureen Laurie			13 (13)	–	–	6 (6)	9 (9)	5 (5)
Derek Weir			13 (13)	9 (10)	9 (10)	–	–	–
Niall Booker			13 (13)	–	–	–	–	–
John Baines			12 (13)	–	–	1 (2)	–	–
Charles Bralver	23 April 2015		9 (10)	–	7 (7)	–	–	–
Aidan Birkett	1 July 2015		5 (7)	1 (2)	–	–	–	1 (1)

1. Business as usual scheduled meetings.

2. The Director concerned was entitled to attend because he/she was a member of the Board or Committee at the time of the meeting.

Number of meetings in 2015

Board meetings (scheduled):	13
Audit Committee meetings:	10
Risk Committee meetings:	10
Remuneration Committee meetings:	9
Values and Ethics Committee meetings:	6
Nomination Committee meetings:	5

During 2015, 13 additional Board meetings or meetings of a Committee of the Board were held. The Board agreed the arrangements for those meetings, and agreed, where it was appropriate to do so, the identity or the number of Directors required to attend. Accordingly not all Directors were required to attend all those additional meetings. All Directors had notice of the meetings being held and access to the materials to be discussed and the opportunity to provide their comments on the business to be considered in advance to the Chairman, other members of the Board or the Secretary.

Where Directors are unable to attend Board meetings, usually for reasons of illness or a requirement to hold these at shorter notice than is usual, the Chairman encourages Directors to provide their views, questions and comments directly to him.

During 2015, all Directors exceeded the time commitment set out in their letter of appointment.

Relations with Shareholders

As at 23 February 2016, the Bank has been advised that each of the following shareholders beneficially own in excess of 9.9% of the ordinary shares of the Bank:

Beneficial Shareholder	% holding of Ordinary Shares
The Co-operative Banking Group Limited	20.16%
SP COOP INVESTMENTS LTD[1]	12.92%
GoldenTree Asset Management[2]	11.55%

1. SP COOP INVESTMENTS LTD is the entity through which Silver Point Capital holds its investment in the Bank.
2. Golden Tree Asset Management manages its investment in the Bank through various Golden Tree funds.

The Annual General Meeting

The 2015 Annual General Meeting was held at 9 am on 17 June 2015 at 10 Upper Bank Street, Canary Wharf, London, E14 5JJ.

In support of best practice, all resolutions at the 2015 AGM were voted separately and by way of a poll. The result of the AGM recorded all votes cast for, against and those withheld. A vote withheld is not a vote in law and is not counted in the calculation of the proportion of the votes for or against a resolution.

The notice and results of the 2015 AGM can be found at:

www.co-operativebank.co.uk/aboutus/agm

Shareholder Engagement

During 2015, the Chairman and the Executive team led by the Chief Executive and Finance Director (with the assistance of its Investor Relations team), enabled and continued the dialogue with shareholders, which was reported back to the Board. All Directors are expected to attend the Bank's AGM.

Values and Ethics

Under the Bank's Articles of Association, there is a requirement on 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, in particular with regard to:

- how it relates to, communicates with, balances the interests of, and otherwise deals with its stakeholders; and
- how it applies the profits of the Bank, in accordance with the dividend policy set out in its Articles of Association.

Agreements with Shareholders

In anticipation of the completion of the Bank's LME in December 2013, whereby the Bank ceased to be a wholly-owned subsidiary of The Co-operative Group, and at the time of the Bank's Placing and Open Offer in May 2014, the Bank entered into certain agreements with its shareholders governing matters such as Director appointment rights, conduct of transactions and other governance related matters. These agreements are:

- A Relationship Agreement entered into between the Bank, The Co-operative Group and The Co-operative Banking Group on 4 November 2013;
- A Shareholder Rights Agreement entered into between Silver Point, Perry Capital, Invesco Asset Management Limited and York Capital (collectively, the Committed Shareholders), the Bank, The Co-operative Group and The Co-operative Banking Group on 9 May 2014; and
- A Variation and Director Appointment Deed entered into between the Bank, The Co-operative Group and The Co-operative Banking Group on 10 May 2014.

The following is an overview of the main terms of these agreements.

Director Appointment Rights

Under the Relationship Agreement, for so long as it remains a bona fide co-operative society, The Co-operative Group may appoint and remove:

- up to two Directors for so long as it directly or indirectly controls 25% or more of the rights to vote at a general meeting of the Bank; or
- one Director for so long as it directly or indirectly controls 20% or more (but less than 25%) of the rights to vote at a general meeting of the Bank.

The Co-operative Group's rights were supplemented in the Variation and Director Appointment Deed to the effect that, for so long as it remains a bona fide co-operative society, it may appoint and remove one Director for so long as it directly or indirectly controls 15% or more (but less than 20%) of the rights to vote at a general meeting of the Bank.

With its current shareholding, therefore, The Co-operative Group currently has the right to appoint one Director to the Board.

These agreements also provide that The Co-operative Group's Directors shall not be entitled to vote where there is a potential conflict of interest between the Bank and its group (on the one hand) and The Co-operative Group and its group (on the other). The Co-operative Group has the right to appoint one of its nominee Directors to the Values and Ethics Committee.

The Relationship Agreement also provided a mechanism, varied by an amendment contemplated by the Shareholder Rights Agreement, for the appointment of up to two persons as Non-Executive Directors who were nominated by certain former bondholders who were the purchasers of additional ordinary shares during the LME. Any Directors so nominated must satisfy the criteria to be independent pursuant to the Code. Two directors, Derek Weir and Aidan Birkett have been appointed pursuant to these rights.

Finally, under the Shareholder Rights Agreement, the Bank has granted to each of Silver Point and Perry Capital (two of its largest shareholders) the right to nominate a Director for appointment to the Board. These rights continue for so long as Silver Point and Perry Capital, as the case may be, directly or indirectly controls 5% or more of the rights to vote at a general meeting of the Bank. Such rights are not transferable, save that they will automatically transfer and be exercisable by another Committed Shareholder if Silver Point or Perry Capital ceases to control such level of voting rights in the Company, provided that such other Committed Shareholder itself directly or indirectly controls 5% or more of such voting rights. Any such Directors so nominated may be, but are not required to be, independent pursuant to the Code. All such Directors are subject to regulatory approval and approval by the Bank's Nomination Committee (such approval not to be unreasonably withheld). Currently, one Director, Charles Bralver (who was nominated by Silver Point), has been appointed pursuant to these rights.

The Relationship Agreement

The Relationship Agreement's other key terms as they affect the Bank's governance are as follows:

- The Co-operative Group is to 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 the Bank and The Co-operative Group require the approval of a majority of the Bank's Independent Directors;
- The Bank is required to have a Values and Ethics Committee and the Agreement stipulates its role, which has been reflected in the Bank's Articles of Association; and
- Until 20 December 2016, the Bank may not issue or grant any right to subscribe for any shares or other equity linked securities without the consent of The Co-operative Group. This is subject to certain exceptions, including capital raisings required by, or undertaken by the Bank in anticipation of a requirement from, a government authority or regulator.

The Relationship Agreement will continue in effect for so long as The Co-operative Group directly or indirectly controls 20% or more of the rights to vote at a general meeting of the Bank. Certain key obligations of The Co-operative Group will survive any such termination, including its obligations to use the Bank and not to compete with the Bank (described further below).

Shareholder Rights Agreement

The Shareholder Rights Agreement's other key terms as they affect the Bank's governance are as follows:

- If any Director appointed under the Shareholder Rights Agreement is independent, such Director may serve on the Board's Audit and Remuneration Committees, so that at all times at least one such independent Director shall serve on such Committees. If no such Director is independent, at least one of the Directors appointed under the Relationship Agreement by the purchasers of additional ordinary shares during the LME, but only if they are independent, shall serve on the Board's Audit and Remuneration Committees. All such Directors may only serve on the Audit Committee if the Committee considers, acting reasonably, that they are financially literate.
- Subject to a majority of the members being independent, at least one Director appointed under the Shareholder Rights Agreement will serve on each of the Board's Risk and Nomination Committees.
- The Bank agreed to establish, and has established, a sub-committee of the Board to assess the feasibility of the Bank listing its ordinary shares on the Official List and make recommendations to the Board with regard to the timing of such a listing (the Initial Public Offering Committee (IPO Committee)). That sub-committee is to be comprised of four Directors, being one Director appointed pursuant to the Relationship Agreement, one Director appointed pursuant to the Shareholder Rights Agreement, one Executive Director and one independent Non-Executive Director who is not a Director appointed pursuant to the Relationship Agreement or the Shareholder Rights Agreement.
- In addition, any of the Committed Shareholders and The Co-operative Group, who together hold 25% or more of the Bank's issued ordinary share capital, have the right to require the Bank to assist in a secondary offering of their ordinary shares, provided that such shareholders intend to sell shares with a value of at least £100 million. The Committed Shareholders may only exercise this right once in any 12 month period and three times in total. The launch of any secondary offering would be subject to Board approval of the documentation and certain other specified matters relating to that secondary offering. All fees and costs of any secondary offering must be pre-approved by the selling shareholders and will be paid out of the offering proceeds.

The rights of each Committed Shareholder and of The Co-operative Group under the Shareholder Rights Agreement shall continue for so long as each directly or indirectly controls 5% or more of the rights to vote at a general meeting of the Bank.

Separation from The Co-operative Group

Support Arrangements

In addition to dealing with governance matters, the Relationship Agreement includes certain obligations on The Co-operative Group to use the Bank's services, to promote the Bank's business and support the enhancement and rejuvenation of The Co-operative brand and franchise. Such obligations will continue until the later of two years after the termination of the Relationship Agreement or 20 December 2020.

Non-Compete Arrangements

The Relationship Agreement also includes certain non-compete obligations on The Co-operative Group not to operate a business which principally involves the provision of banking and other services in the UK that were provided by the Bank at the date of the Relationship Agreement or in the 12 months prior to it (excluding any business activities carried on by The Co-operative Group at the date of the LME). These obligations will now continue until three years after the termination of the Relationship Agreement.

Branding Arrangements

The Bank owns the trademark rights to The Co-operative Bank. The Co-existence Principles agreed with The Co-operative Group govern the use of trademarks containing 'Co-operative' or 'Co-op' and other associated trademarks owned by both parties. The principles are as follows:

- Unless the Values and Ethics provisions entrenched in the Bank's Articles of Association are removed (a Trigger Event), The Co-operative Group cannot conduct any business under a brand that combines the words 'Co-operative' or 'Co-op' and 'Bank';
- Until a Trigger Event, the Bank can continue to use the terms 'Co-operative' and 'Co-op' provided it does not confuse the public into believing that the Bank is still a part of The Co-operative Group;
- After the expiry of the non-compete period in the Relationship Agreement, The 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', provided that until five years after the end of the non-compete period, The Co-operative Group may not conduct any business which competes with the Bank under a main business brand including the words 'Co-operative' or 'Co-op'.

Separation Principles

Prior to the LME, certain functions of the Bank were centralised and carried out by The Co-operative Group. Since the LME (whereby the Bank ceased to be a wholly-owned subsidiary of The Co-operative Group), the Bank and The Co-operative Group have been working towards renegotiation of these arrangements. Pending finalisation of the revised arrangements, the Bank and The Co-operative Group agreed high level principles (the Separation Principles) to govern their separation discussions.

The Separation Principles include an overarching agreement to act in good faith and, amongst other things, agreements that:

- The Co-operative Group will continue to provide services to the Bank under the same terms that such services are currently provided until alternative arrangements are agreed;
- The Bank and The Co-operative Group will take reasonable steps to avoid the Bank incurring incremental costs and to mitigate costs incurred by both parties from the separation;
- There will be a limit on the mark-up charged by The Co-operative Group for certain services;
- Costs will be allocated between the Bank and The Co-operative Group on an equitable basis; and
- A working group consisting of representatives from the Bank and The Cooperative Group will be established to address and oversee the separation.

For further information on the separation of the Bank and The Co-operative Group, refer to note 2.

Appointment and Replacement of Directors

The Directors retire from office at each Annual General Meeting. A retiring Director is eligible for re-election. The Nomination Committee is responsible for considering and making recommendations to the Board in respect of appointments to the Board.

Powers of the Directors

The powers of the Directors are determined by the Companies Act 2006 and the Bank's Articles of Association.

Powers of the Board

The Board may exercise all the powers of the Bank to:

- Pay pensions or other benefits to any Director or employee;
- Establish participation in any profit-sharing or incentive scheme; and
- Support and subscribe to any institution or association which may be for the benefit of the Bank, its Directors or employees, and subscribe to any charitable or public object.

Subject to the provisions of the Bank's Articles of Association and the Relationship Agreement the Bank may exercise the powers conferred by the applicable statutory provisions to:

- Increase its share capital by allotting new shares;
- Reduce its share capital, any capital redemption reserve and any share premium account;
- Subdivide or consolidate and divide all or any of its share capital;
- Re-denominate all or any of its shares and reduce its share capital in connection with such redenomination;
- Issue redeemable shares; and
- Purchase all or any of its own shares including any redeemable shares.

The Relationship Agreement and the rights of the preference shares owned by the Co-operative Group Limited contain various provisions that may limit the Bank's ability to issue or allot shares, other equity securities or any securities convertible into, or exchangeable for, or grant any right to subscribe for, shares or other equity securities, without the consent of the Co-operative Group Limited.

Further details on voting rights can be found on page 79.

The Bank's Articles of Association can be found on our website at:

www.co-operativebank.co.uk/aboutus/governance/articles-of-association

Board Committees

The Board has established Board Committees, namely, the Audit Committee, the Risk Committee, the Values and Ethics Committee, the Nomination Committee, the Remuneration Committee and the IPO Committee.

All Board Committees have terms of reference describing the authority delegated to it by the Board. Each of these Committees has a role in ensuring the effective oversight by the Board of the Bank and its subsidiaries.

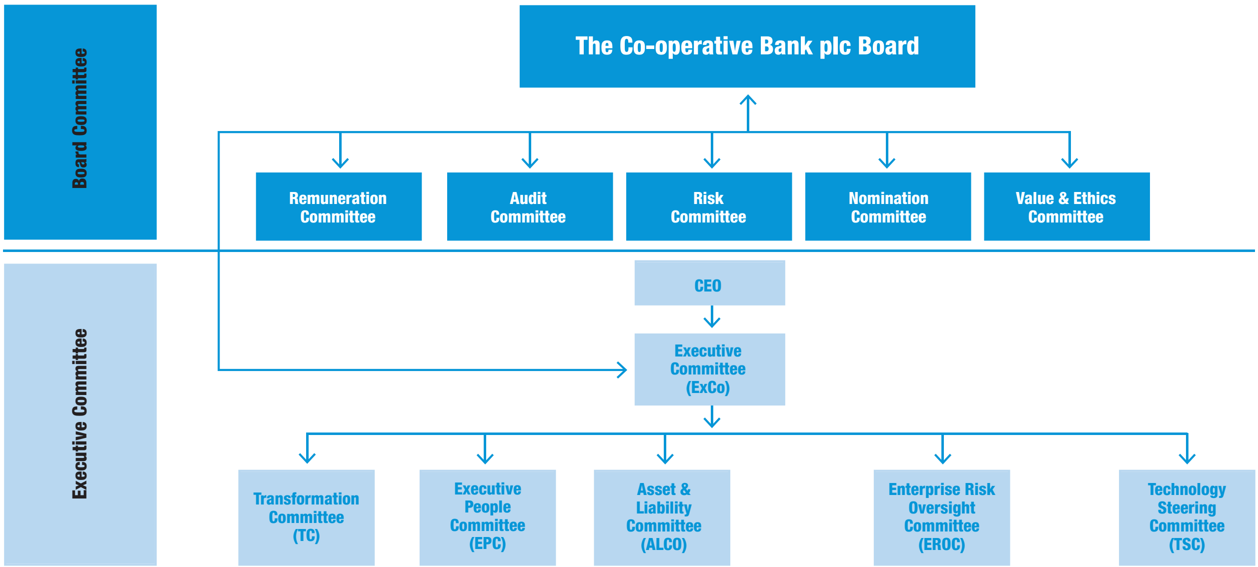
The terms of reference for Audit Committee, Risk Committee, Values and Ethics Committee, Nomination Committee and Remuneration Committee can be found at:
www.co-operativebank.co.uk/aboutus/governance/terms-of-reference-for-Board-Committees

The Board receives the minutes of all Committee meetings. During the year each of the Committees reviewed its terms of reference.

Information on the Committees can be found on the following pages:

Governance structure

The diagram below illustrates the Bank's Board and Management Committee structure as at the end of 2015. The Bank continues to review and refine this structure.



Audit Committee report

Introduction by Audit Committee Chairman

"The Audit Committee continued to provide significant oversight and challenge, and sought assurance over, improvements to the financial reporting process, the execution of the turnaround and monitoring progress in the ongoing roll out of the Risk Management Framework across the day-to-day operations of the Bank. Ongoing focus in these areas will continue in 2016."

Richard Coates
Audit Committee Chairman
31 March 2016

Purpose of the Audit Committee

To monitor, review and report to the Board on the formal arrangements established by the Board in respect of the financial and narrative reporting of the Bank, the internal controls and the Risk Management Framework, the internal audit and the external audit processes.

Audit Committee membership	Date of appointment	Date of resignation
Richard Coates	Appointed 16 January 2013 Chairman since 9 April 2013	
Graeme Hardie	Appointed 30 August 2013	
Derek Weir	Appointed 9 December 2014	
Aidan Birkett	Appointed 23 September 2015	

During the year the Committee membership changed with the appointment of Aidan Birkett on 23 September 2015. Meetings of the Committee are generally attended by the Chief Financial Officer, Chairman of the Board, Chief Executive, invited members of the finance and risk teams and the Director of Internal Audit, none of whom attend as of right. The external auditor attends Committee meetings and private meetings are held with internal and external auditors as necessary to afford them the opportunity of discussions without the presence of management. The Committee met 10 times during the financial year. The Chairman of the Committee reports back to the Board on the outcomes of meetings and the Board receives the minutes of all Committee meetings.

Alignment with Risk Committee

The Committee recognises the common interest in issues relevant to both Committees. To support the co-ordination of information between the Committees, the Chairman of each of the Audit and Risk Committees are members of both Committees. Both the Audit Committee and Risk Committee welcome attendance by representatives of the Internal Audit function and the external auditor at their meeting.

Principal responsibilities of the Audit Committee	Key areas discussed and reviewed by the Committee in 2015
Financial and narrative reporting • Review the content of the Annual Report and Accounts and advise the Board on whether, taken as a whole, it is fair, balanced and understandable and provides the information necessary for shareholders to assess the Bank's performance, business model and strategy. • Monitor the integrity of the financial statements of the Bank. • Review and challenge where necessary: – the consistency of, and any changes to, significant accounting policies both on a year on year basis and across the Bank; – the methods used to account for significant or unusual transactions where different approaches are possible; – whether the Bank has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditor; – the assumptions or qualifications in support of the going concern statement and the viability statement; and – the clarity and completeness of disclosure in the Bank's financial reports and the context in which statements are made. • Review and report to the Board on significant financial reporting issues and judgements, including matters communicated to it by the auditor.	• The Committee allocates a number of meetings in its calendar to focus on the preparation for and review of the Interim and the Annual Report & Accounts. During 2015 the review process included a detailed review of significant accounting judgements and accounting policies and regular dialogue with Ernst & Young LLP. The Committee also considers the Annual Report and Accounts and Interim Accounts process to assess the impact on Financial Reporting Risk. • The Board receives a report from the Audit Committee prior to the Board considering the content of Interim or Annual Reports. Compliance with Auditing Standards and the completeness of disclosures are also discussed. • Key judgements discussed as part of the 2015 accounts process are detailed on pages 166 to 186 including reports by the auditor throughout the year. • During 2015 the Committee considered the effectiveness, resource requirements and retention of staff in the finance team.
Internal controls and risk management systems • Review the adequacy and effectiveness of the Bank's internal financial controls and internal control and risk management systems and statements in the Annual Report concerning internal controls and risk management.	• During 2015, the Audit Committee considered the recommendations of Internal Audit and the external auditor in respect of internal control mechanisms and monitored progress against those recommendations. Both the Director of Internal Audit and the CRO attended Audit Committee meetings during the year. • The Committee considered reports of fraudulent activity and other major breakdowns in controls.
Internal audit • Approve the appointment or termination of appointment of the Director of Internal Audit. • Review and approve the Charter of the Internal Audit function and ensure the function has the necessary resources and access to information to enable it to fulfil its mandate, and is equipped to perform in accordance with appropriate professional standards for internal auditors. • Ensure the Director of Internal Audit has direct access to the Chairman of the Board and to the Chairman of the Committee, and is accountable to the Committee. • Review and assess the annual internal audit work plan and the reasons for any significant change or delay to this plan. • Receive reports on the results of the internal auditor's work. • Review and monitor management's responsiveness to the internal auditor's findings and recommendations. • Meet with the Director of Internal Audit at least once a year without the presence of management. • Monitor and review the effectiveness of the Bank's Internal Audit function, in the context of the Bank's overall risk management system.	• During 2015 the Committee considered the effectiveness and resourcing requirements of the Internal Audit function. • During 2015 the Committee reviewed and challenged the Internal Audit Charter and the plan of activities taking place during the year. • The Committee considers internal audit activity reports covering key Thematic Risks. • The Committee receives all red rated internal audit reports and invites management to present findings and remedial actions.

Principal responsibilities of the Audit Committee	Key areas discussed and reviewed by the Committee in 2015
External audit • Consider and make recommendations to the Board, to be put to shareholders for approval at the AGM, in relation to the appointment, re-appointment and removal of the external auditor. • Ensure that at least once every ten years the audit services contract is put out to tender and oversee the selection process. • If an auditor resigns, investigate the issues leading to this and decide whether any action is required. • Oversee the relationship with the external auditors and review the findings of the audit with the external auditor. • Review any representation letter(s) requested by the external auditor before they are signed by management. • Review the management letter and management's response to the auditor's major findings and recommendations. • Meet regularly with the external auditor and at least once a year, without the presence of management. • Develop and implement policy on the supply of non-audit services by the external auditor.	• The Committee engaged fully with the external auditor on all of the key accounting judgements. • The Committee reviewed the external audit strategy. • In the course of making a recommendation to the Board in respect of representations to the auditor, the Committee reviewed and challenged management assurances supporting management representation letters to the external auditors. • The Committee considered the external auditor's management letter containing observations arising from the annual and interim audits leading to recommendations for control or financial reporting improvement and monitored progress. • The Committee considered the policy and reporting on non-audit fees. • The Committee reviewed the independence of the external auditors and the objectivity of the audit engagement partner and audit staff.
Whistleblowing, bribery prevention and anti-money laundering/terrorist financing • Review the adequacy and security of the Bank's arrangements for its employees and contractors to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters and recommend the Bank's Concern at Work (Whistleblowing) Control Standard to the Board. • Review the adequacy and effectiveness of the Bank's systems and procedures for the prevention of bribery and recommend the Bank's Anti-Bribery & Corruption Control Standard to the Board. • Review regular reports from the Money Laundering Reporting Officer and the adequacy and effectiveness of the Bank's anti-money laundering and counter terrorist financing systems and controls. • Review the Committees' Terms of Reference and monitor its execution.	• The Committee reviewed reported whistleblowing incidents and the Bank's Concern at Work (Whistleblowing) Control Standard and Anti-Bribery & Corruption Control Standard. • The Committee considered reporting from the Money Laundering Reporting Officer during the year, including the Annual Money Laundering Reporting Officer's Report.

Significant accounting matters

During the year the Committee considered the following significant accounting issues, matters and judgements in relation to the Bank's half year and full year 2015 financial statements as well as the disclosure and presentation of those areas in the Annual Report and Accounts. These were discussed and debated with management and the external auditors (Ernst & Young LLP).

Going Concern and Viability Statement

There continues to be a material uncertainty around the Going Concern position of the Bank and this was considered in detail by the Committee. The continuing operation of the Bank and the Company is dependent on successfully funding their respective balance sheets and maintaining adequate levels of capital. In order to satisfy themselves that the Bank and the Company have adequate resources to continue to operate for the foreseeable future, the Committee evaluated a number of factors including capital position, liquidity, profitability and forecasts. The Committee considered the position in light of the stage of completion of the Bank's turnaround and the Updated Plan.

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.

The Committee considered and recommended to the Board that Going Concern disclosures prepared by management form part of note 1 to these financial statements.

The Committee also considered the Viability statement, a new requirement which forms part of the 2014 Corporate Governance code. The Committee considered the period of assessment and discussed factors used in determining if the Bank and Company will be able to continue in operation and meet liabilities as they fall due over the period of assessment.

Deferred tax assets

The Committee again considered the recognition of a deferred tax asset (DTA), the key judgement being the Bank's ability to recover the DTA based on forecasts of future taxable profits, and concluded that a DTA would not be recognised in the Company accounts in 2015.

The Committee also agreed that the DTA should continue to be recognised in the 2015 subsidiary accounts of certain subsidiaries and consolidated into the accounts of the Bank in accordance with the Bank's accounting policies.

Group relief debtor

The Committee discussed the measurement of the group relief debtor due from The Co-operative Group and reviewed a paper prepared by management setting out underlying assumptions inherent in the calculation as well as changes to the repayment profile provided by The Co-operative Group which led to an overall reduction in the group relief debtor reported in the Annual Report and Accounts.

Impairment of loans and advances to customers

The Committee reviewed detailed papers prepared by management covering the drivers for changes to impairment provisions which include as in previous years, the emergence period and probability of default, governance and controls over the provisions and substantive evidence supporting model parameters. The Committee also considered the impacts on impairment of the continued deleverage of Non-core activity. The Committee reviewed and challenged the methodology and supporting data analysis for the corporate collective provision in respect of probabilities of default, loss emergence periods and management overlays to model outputs. The Committee carefully considered evidence in the post balance sheet period as to whether additional provisions were required relative to conditions existing at the balance sheet.

De-recognition of Financial Assets

The Committee considered papers prepared by management which outlined the assessment of asset derecognition as a result of the securitisation transactions completed during the year. This assessment includes whether substantially all the risks and rewards of ownership of the securitised mortgages had been transferred, variable rights of return and the obligation to pay the cashflows directly to third parties had been met. The Audit Committee was also asked to consider whether any element of the securitisation transaction contained an embedded derivative and concurred with management's assessment that this was not the case.

Pensions

The Committee again debated the accounting treatment of both of the Bank's principal pension schemes, Pace and Britannia. It concluded that, as at 2015 year end, insufficient information was available to properly account for the Pace scheme as a defined benefit scheme but the Bank would continue to reflect a liability in the balance sheet as in 2014 since agreement had been reached on short term funding of the deficit.

The Committee discussed and concluded that the Britannia Pension scheme would continue to be accounted for as a defined benefit scheme in line with 2014, since the scheme is now owned by the Bank.

Outsourcing of mortgage processing services

The outsourcing of mortgage processing services in the second half of the year led to recognition of intangible assets and prepayments as well as expenses written off to the income statement. The rationale for the accounting treatment was presented in a paper prepared by management, together with the individual elements to this transaction and the Committee agreed that basis of preparation and accounting treatment of this transaction.

Conduct risk and legal provisioning

The Committee discussed an overview of the key assumptions and judgements made by management in arriving at the conduct and legal provisions. In particular the Committee considered the Plevin case, and how this would impact provisions and disclosures.

The Audit Committee reviewed recommendations from management regarding CCA, PPI, Packaged Accounts, arrears fees and charges and the mortgage customer detriment provision, and considered the underlying assumptions for the population affected, size of potential redress and customer complaints received. Detailed papers were presented outlining the key judgements used and these were debated and challenged by the Committee.

Business separation

In line with previous years, the Committee debated the requirement for a separation provision and concluded that the Bank was obligated to separate from The Co-operative Group and that a separation provision was required. The Committee reviewed reports from management and considered the adequacy of the provision in the light of changes to assumptions and work performed to date. Consideration was also given to the types of provisions included within separation, for both restructuring due to data migration and provision of service levels to customers.

Fair Value Adjustments (FVA) and unwinds

When the Bank merged with Britannia Building Society in 2009, the assets and liabilities of Britannia were brought onto the balance sheet of the Bank at estimated fair value. The Committee considered a paper prepared by management which addressed the improvements to fair value disclosures made in the Annual Report and Accounts and Interims and considered if there should be any changes to underlying assumptions as a result of the deleverage activity.

EIR

The Committee considered a paper prepared by management discussing a review of EIR model governance in the Bank. In particular the Committee discussed the income statement volatility caused by changes to the economic assumptions and agreed that the underlying models reflect the requirements of IAS 39.

Governance over accounting policy and judgements

The Committee considered the changes to governance to support Financial Reporting Risk, which have been set up during 2015 namely; the Accounting Policy Forum, which oversees accounting policy, and the Key Judgements Forum which reviews and challenges significant accounting matters.

Sale of share in Visa Europe

The sale of Visa Europe (subject to completion) was the subject of a paper, outlining the timing for the recognition of the profit on sale and basis of valuation of the shares, potential loss share provision recognition and any potential future provisions. The Committee reviewed and challenged these assumptions and carefully considered the impacts of any post balance sheet events on the proposed disclosures.

Unadjusted Errors

The external auditors reported to the Committee the misstatements that they had found in the course of their work including in respect of prior years, and no material amounts remain unadjusted.

Fair, Balanced and Understandable

The Committee considered whether the 2015 ARA were fair, balanced and understandable. The Committee satisfied itself that there was a robust process of review and challenge to ensure balance and consistency. This process included internal verification of the document and senior level review of the document both on an individual and committee basis prior to a meeting of the Audit Committee held to review and consider the ARA in advance of approval by the Board.

Performance Evaluation

External audit

The external auditor is appointed by shareholders to provide an opinion on the financial statements and certain other disclosures prepared by the Directors.

The Audit Committee is responsible for oversight of the external auditor, including reviewing the audit strategy and, on behalf of the Board, approving the audit fee. The Audit Committee has developed and implemented policy on the supply of non-audit services by the external auditor to avoid any threat to auditor objectivity and independence, taking into consideration any relevant guidance on the matter.

Non-audit services are normally limited to assignments that are closely related to the annual audit or where the work is of such a nature that a detailed understanding of the Bank is necessary. Management regularly provides the Audit Committee with reports on audit, audit-related and non-audit expenditure, together with proposals of any significant non-audit related assignments.

The Audit Committee reviews and, where necessary, challenges management to ensure auditor objectivity and independence is not impaired. Fees for audit-related and non-audit services incurred during the year amounted to £2.5m (2014: £2.7m). Details of the fees paid for audit services, audit-related services and non-audit services can be found in note 4 to the financial statements. The Audit Committee is satisfied that the overall levels of audit-related and non-audit fees are not material relative to the income of the external audit offices and firm as a whole and did not impair the objectivity and independence of the external auditor.

The Audit Committee evaluated the performance since appointment, independence and objectivity of Ernst & Young LLP and also reviewed their effectiveness as external auditor, taking into account the following factors:

- The external auditor's progress achieved against the agreed audit plan and communication of any changes to the plan, including changes in perceived audit risks;
- The competence with which the external auditor handled the key accounting and audit judgements and communication of the same with management and the Audit Committee;
- The external auditor's compliance with relevant regulatory, ethical and professional guidance on the rotation of partners;
- The external auditor's qualifications, expertise and resources and their own assessment of their internal quality procedures; and
- The stability that would be provided by continuing to use Ernst & Young LLP.

During 2015, the external auditor provided the Audit Committee with a management letter summarising its main observations and conclusions arising from the year end audit, half year reviews and any recommendations for enhancements to the Bank's reporting and controls. Mitigating actions were identified for implementation by the business. IA have been monitoring and tracking the implementation of these actions (with the exception of the actions arising from the specialist reviews, which are being tracked and validated by EY), with regular reporting to the Audit Committee on progress made.

Internal controls

Where material risks have been identified, the Bank has instigated action to strengthen its systems of internal control to mitigate these risks. The Board is ultimately responsible for the Bank's system of internal controls and it discharges its duties in this area by ensuring management implements effective systems of risk identification, assessment and mitigation. These risk management systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives and cannot provide absolute assurance against material misstatement or loss.

Management is responsible for establishing and maintaining adequate internal controls over financial reporting, including the consolidation process. Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes. A strategic planning, budgeting and forecasting process is in place. Monthly financial information is reported to the Board and management. Executive Committee (ExCo) reviews performance against budget and forecast on a monthly basis and senior financial managers regularly carry out an analysis of material variances.

Responsibility for reviewing the effectiveness of the internal controls has been delegated to the Audit Committee by the Board.

The Audit Committee uses information drawn from a number of different sources to carry out this review:

- Internal Audit provides objective assurance – their annual work plan is developed in conjunction with management and approved by the Audit Committee focusing on key risks and key internal controls. In the light of Internal Audit's recommendations, management develops and implements corrective action plans, which are tracked to completion by Internal Audit, with the results reported to Executive Management and to the Audit Committee.
- An annual review of the Bank's systems of internal control was undertaken by the Audit Committee and facilitated by the Risk Function.
- Further objective assurance is provided by external specialists.

Risk Management, Internal Control and Related Financial and Business Reporting (Previously known as Turnbull)

In line with the UK Corporate Governance Code and the Financial Reporting Council (Risk Management, Internal Control and related Financial and Business Reporting Risk Guidance), the Directors have undertaken a review of the effectiveness of the Bank's system of internal control. The review covered the systems of internal control for all Principal Risks within the Risk Management Framework (RMF).

The review concluded that the Bank's systems of control have improved since 2014 and further steps have been taken during 2015, but still require significant further strengthening in order to fully and effectively embed a RMF into the Bank that is fit for purpose. Enhancements have been made to the RMF during 2015 and further work is required to mature and embed all elements across the Bank to a consistent standard. This has been supported by improved capability across the three lines of defence as well as the beginnings of a cultural shift in driving accountability for actions. However, there remain challenges to embedding the implementation of the RMF, including the capability of systems to effectively report risks on an end-to-end basis across the Bank consistently and the ability to attract and retain staff with the requisite skills and knowledge into the first and second line Risk functions.

This continues to be a priority for 2016 and the Regulators will continue to closely review the Bank's progress during 2016. A failure to implement a RMF that addresses any remaining material deficiencies could potentially result in regulatory actions.

The more detailed conclusions of the review are detailed below.

As described in the Risk Management section, the Bank has a RMF that sets out a hierarchy of strategies, policies and standards to support risk based decision making and operational control. Significant enhancement work has continued on the RMF in 2015 including:

- A reassessment of risk appetite statements, key metrics and tolerance limits.
- The review and re-approval of Risk Policies in a simpler and consistent format.

- Commencing the review and re-approval of all control standards.
- An attestation by executives stating their level of compliance with the Risk and Control Self-Assessment (RCSA) process and relevant risk policies and control standards.

The Bank's Operational Risk Management Framework which provides a structure for risk management and assessment of internal controls continues to be embedded in line with good practice and regulatory guidance. Particular emphasis has been focused on ensuring that the methodology and general approach which underpins the framework is effective and fully developed as fit for purpose. This has been supported by the implementation of a new operational risk system which facilitates appropriate operational risk reporting. The Bank recoigunises that there is additional work required during 2016 to develop the Operational Risk Management Framework to be in line with industry standards.

It is noted that given the Bank's legacy source systems, data issues and resulting number of manual processes this does give rise to increased level of operational risks and specifically financial reporting risks. Whilst control enhancements have been made further investment is required in this area to meet regulatory and statutory reporting requirements.

Material operational risks are reported through an appropriate governance structure, and an Operational Risk Oversight Committee meets regularly to monitor the development and effectiveness of the operational risk processes and material and emerging risks within the Bank.

The Bank adopts a standard "three lines of defence model" which sets out the responsibilities of first line management, the Risk function and Internal Audit. The appropriateness of resource allocation between these areas will be kept under review as the Bank simplifies its operating model. Accountabilities across the three lines of defence and for specific roles are clearly set out in the RMF policy. During 2016, further work is required to ensure this is consistently applied across all areas of the Bank.

A Risk Adjustment Committee has been formalised. The purpose of this Committee is to ensure risk adjustment is effectively embedded into the existing reward framework by considering all matters that may give rise to ex-ante or ex-post performance adjustment to variable pay.

The Risk function was restructured in early 2015 to strengthen the Risk Framework team and improve the three lines of defence. The Bank continues to upskill in specialist areas whilst seeking to retain existing key staff to maintain and support transformation of the Bank in a controlled way. Resource allocation, training and clarity on the roles played between first and second line requires additional strengthening in 2016 to ensure this is consistent across the Bank.

Whilst the Bank has made progress in enhancing its RMF in 2015 it is noted that further work is required throughout 2016 to ensure it is firmly embedded, is effective and meets regulatory requirements and expectations. One key area that will require significant development is in model risk management to bring this in line with industry best practice which is being supported by appropriate resources to assist in these development activities. Specifically, the Bank's use of Internal Rating Based (IRB) models requires improvement and a remediation plan to be put in place to rectify certain areas of non-compliance. It also noted that significant resource has also been invested in overhauling the Bank's change capability which is recognition that this has not historically met industry standards.

Whilst progress has been made in 2015 in the quality and coverage of management information provided to the Board and sub committees in relation to the Bank's systems of internal control further enhancement is required in 2016 to bring this in line with industry standards.

Internal Audit has increased its capability and there is significant focus on addressing internal audit action points within agreed timescales. Where progress is not being made on audit issues, these are routinely escalated through executive reporting and governance forums. This is part of the wider cultural change being introduced across the Bank.

Both Internal Audit findings and risk events reported in 2015 support the above assessment of the Bank's system of internal control.

Internal Audit

The Audit Committee is responsible for evaluating the performance of the Internal Audit (IA) function on a regular basis to ensure that the function complies with the Institute of Internal Auditors (IIA) International Standards. In doing so, it will need to identify appropriate criteria for defining the success of Internal Audit. Delivery of the audit plan should not be the sole criterion in this evaluation.

An independent external third party has been appointed to perform an external quality assessment (EQA) of the IA function in Q1 2016, using assessment criteria established by the IIA. The results of the EQA will be presented to the April 2016 Audit Committee.

The Bank has an Internal Audit department comprising 20 in-house auditors supported by an Internal Audit co-source arrangements with Deloitte LLP, PwC LLP and Grant Thornton UK LLP. The co-source arrangements, which have been in place for a number of years, support the Bank's requirements for specialist skills or additional resources where it would be inefficient to resource internally. Independence of the internal audit function is supported by the Internal Audit Director reporting directly to the Chairman of the Audit Committee and administratively to the CEO.

To provide coverage of risks, Internal Audit has an audit universe which provides a holistic view of audit coverage at a business entity and process level. This is supplemented by an assessment of inherent risks and control environment, aligned to the Bank's Risk Management Framework. The audit plan is aligned to the Updated Plan and also covers mandatory requirements from relevant regulators.

During 2015 the scheduled internal audit reporting activity addressed a cross section of the Bank's key operations and internal control mechanisms. A total of 49 internal audit reports were delivered for the 2015 Internal Audit plan (2014: 41) which enabled the Audit Committee to assess the control environment overall and make recommendations for areas of focus to the Risk Committee and to the Board.

The Internal Audit plan remains based upon a quarterly planning cycle which continues to give flexibility on the type of assurance provided, aligned to the risk profile of the Bank which continues to develop with the progress of the Bank's turnaround.

Internal audit reports are reviewed by operational and line management and then by ExCo and other Board Committees as appropriate.

Audit findings and the related management actions are tracked to completion by Internal Audit. Where audit issues are overdue these are reported to ExCo and the Audit Committee and escalated as appropriate. The Committee is provided with reports on material findings and recommendations and regular updates on the progress made by management in addressing the findings. All action points are recorded on a newly implemented bank-wide database to facilitate tracking and reporting. Monthly reports are produced on action status updates, which are shared with the business, ExCo and other Board Committees.

Presentation of Internal Audit reports to the Audit Committee or when required other Board Committees includes attendance by the Executive Committee members and senior managers responsible to explain the activities underway to address any actual or potential weaknesses identified.

The audit plan is approved by the Audit Committee, and shared with the regulator quarterly.

Risk Committee report

Introduction by Risk Committee Chairman

“The Committee has continued to review and challenge the work being undertaken to derisk the Bank and mitigate the risks inherent in the Revised Plan. Significant progress has been made in a number of key areas in particular capital, liquidity and the reputational risks facing the Bank. The remediation of past issues has taken a substantial element of the Committee’s time this year and whilst the foundations of the Risk Management Framework have been laid further work is required in some areas of the Bank to embed it fully. The risk culture of the organisation continues to improve and the focus of the Committee for 2016 will be to build on this. It should be noted that the Bank continues to face significant risks which could impact its ability to implement its Updated Plan.”

Derek Weir
Risk Committee Chairman
31 March 2016

Purpose of the Risk Committee

To review and report its conclusions to the Board on the Bank’s risk appetite and Risk Management Framework, taking a forward looking perspective and anticipating changes in business conditions.

Risk Committee membership[1]	Date of appointment	Date of resignation
Derek Weir (Chairman)	Appointed 30 September 2014 Chairman since 26 January 2016	
Graeme Hardie	Appointed 21 August 2013 Stepped down as Chairman with effect from 26 January 2016	
Richard Coates	Appointed 21 August 2013	
William Thomas	Appointed 1 January 2014	
Charles Bralver	Appointed 23 April 2015	

1. Niall Booker attended as a member over the period from May 2014 to February 2015 but is not shown in the table above as only Non-executives should be counted as members of the Risk Committee. During this period the other members were all Non-executive and no matters were formally put to the vote. Niall Booker, as CEO, attended the Committee meetings for the remainder of 2015, but not as a member.

The Risk Committee met in total 10 times during the financial year. A Sub-committee of the main Risk Committee was convened for the purpose of reviewing Risk policies. The Risk Sub Committee met four times during the financial year. In performing its duties, the Committee has access to the services of the Chief Risk Officer, the Chief Executive Officer, the Finance Director, the Director of Internal Audit and the General Counsel, as well as external professional advisors. To support the interplay between the role of the Risk Committee and the Audit Committee, the Chairman of the Audit Committee is a member of the Risk Committee and the Chairman of the Risk Committee is a member of the Audit Committee. Graeme Hardie, the Chairman of the Risk Committee during 2015 was a member of the Remuneration Committee and remains a member of both committees, even though he has stepped down from the Chairmanship of the Risk Committee. This is to ensure that qualitative and quantative advice is provided to the Remuneration Committee on risk weightings to be applied to performance objectives incorporated in executive remuneration.

During 2015 the risk management structure continued to be overhauled alongside the roll-out of the cultural transformation programme across the Bank. The continued embedding of the Risk Management Framework is a key component in the transformation of culture in the organisation and some progress has been made. The Committee has worked closely with the Audit Committee to monitor risk management and internal controls.

The Bank has determined its principal risks, and the level of acceptable risks, as stipulated in the Bank’s risk appetite statement, which aims to ensure that there is an adequate system of risk management and that the level of capital and liquidity held are consistent with the risk profile of the business. The Bank’s exposure to credit and other risk types such as market, liquidity, operational, pension, reputational and other risks that are inherent to our industry such as strategy, product range and geographical coverage and the processes for managing those risks are described in detail on pages 98 to 144. The Principal risks and uncertainties which the Bank faces are described on pages 32 to 42.

<table>
<thead>
<tr><th>Principal responsibilities of the Risk Committee</th><th>Key areas discussed and reviewed by the Committee in 2015</th></tr>
</thead>
<tbody>
<tr><td>Risk Management Framework
Review and challenge the design and implementation of the Risk Management Framework and recommend to the Board for approval.
At least annually, review the quality and effectiveness of the Risk Management Framework and the Risk Management Framework Policy.
Ensure the remit of the risk management function has:
adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards; and
adequate independence, being free from management or other restrictions.
Review the capability of the Bank to identify, assess, and manage new risk types.</td><td>During 2015, the Committee actively discussed the significant progress made in embedding the RMF and the various challenges which the Bank faced in embedding across the organisation. Such challenges were set against the wider context of the Bank's overall risk profile and risk appetite. The successful embedding of a Risk Management Framework is dependent upon the Bank being able to improve the quality of Risk Culture across the organisation and to instil a strong three lines of defence operating model – a model which is generally standard across the industry.
To embed a sound Risk Culture, the Bank must resource the appropriate level of suitably skilled people in Risk and across the Bank. The Committee called for the CRO and the HR Director to provide regular reporting on people risk, on breaches to regulation and policy and breaches on operational controls as well as wider HR challenges.
The Committee has regularly reviewed the Bank's preparedness to meet increasing regulatory and operational risk.</td></tr>
<tr><td>Risk Culture
Review, promote and challenge the Bank's risk culture, and seek assurance to satisfy itself that an appropriate risk culture prevails in the organisation.
Provide qualitative and quantitative advice to the Remuneration Committee on risk weightings to be applied to performance objectives incorporated in executive remuneration.</td><td>At each meeting of the Committee, regular reports were provided by the CRO on the main risks which the Bank faces. A principal focus of the Committee was to monitor activities being undertaken on risk culture.
The Chairman of the Risk Committee during 2015 was a member of the Remuneration Committee and remains a member of both Committees even though he has stepped down from the Chairmanship of the Risk Committee with effect from 26 January 2016. The CRO has reviewed risk weightings applying to executive remuneration structures and provided analysis to support Remuneration Committee activities in this area.</td></tr>
<tr><td>Risk appetite, limits and tolerances
Review, challenge and recommend to the Board for approval, at least annually, risk appetite, risk measures, risk tolerance and risk limits.
Review, challenge and exercise oversight of capital and liquidity management and advise the Board on strategy for capital and liquidity management.
Annually review, challenge and recommend to the Board for approval the ICAAP.
Annually review, challenge and recommend to the Board for approval the ILAAP.
Review, challenge and recommend to the Board for approval, submissions to competent authorities to be submitted in the Board's name.</td><td>The Committee considered at each meeting reports and findings in relation to customer conduct matters and regulatory risk. On these matters (as on other matters), the Committee was engaged with Management to ensure that appropriate steps were being taken to redress issues where customers were potentially facing or had suffered detriment as a result of previous operational shortcomings. The Committee regularly reviewed the development of plans to improve regulatory compliance.
During the year, the Committee has worked with the CRO to continually evolve the quality of data reporting seen at Committee and Board levels in order to assist the Committee in its oversight of the monitoring of risk appetite, of risk acceptances and of risk events.
Prior to recommending to the Board for approval, the Committee reviewed all material submissions to be provided to regulatory bodies.
The Committee has also engaged in extensive monitoring and oversight of the various remediation programmes currently under way across the Bank.</td></tr>
<tr><td>Business Strategy
Provide detailed review and challenge of proposed business strategy giving consideration to the impact on the Bank's risk profile and make recommendations to the Board.
Ensure an appropriate due diligence is carried out focusing on risk aspects and implications for risk profile and appetite when advising the Board on strategic acquisitions or disposals.</td><td>The Committee, throughout 2015, discussed and monitored the Principal risks and uncertainties that faced the Bank. The Committee reviewed the plans under consideration to determine if they were sufficiently robust and practical.
The Committee undertook a number of reviews of IT plans for remediation, for a migration of key applications on to IBM infrastructure and for separation of key services away from The Co-operative Group. In addition, the Committee also reviewed the risks associated with outsourcing a number of key services to third party suppliers.</td></tr>
</tbody>
</table>

Principal responsibilities of the Risk Committee	Key areas discussed and reviewed by the Committee in 2015
Risk Monitoring • Consider, oversee and advise the Board on, and provide challenge on the Bank's exposure to, all significant risks to the business, and dedicate clear and explicit focus to current and forward-looking aspects of risk exposure, especially where those risks could undermine strategy reputation or long term viability. • Review and challenge management's risk mitigation and control remediation actions. • In co-operation with the Audit Committee, monitor identified control failings and weaknesses that raise systemic risk issues and management actions taken to resolve them. • Review reports on any material breaches of risk limits and the adequacy of proposed action. • Consider risks posed to the Bank by the current and prospective macroeconomic and financial environment, drawing on financial stability assessments such as those published by the Bank of England, the Prudential Regulation Authority, the Financial Conduct Authority and other authoritative sources that may be relevant for the Bank's risk policies when preparing advice for the Board.	• During 2015 the Committee continued to consider and monitor organisational decision making and judgements and customer outcomes. • The Committee considered key corporate exposures in terms of consolidated exposures and large exposure positions and risk mitigation. • The Committee has received regular reporting to help it review IT Risk and the remediation programme. • The Committee has considered reporting of emerging risks during the year together with regulatory feedback given to the Bank by the Prudential Regulation Authority and the Financial Conduct Authority and the plans agreed with regulators published to the market from time to time.
Regulatory risks and Compliance • Review and approve the annual regulatory monitoring plan and the reasons for any significant changes to the plan, taking into account the regulatory risks identified from time to time. • Review, consider and challenge regular reports from the Chief Risk Officer and keep under review the adequacy and effectiveness of the Bank's regulatory risk function. • Receive prompt notification of any material adverse reports or sanctions by any competent authority.	• The Committee has challenged the development of certain risk models to support the attestation of and compliance with the Capital Requirements Regulation. Further commentary can be found in the Principal risks and uncertainties section. • The Committee considered regulatory monitoring plans during the year. • The Chief Risk Officer attended Risk Committee meetings during the year providing regular reporting analysis.
Risk Reporting • Receive reports, findings and recommendations from the Enterprise Risk Oversight Committee (formerly the Executive Risk Committee) noting significant issues. • In co-operation with the Audit Committee, review and approve the statements to be included in the Annual Report and Accounts concerning internal controls and risk management.	• Through the reporting from the CRO, the Committee continued to have access to the findings and recommendations of the EROC on matters referred to the Risk Committee or to the Board. • The Committee continues to work closely with the Audit Committee in determining the Company's Annual and Interim reporting.
Chief Risk Officer • Recommend to the Board the appointment and/or removal of the Chief Risk Officer. • Meet at least once a year with the Chief Risk Officer without the presence of management.	• The Board reviewed the resignation of the Chief Risk Officer and concurred with the risk committee recommendation to accept it. • The Committee met with the Chief Risk Officer without the presence of management during the year.

Nomination Committee report

Introduction by Nomination Committee Chairman

"During 2015 the Nomination Committee has spent significant time discussing Board composition and effectiveness. The Committee has recommended changes to the Board and its Committees to further strengthen these to meet the current and developing needs of the business and to consider succession planning for directors and other senior executives, taking into account the challenges and opportunities facing the Bank."

Dennis Holt
Nomination Committee Chairman
31 March 2016

Purpose of the Nomination Committee

To lead the process for Board appointments by comprehensively reviewing and making recommendations on the Board composition, succession planning for Executive Directors, Non-Executive Directors and certain Senior Executives, identifying and nominating candidates for Board vacancies and evaluation of candidates for the Board.

Nomination Committee membership	Date of appointment	Date of resignation
Dennis Holt (Chair)	Appointed 25 February 2014	
Maureen Laurie	Appointed 30 June 2014	
William Thomas	Appointed 30 May 2014	
Aidan Birkett	Appointed 27 October 2015	

During 2015 the Nomination Committee continued to focus on building and strengthening the Board to meet the needs of the business and to be responsive to the regulatory environment in which the Bank operates. The Nomination Committee consider that the Board does consist of individuals with the right balance of skills, experience and knowledge to provide strong leadership of the Bank. Biographies for each of the Bank's Directors can be found on page 48 and 49.

During 2015 the Nomination Committee considered appointments of Non-Executive Directors to the Board and key Executive appointments. Skillcapital were retained by certain shareholders that are able to nominate Non-Executive Directors under the Relationship Agreement and Shareholder Rights Agreement (details of which can be found in this report). Charles Bralver was appointed as a Non-Independent Non Executive Director on 23 April 2015 and Aidan Birkett was appointed as an Independent Non-Executive Director on 1 July 2015. The Bank engaged external search consultancy MWM Consulting to assist in the search for a Senior Independent Director which culminated in Aidan Birkett being appointed Senior Independent Director on 27 October 2015. Spencer Stuart, JCA Group and Ridgeway Partners have been retained in respect of succession requirements as these arise.

Skillcapital, MWM Consulting, Spencer Stuart, JCA Group and Ridgeway Partners do not have any connection with the Bank.

During 2015 the Nomination Committee considered Executive Committee succession planning.

The Bank has full regard to the benefits of diversity in all its elements, including gender diversity. During 2015 the Bank has been developing its Diversity policy across the business creating colleague networking groups and driving awareness. In February 2015 the Nomination Committee considered a policy to promote diversity on the Board in recognition that a diverse Board represents the views of society, brings a wide range of skills and knowledge to the Board and enhances challenge. The Board agrees with the conclusions of the Women on Boards report by Lord Davies of Abersoch that greater efforts should be made in improving the gender balance of corporate boards and that quotas for female board representation are not the preferred approach. The Nomination Committee recommended the policy for approval by the Board. The Board reviewed and approved the policy in March 2015. The Board considers diversity, of which gender diversity is one element, to be an important part of the search mandates for new appointments to the Board.

As the Board structure develops and further appointments are nominated by shareholders, we will continue to encourage those shareholders, directly, and through the executive search consultancies engaged in the search process, to reflect diversity in the lists of candidates nominated for the consideration of the Board although the ultimate choice of nomination is a matter for the shareholder in question. The permanent Senior Independent Director and Non-Executive Director selection process during 2015 considered diversity amongst other attributes in the review of candidate selection criteria alongside the overarching requirement of appropriate skill set, experience and expertise.

At the end of 2015, of the eleven Directors on the Bank's Board, two were women (18%). The Board's target for the number of women on its Board is three by the end of 2016.

Principal responsibilities of the Nomination Committee	Key areas formally discussed and reviewed by the Committee in 2015
• Regular review of the structure, size and composition of the Board. • Identify and nominate, for approval by the Board, candidates to fill Board vacancies having regard to the balance of skills, knowledge, independence, experience and diversity on the Board. • Formulate plans for succession for Directors and Non-Executive Directors and senior executives including the re-appointment of any Non-Executive Director at the conclusion of their specified term of office taking into account the skills and expertise needed on the Board in the future and the continued ability of the organisation to compete effectively in the marketplace. • Keep under review the Bank's policy on diversity, including gender, and the measure of objectives that it has set in implementing the policy, and progress on achieving the objectives. • Membership of the Audit and Remuneration and Risk Committees, and any other Board Committees. • Review the results of the Board performance evaluation including the time required from Non-Executive Directors. • The election or re-election of Directors by shareholders at the Annual General Meeting. • Review the leadership needs of the Bank and considering proposals in respect of these.	• Review of the structure, size and composition of the Board along with the skills, knowledge and experience of its members to ensure that Directors remain able and have sufficient time to discharge their duties and responsibilities effectively and to the high standard required. • During 2015 the Committee considered a number of nominations at both Board and Senior Executive level. Aidan Birkett and Charles Bralver were appointed as Non-Executive Directors during 2015. This activity included the role and capability requirements together with the overarching succession plan required for the Board and Senior Executive. • Succession planning, including identification of external and potential external candidates for senior vacancies which may arise on a crisis, short, medium or long term basis. • The Board adopted the Board Diversity policy recommended by the Committee in February 2015 and the Committee reviewed progress against this in December 2015. The Committee will continue to monitor progress against the policy during 2016. • During the year and as a result of new appointments to the Board and retirements during the year, the Committee considered and made recommendations to the Board on Committee Composition across all Board Committees. • An external Board Evaluation took place in Q4 2015 and the results have been made available to the Board for its review in Q1 2016. • The Committee reviewed the position of Directors offering themselves for election and re-election at the 2015 AGM.

Values and Ethics Committee report

Introduction by Values and Ethics Committee Chair

"I am pleased to present the report of the Bank's Values and Ethics Committee (V&E Committee) and my second as its Chair. In 2015, the Committee focused on both the launch of our updated Ethical Policy and its embedding into all aspects of the Bank's business, in particular the development of products and services such as overdrafts, credit cards and our new current account. As part of our ongoing support for the co-operative movement, I attended the annual congress of Co-operatives UK in Birmingham. There I pledged action from the Bank to support the co-operative sector and in October 2015 we announced The Hive.

A personal highlight for me was seeing the Bank return to its campaigning heritage with the launch of "My money, my life" in December. This campaign, which aims to lift the lid on financial abuse within intimate relationships, was launched in partnership with leading domestic violence charity, Refuge. The Bank is now working towards the adoption of an industry-wide Code of Practice to enshrine the recommendations coming out of the research performed.

Finally, I was delighted with our colleagues' exceptional efforts in fundraising for 2015 during our Festive Fundraiser activity which saw £100,000 donated to local charities across the UK."

Laura Carstensen
Values and Ethics Committee Chair
31 March 2016

Purpose of the Values and Ethics Committee

To recommend to the Board for its approval and adoption the Values and Ethical policies of the Bank and to advise the Board of the Bank's conformity with such Values and Ethics in its operations and activities.

V&E Committee membership	Date of appointment	Date of resignation
Laura Carstensen (Chair)	Appointed 27 May 2014	
Dennis Holt	Appointed 30 June 2014	
William Thomas	Appointed 13 December 2013	
Maureen Laurie	Appointed 30 June 2014	
John Baines	Appointed 1 July 2015	
Liam Coleman	Appointed 1 July 2015	
Brona McKeown	Appointed 31 May 2014	Resigned 1 July 2015

The V&E Committee was constituted on 1 November 2013, demonstrating the Bank's commitment to promoting and conducting its business in accordance with its established Values and Ethics. Laura Carstensen was appointed as Chair of the V&E Committee on 27 May 2014. The Co-operative Group has the right to appoint its appointee to the Committee whilst it indirectly or directly holds 20% or more of the ordinary shares of the Bank. The Group has currently chosen not to appoint a member of the Board and hence a member of the V&E Committee. The Chief Executive regularly attends the V&E Committee.

During 2015 we were encouraged by the continuing support and engagement of our customers in particular with the launch of our new Ethical Policy in January 2015. Strong values are what our customers have expected from us since we were established, and in 1992 we became the first bank to have a customer led Ethical Policy. The Policy remains unique in UK banking because it is shaped by our customers and embodies the values we share. The Ethical Policy is published on the Bank's website at: www.co-operativebank.co.uk/aboutus/ourbusiness/ethicalpolicy. The Committee oversaw the application by the Bank for Living Wage Accreditation which was achieved in July 2015 and meets one of the commitments made by the Bank as part of its new Ethical Policy.

The work of the Committee included the preparation of the annual Values & Ethics report, review of the development of various products and propositions with ethical features (such as the new overdraft proposition and balance transfer credit card with ethical features) and the monitoring of customer satisfaction metrics.

The Committee was also fully involved in the Bank's campaigning and community proposals which saw the launch of our ethical campaign "My money, my life" which raises awareness of the true scale of financial abuse for the first time, as it occurs within intimate relationships, where financial control, exploitation or sabotage are used to control a person's ability to acquire, use and maintain financial resources in December 2015.

The Committee also reviewed the proposals which culminated in an agreed £1 million three-year partnership to support the development and growth of the UK's dynamic co operative and social enterprise sector with Co-operatives UK in October 2015.

The Terms of Reference of the Committee were changed in July 2015 to add an additional responsibility for the Committee to monitor the Bank's compliance with its statement to the Co-operatives UK, on the use of the co-operatives name, which it will report annually to the Board. The terms of reference of the Committee can be found here: www.co-operativebank.co.uk/aboutus/governance/terms-of-reference-for-board-committees

The Committee agreed that it would meet more frequently in 2015 than required by its terms of reference, particularly as it focused on a review of the performance of the Bank against the five pillars of the Ethical Policy, namely: ethical banking, ethical products and services, ethical business, ethical workplace and culture and ethical campaigning. This is summarised in an annual report for approval by the Board. The Committee met six times during 2015. The Committee has agreed to meet four times during 2016 to ensure that more substantive items are reviewed together.

During 2015, the Chair of the Committee together with each of the Chairs of the Remuneration and Risk Committees regularly engaged to ensure that there was consideration of the Bank's Values and Ethics in the discussion and reporting of issues at Board and Committee meetings including matters such as product reviews, policies and executive remuneration structures.

The Committee Chair, together with other members of the Committee will attend the Annual General Meeting to answer any shareholder questions on the Committee's activities.

Principal responsibilities of the Values and Ethics Committee	Key areas discussed and reviewed by the Committee in 2015
Values and ethical policies of the Bank • Recommend to the board for approval and adoption the Values and Ethical policies of the Bank. • Represent, monitor and advise the board on matters concerning the interests of customers, suppliers, employees and other stakeholders in their dealings with the Bank in line with the objects of the Bank as described in the Articles of Association having regard to: (i) the legal and regulatory requirements applicable to the Bank and its 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 Committee oversaw the development and launch of the expanded Ethical Policy in January 2015 in response to the ethical poll. • The Committee reviewed and provided input into the Bank's Annual Values and Ethics Report which featured the key steps that the Bank took in the first half of 2015 to bring the Ethical Policy to life and embed ethics into how it does business. • Consideration of matters by the Board regularly draws upon the views and advice of the Committee in respect of the interests of stakeholders and Values and Ethics of the Bank.
Monitoring and reporting V&E related activities and alignment to the Bank's Ethical Policy • Customer satisfaction levels (with a focus on service levels and on the product offering in the light of the Bank's Values and Ethics policies, in each case assessed by reference to relevant customer metrics) • Alignment of treatment of the Bank's customers with its Values and Ethics • Alignment of employee training and culture with its values and ethical policies • Corporate social responsibility, community investment, environmental and other projects and activities of the Bank • The Bank's approach to improving the social and environmental impacts of the Bank's own operations • Establishment of a clear ethical policy and ethical strategy informed by customer consultation that aligns with the commercial strategy and is reviewed annually • The extent to which executive remuneration policies are consistent with the Bank's Values and Ethics • Provision of products and services to sectors/organisations with clear social justice or community benefit purpose • The development of products and services with ethical features • The choice of suppliers, partners and third party relationships which should be informed by the Bank's Ethical Policy.	• The Committee was presented with the top five service improvement plans and the Bank's strategy for putting customers at the heart of the Bank. The Committee monitored complaints resolution and the level of improvement in customer satisfaction. • The Committee had oversight of account closures and ratified the decisions taken by Bank executives. This included decisions based on anti money laundering regulations which could have reputational impacts for the Bank. • The Committee oversaw and considered aspects of the Bank's Vulnerable Customers work. For example, the Committee provided input into the establishment of the Vulnerable Customer Steering Group. • The Committee was updated on the embedding of the Values and Ethics framework within the Bank. Particular focus has been placed on incorporating V&E in performance management, the Induction Programme and in ongoing e-learning modules. • The Committee considered the allocation of "Customers who Care" provision and oversaw the financial abuse campaign with Refuge, as well as Bank match funding. The Committee also supported the relaunch of the colleague volunteering scheme and has been monitoring the uptake amongst colleagues.

Principal responsibilities of the Values and Ethics Committee	Key areas discussed and reviewed by the Committee in 2015
• In 2015, the Committee supported the development of a "Combined Reporting Pack" which would help the Committee to form an integrated view, and monitor over time: customer and supplier screening, volunteering, stakeholder management and quarterly government relations. Over the course of 2015, the Combined Reporting Pack developed into the Ethical Policy Compliance Report which measures the level of impact the Bank's Ethical Policy has on the Bank's activities.	• The Committee considered and evaluated the impact of a number of programmes on the Bank's Values and Ethics, for example, assessing the compatibility of the outsourcing of mortgage operations to Capita with the Ethical Policy. The Committee also supported the Bank's commitment to an ethical workplace including monitoring its commitment to the Living Wage. The Bank received Living Wage Employer accreditation in July. • The launch of the expanded Ethical Policy in January was followed by the Values and Ethics report in July. The Committee has initiated the development of a Values and Ethics scorecard. • A review was undertaken in January 2015. The Committee confirmed that remuneration policies remained a matter for the Remuneration Committee, but that they would continue to consider the impact on the Values and Ethics of the Bank. • The Committee supported the ongoing piece of work to identify a territory to define the Bank in the minds of customers with an impact similar to that of the Ethical Policy when it was created 20 years ago. • The Committee reviewed a number of new products launched by the Bank in 2015 including a new overdraft proposition resulting in a simpler, more transparent overdraft tariff and a new balance transfer card which similarly adopts the principles of simplicity, transparency and fairness. The Committee reviewed and challenged the level of customer advocacy in the "Everyday Rewards" current account proposition, monitoring the alignment of the proposition to the Bank's Values and Ethics Policy. • The Committee provided input into the Sustainable Procurement and Supplier policy and considered the impact of living wage changes on suppliers. The Committee has supported, and will consider, a proposal for in-housing Social Goals activity. The Committee reviewed the decision to close a number of accounts and concluded that for regulatory reasons and alignment with the Bank's V&E policy this was appropriate.
Statement to Co-operatives UK • Monitor the Bank's compliance with its statement to Co-operatives UK • Report at least annually to the Board on the Bank's compliance with its statement to Co-operatives UK.	The Committee approved the signing of a contract with Co-operatives UK which established a three-year Co-operatives UK business support programme to support social and economic development and enterprise in accordance with Co-operative Values. The Committee also hosted the Secretary General of Co-operatives UK at the final meeting of 2015. Regular meetings continue between management of the Bank and Co-operatives UK to monitor compliance with the statement.

Board effectiveness

Performance evaluation

The Board recognises the requirement to undertake a formal and rigorous annual evaluation of its own performance and that of its Committees and individual Directors.

The UK Corporate Governance Code describes the principles by which a Board should consider, in a formal and rigorous manner, its own performance and that of its Committees and individual Directors.

During the 2014 financial year, the Bank did not satisfy the Code provision regarding external evaluation of the Board. The Board last underwent an external evaluation of its effectiveness at the end of 2010. As further appointments to the Board were anticipated during 2015 under the terms of the Relationship Agreement and Shareholder Rights Agreement, the Board agreed that the external evaluation would take place in 2015.

An internal self-assessment of Board effectiveness took place early in 2015 in relation to 2014 Board activity. Each director received a questionnaire in February 2015 which asked for their views on the composition and membership of the Board, the way the Board works, the role of Committees and learning and development opportunities. The action plan developed from that process was shared with the Nomination Committee and with the Board and was the subject of a progress update in December 2015.

In Q2 2015, as part of the Board effectiveness process, the Chairman carried out individual assessments of Board members, based on individual self-evaluations and using a skills matrix. This will enable ongoing Board training and recruitment requirements to be appropriately informed. The Directors consider that the development of Board strength and specific skill sets and expertise through further Board training and appointments will further support the Board's ongoing effectiveness.

An external self-assessment exercise in respect of 2015 was embarked upon in Q3 2015. Deloitte LLP and a second provider were interviewed and, at the recommendation of the Nomination Committee, Deloitte LLP was appointed by the Board in September 2015 to conduct an external assessment of Board effectiveness. The assessment involved extensive engagement by Deloitte LLP with the Board and Committee members and with senior management, together with the analysis of a significant amount of Board and Committee papers and other corporate documentation. The results of the external assessment undertaken by Deloitte LLP in respect of 2015 were reported to the Board during January 2016 and a detailed action plan will be returned to the Board later in H1 2016.

During 2015, the Directors, led by Richard Coates as the Interim Senior Independent Director, were responsible for the performance evaluation of the Chairman.

Induction and continuing professional development

All newly appointed Directors undertake a structured induction programme which is designed to provide them with key business information about the Bank, and includes briefing sessions with members of the Executive team and a branch visit.

As part of the Approved Persons' process an individual training plan is designed for each Director which is reviewed periodically. Throughout 2015 the Board continued to hold collective training sessions which were scheduled to take place before Board meetings. On some occasions the scheduled training did not take place and the allocated training sessions were used to consider urgent business issues.

In addition to formal training sessions, the Directors, where appropriate, have one to one sessions with members of the Executive.

An electronic 'Reading Room' is available as a resource to enable all Directors to access, revisit and review copies of presentations and materials from formal development sessions.

The Chairman's role is to address 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 Bank and their responsibilities as Directors.

Senior Managers Regime (SMR)

In response to the new requirements for regulated firms and the individuals within those firms set out in the Senior Managers Regime, that came into force in March 2016, a dedicated SMR Programme has been established within the Bank to ensure that the Bank fully addresses and implements the new rules under the Senior Managers Regime.

All Directors have been briefed extensively and have received training in connection with the new requirements set out in the Senior Managers Regime. The SMR Programme will continue to support the Directors and the Bank during the implementation of the new rules.

Deloitte LLP was engaged during 2015 to provide advice and challenge to the SMR Programme and its implementation of the new rules, to ensure this is aligned with industry best practice.

Conflicts of interest

Pursuant to the Companies Act 2006, the Directors have a duty to avoid situations in which they have or may have interests that conflict with those of the Bank unless that interest is first authorised by the other Directors. The Bank's Articles of Association allow the Board to authorise such potential conflicts and there is a procedure to deal with actual or potential conflicts. Directors are reminded, at each Board meeting, of their duty to report actual or potential conflict as soon as they become aware of any such events. All potential conflicts approved by the Board are recorded in the Conflicts of Interest Register which is reviewed by the Board annually. The Board considers the Conflicts of Interest Register at each Board meeting and is satisfied that all potential conflicts are appropriately considered and have been approved. The Board has determined that a Director with a potential or actual conflict will not be permitted to form part of the quorum or vote upon the matter giving rise to the conflict.

Prior to taking up any external appointment or responsibilities, Directors are asked to consult with the Company Secretary and the Chairman.

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.

Insurance and indemnities

During 2015 the Bank maintained appropriate Directors' and Officers' liability insurance in respect of legal action against its Directors and Officers. Various Officers had, and continue to have, the benefit of indemnities from the Bank in relation to losses and liabilities they may incur in their employment. In addition, qualifying third party indemnity provisions (as defined by section 224 of the Companies Act 2006) were in operation during 2015 and are in force for the benefit of the Directors in relation to certain losses and liabilities which they may incur in connection with their appointment.

Professional advice and board support

A number of external consultants provide from time to time professional advice to the Board. There is an agreed procedure by which the Directors may take independent professional advice at the Bank's expense in furtherance of their duties.

Statutory disclosures information

Share capital structure, transfer restrictions and takeover bid related disclosures

As provided in the Bank's Articles of Association, the Bank has two classes of share capital, ordinary shares, representing 88% of the total share capital, and preference shares representing 12% of the total share capital. For information about the ownership of each class of shares, please see the Corporate Governance report – Relations with Shareholders on page 57.

Transfer of shares

Shareholders may transfer any shares in any manner which is permitted by law and is from time to time approved by the Board. PRA approval is required if a person intends to acquire or increase its 'control' of a UK authorised person (which includes the Bank). Acquiring 'control' includes where a person first holds 10% or more of the shares or voting power in the Bank. Increasing control means when an existing shareholder increases their shareholding or entitlement to voting power from a holding below certain thresholds to a holding above them. The thresholds are 10%, 20%, 30% or 50% of shares or voting power.

Voting rights

Subject to the Bank's 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 2006 shall apply in relation to voting rights of the Bank's shares.

Ordinary shareholders are entitled to vote at general meetings and appoint proxies. On a show of hands, every member or proxy has one vote. On a poll, every member present in person or by proxy has one vote for every share held. Ordinary shareholders may receive: (1) dividends; (2) assets upon the liquidation of the Bank; and (3) capital payments through the capitalisation of reserves as provided in the Bank's Articles of Association.

In connection with the LME as described on page 32, the Co-operative Group Limited acquired the entire issued amount of the Bank's preference shares, and signed a deed of waiver waiving any rights to income and capital in respect of the preference shares. As holder of the preference shares, the Co-operative Group Limited has the right to speak and vote at a general meeting of the Bank if: (1) its rights are being varied; or (2) the Bank is being wound up or there is other return of capital.

Rights attaching to the preference shares can only be varied by consent of the holder of the preference shares. The Bank's Articles of Association require this consent to be obtained under certain circumstances, including:

- Issuances of shares or grants 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 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; and
- Repayments or reductions in the Bank's share capital.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and Accounts and the consolidated financial statements of The Co-operative Bank plc and its subsidiaries (the Bank) and parent company financial statements for The Co-operative Bank (the Company) in accordance with applicable law and regulations.

Company law requires the Directors to prepare Bank and Company financial statements for each financial year. Under that law they have elected to prepare the Bank and the Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and applicable law.

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 Bank and Company and of their income statement for that year. In preparing each of the Bank and Company financial statements, the Directors are required to:

- select suitable accounting policies in accordance with International Accounting Standard 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs as adopted by the EU is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the financial performance; and
- state that the Bank and Company have complied with IFRSs as adopted by the EU, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Bank's and Company's transactions and disclose with reasonable accuracy at any time the financial position of the Bank and Company and enable them to ensure that the 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 Bank and Company and to prevent and detect fraud and other irregularities.

The Directors are also responsible for preparing, in accordance with applicable laws and regulations, a Strategic report, Directors' report and Corporate Governance statement that complies with that law and those regulations. 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. The Directors consider the Annual Report and Accounts and financial statements, taken as a whole, to be fair, balanced and understandable and provide the information necessary for shareholders to assess the Bank and the Company's performance, business model and strategy.

Disclosure of information to the Auditor

So far as the Directors are aware, there is no relevant Audit information of which the Bank's Auditor is 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 Auditor is aware of that information.

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 income statement of the Company and of the undertakings included in the consolidation taken as a whole;
- the Strategic report includes a fair review of the development and performance of the business and the position of the Bank/Company and the undertakings included in the consolidation taken as a whole, together with a description of the Principal risks and uncertainties that they face; and
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Bank/Company's performance, business model and strategy.

This responsibility statement was approved by the board of directors on 31 March 2016 and is signed on its behalf by:

Dennis Holt
Chairman
31 March 2016

Directors' Remuneration report

Introduction by the Remuneration Committee Chairman

Dear Shareholder,

2015 was the first full year in which the Bank's revised Remuneration policy and Long Term Incentive Plans were introduced, following shareholder approval of the Bank's Remuneration policy in June 2015.

31 Executives and senior colleagues in key roles were offered the opportunity to participate in the Long Term Incentive Plan, including a transitional award for 2014-2016, and a full award covering the three year period 2015-2017. These awards, ranging from 50% to 100% of base salary, meet the commitments given to shareholders and regulators that the Bank's Remuneration policy provides appropriate annual and longer term incentives to support the Bank's recovery, aligned to the Bank's Updated Plan.

Performance measures for the Bank's Long Term Incentive Plan have been set in a ratio of 70:30 for financial and non-financial goals respectively.

Annual Incentive Plan financial and non-financial performance measures are set at 50:50. Further details of these plans are set out in pages 89 and 90.

In introducing annual and long term incentives, the Bank has ensured that an increasing proportion of total remuneration becomes subject to the malus and clawback requirements of the Remuneration Code.

A summary of matters considered by the Remuneration Committee in 2015 is set out in pages 83 to 86. These include a revised approach to the identification of and reward for Material Risk Takers, affecting the structure and deferral conditions that apply to variable pay. These changes extend the period of time in which variable payments may be clawed back or cancelled in the event of serious failures affecting the Bank's stability, resilience and customer outcomes.

2015 performance

The Remuneration Committee considered the Bank's achievements in 2015 against the financial and strategic measures as set out on page 88 and reviewed the performance reports for key executives. Throughout the second half of 2015, the Remuneration Committee received and monitored reports from the Chief Risk Officer. The year-end Chief Risk Officer's report was accompanied by specific recommendations from the Individual Risk Adjustment Committee and Chief Executive Officer on annual bonus pool outcomes.

The Remuneration Committee concluded that the Bank had made strong progress against the key financial objectives, noting in particular the improvements in capital resilience, reductions in operational costs and the successful deleveraging of Non-core assets. Overall, performance against financial objectives has consistently met or exceeded expectations.

Progress against other objectives was broadly on target, a point which the Remuneration Committee considered carefully with regard to the difficult and challenging nature of the Revised Plan. The Core Bank continued to make steady and encouraging progress throughout 2015. Reputational and customer satisfaction scores strengthened, reflecting considerable efforts on the part of colleagues in addressing customer requirements and developing new products and services. Colleague engagement measures also showed notable improvement, from a low point at the beginning of the year to a level which is now close to sector benchmarks. The improvement in these key measures reflect the influence of the Bank's revised Values and Ethics policy which has been pivotal in strengthening dialogue with customers and colleagues alike.

Business transformation initiatives gathered pace in 2015 including the outsourcing of IT infrastructure and mortgage servicing. The foundations are in place to enable substantial improvements in the Bank's IT capability, resilience and ability to deliver its customer-centric strategy in line with the Strategic Plan.

The Bank has paid considerable attention to its risk exposures, reflecting increasing regulatory requirements and building the Bank's resilience and sustainability over the longer term. Developing and embedding a robust risk management framework has been a key objective for 2015 and will remain so in 2016.

Similarly, a key part of the Bank's recovery is the transformation of its finance operations, streamlining processing and reporting and providing strong management information to support the ongoing plan. Whilst progress has been made, this objective extends into 2016.

Overall assessment against the objectives outlined in the Bank's scorecard was determined as 72.9% achievement. Taking all performance measures and reports into account, together with affordability considerations, the Remuneration Committee determined the final bonus pool for the Bank, as a whole, to be 50% of maximum.

Year on year, the bonus pool is broadly flat, at £5.79m for 2015, compared with £5.76m in 2014. It should be noted that in 2015, for the first time, the Chief Executive Officer receives an annual variable incentive payment and this is incorporated within the overall 2015 bonus pool. Details of remuneration for the Chief Executive Officer and the Finance Director are set out on page 87. The Remuneration Committee has made no recommendation to change remuneration arrangements for the Executive Directors.

Overall, taking into account the challenging expectations for 2015, the Remuneration Committee is satisfied that the Bank has made progress in key areas of its recovery objectives and has confirmed that it is therefore appropriate to make performance and risk adjusted payments under its annual incentive policy.

Chief Executive Officer and Finance Director Remuneration

During 2015 the Bank completed discussions with the Chief Executive Officer to extend his contract from 10 June 2015 until the end of 2016. The revised contract rebalanced the remuneration package, increasing the proportion which would vary according to performance. The Chief Executive Officer's Role Based Allowance reduced from £1.68m to £0.4m, and the contract incorporated the opportunity to receive an annual variable incentive and a long term incentive award, which when combined, may not exceed 200% of base pay. Overall, the Chief Executive Officer's annual remuneration for 2015 was £3.85m. Further details can be found on page 87.

During 2015, no changes were made to the remuneration package or contractual terms for the Finance Director. Overall, the Finance Director's annual remuneration for 2015 was £0.93m. Further details can be found on page 87.

Remuneration Committee agenda for 2016

The Remuneration Committee will continue to ensure that shareholder feedback and regulatory expectations are taken into account throughout 2016 in the ongoing development of the Bank's remuneration structure. This will include updates on performance against the Plan, including evaluation of risk reports and monitoring of annual and longer term measures of achievement. In support of these objectives, the Committee intends to make further long term incentive awards in 2016 to selected key staff, in line with the policy agreed by shareholders and as agreed with the regulator.

The Bank does not expect to become compliant with the CRD IV ICG and PRA buffer requirements until the latter part of the Updated Plan. Accordingly, the Remuneration Committee will consider any necessary, consequential adjustments to ongoing pay policy. This review will include consideration of the ratios of fixed to variable pay and the application of Role Based Allowances, particularly in the context of key staff remuneration and continuing requirements to attract and retain critical skills.

The Remuneration Committee consults with the Values and Ethics Committee on certain aspects of Remuneration policy. These consultations will include reviews into gender and other diversity measures and the Committee will also consider proposals to introduce Bank wide recognition for improvements in customer outcomes and satisfaction.

The agenda for 2016 also includes the ongoing review of pension scheme structures in order to reduce future risk to the Bank, following the completion of moving members of the Pace pension scheme to a defined contribution basis in 2015.

After a demanding year, in which the newly revised annual performance and long term incentive plans have been rolled out, the Remuneration Committee is satisfied that there is a clear understanding of the performance priorities, aligning risk, results and reward to the requirements of the Bank's Plan.

Maureen Laurie
Remuneration Committee Chairman
31 March 2016

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Other information

Remuneration Committee

The Remuneration Committee has the delegated responsibility to determine remuneration for the Executive Directors and the Executive Committee of the Bank. It sets and recommends to the Board for approval, the overarching principles and parameters of the Remuneration policy across the Bank and applies the necessary oversight to ensure an overall coherent approach to remuneration is implemented for all employees. In addition, the Remuneration Committee undertakes to ensure compliance with the Prudential Regulation Authority's Remuneration Code and the UK Corporate Governance Code.

The Remuneration Committee met nine times in 2015. During 2015, the members of the Committee were as follows:

Committee members	Date of appointment	Attended (entitled to attend)
Maureen Laurie (Chair)	30 June 2014	9 (9)
Dennis Holt	5 February 2014	9 (9)
Laura Carstensen	30 May 2014	8 (9)
Graeme Hardie	09 October 2013	9 (9)

The Committee regularly consults with the Chief Executive Officer (CEO), Human Resources Director (HRD), General Counsel and Chief Risk Officer (CRO), all of whom may attend meetings of the Committee but are not present when their own remuneration or terms and conditions are being considered. The Head of Reward also provides advice on compensation and benefits to the Committee. The General Counsel and Company Secretary advises the Committee on corporate governance.

The Committee also works closely with Chairs of the Risk Committee, Audit Committee, Nomination Committee and Values and Ethics Committee.

Advisor to the Committee

The Committee received support and advice from external advisors during the year. From time to time, the Committee will undertake due diligence to ensure that the advice it receives is independent. The table below provides details of the external advisors to the Committee and the respective fees paid to them in 2015. Fees are charged based on the scope and requirements of the work, as agreed with the Committee or the Bank as a whole. Deloitte LLP is a member of the Remuneration Consultants Group and, as such, voluntarily operates under the code of conduct in relation to 'executive remuneration consulting in the UK'.

The total fees paid in 2015 to remuneration advisors for remuneration-related advice to the Committee was:

Name	2015 Fees £000s
Deloitte LLP[1]	**128**

1. The figure above captures only the fees for services in respect of advice that materially assisted the Remuneration Committee.

The Committee reviewed the provision of advice in 2015 and have confirmed that Deloitte will remain as advisor until the end of 2016; a full review of advisory support will take place before that to identify advisors for 2017 onwards.

Principal responsibilities of the Remuneration Committee

Principal responsibilities of the Remuneration Committee	Key areas discussed and reviewed by the Committee in 2015 include
Remuneration policy • Policy and contractual terms including salary, benefits and pension ○ Set and recommend to the Board for approval, 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. Ensure that all relevant legislation, regulatory requirements and guidance on remuneration practice are considered and complied with when setting the Remuneration policy. ○ Support the Chairman of the Committee in overseeing the development and implementation of the Bank's Remuneration policy and supporting practices. ○ The Remuneration policy should have regard to the risk appetite of the Bank, whilst being consistent with effective risk management principles, be aligned to the Bank's long term strategic goals, and comply with relevant applicable legislation. ○ Review at least annually the ongoing appropriateness and relevance of the Remuneration policy and exercise its judgement in the application of the remuneration framework and policies to promote the long term success of the Company.	• A revised Remuneration policy, providing appropriate longer term incentives to support the Bank's recovery was introduced, following shareholder approval in 2015. • Introduction of a Long Term Incentive Plan, together with the Annual Incentive Plan, ensures that an increasing proportion of remuneration becomes subject to the Remuneration Code including deferrals and the capacity to effect malus and/or clawback arrangements for up to seven years from award date. • Consideration of the Chief Risk Officer's report on risk management and relevant events, and adjustment of performance awards. • Changes to pension and benefits to reduce future liabilities and risk to the Bank, including switching colleagues to a defined contribution basis within the Bank's Pace policy and revising several aspects of the Britannia Pension Scheme, in consultation with Trustees. These changes were made in consultation with the Pension Trustees.
Material Risk Takers • Review and agree the Remuneration policy and decisions relating to remuneration, including variable pay, performance related payments and pension arrangements, for any employees, present and prospective, in senior management roles, risk takers and staff in control functions that are included on the Bank's register of Material Risk Takers and therefore subject to the Remuneration Code. • Seek advice from the Board's Risk Committee, the Chief Risk Officer (by way of an annual report from the Chief Risk Officer) and consider the impact of IRAC on the risks arising from the remuneration policies for the purpose of the ICAAP within the key areas discussed and reviewed by the committee in 2015 and other regulatory matters and specific risk adjustments to be applied to performance objectives of any Material Risk Takers, set in the context of incentive packages.	• The Committee approved the revised designated list of Material Risk Takers in 2015. These numbered 71 as at 31 December 2015. • During 2015 the Committee undertook a comprehensive review of its end-to-end performance adjustment and bonus setting processes resulting in: ○ A governance structure with a dedicated review body comprised of senior representatives from key control functions. This body acts in an advisory capacity in support of the Remuneration Committee. ○ Approval of a process so that those responsible or accountable for conduct and risk matters may be subject to in-year adjustments to bonuses and reductions to deferred and prior awards.

Principal responsibilities of the Remuneration Committee	Key areas discussed and reviewed by the Committee in 2015 include
Executive Directors and the Executive Committee (the "Executive") Having regard to the overarching principles and parameters of the Company's remuneration policy:	
Policy and contractual terms: • Establish, implement and maintain the Bank's policy on all aspects of the remuneration of the Executive present and prospective, including pension rights and any compensation payments. • Review at least annually the on-going appropriateness and relevance of the Remuneration policy. • Oversee contractual arrangements and approve the principal terms and conditions of employment. • Ensure that contractual terms on termination, and any payments made, are fair to the individual, and the Bank, that failure is not rewarded and that the duty to mitigate loss is fully recognised. • Within the terms of the agreed policy and in consultation with the Chair and/or Chief Executive, as appropriate, determine the total individual remuneration package of each Executive and the Chair, ensuring full compliance with the relevant legislation and regulatory requirements. • Ensure that the remuneration of each Executive (including any payments for loss of office) is consistent with the most recently approved Remuneration policy. • Review salaries, normally at the start of the Bank's financial year, which may include reference to comparisons against the agreed financial services sector market policies. • Advise on any major changes in employee benefit structures throughout the Bank or its subsidiaries which relate to Executives.	• Role Based Allowances were introduced for certain key staff from 2013 onwards. The Remuneration Committee intends that remuneration packages should be revised to reduce such allowances. This will take account of EBA requirements and will be ongoing from 2016. • The Committee approved changes to the Chief Executive's remuneration in June 2015 resulting in a reduction to the Role Based Allowance, in line with Remuneration policy. No changes have been made to the remuneration package or contractual terms for the Finance Director. • Salaries for each Executive were reviewed in line with relevant market data and against selected benchmark organisations as part of the annual review process. No changes have been made to base salaries or other aspects of fixed remuneration.

Principal responsibilities of the Remuneration Committee	Key areas discussed and reviewed by the Committee in 2015 include
Incentive arrangements – annual and long term	
• Determine and review the policy for all incentive plans for approval by the Board and shareholders in accordance with the agreed Remuneration policy. • Approve any amendments to all incentive plans prior to obtaining any necessary shareholder approval. • For any such plans, determine each year whether awards will be made, and if so, the overall amount of such awards, the individual awards to be made and set appropriate performance targets. Ensuring that appropriate consideration has been taken for risk matters and events that have occurred both in year and in prior years. • Authorise payments under incentive plans, subject to the achievement of performance and balanced scorecard metrics, and underpin as applicable, and in accordance with the rules of the plan. • Authorise the application of the Malus and Clawback policy in relation to specific individual adjustments that may be agreed through the risk adjustment review process. • The Committee shall determine the design, performance measures and associated targets for any performance related pay schemes operated by the Company in respect of Executives and Material Risk Takers and review individuals' performance against those targets and agree any payments proposed. • The Committee shall consider not less than annually whether or not it is necessary to apply malus and/or clawback in relation to the performance related pay schemes.	• The Remuneration Committee considered the performance of the Chief Executive Officer against the measures set for 2014-15 in relation to the vesting of the 2013-2015 Long Term Incentive Plan. • The Committee approved the rules and performance measures of a Long Term Incentive Plan for 2015-2017. • In determining overall performance against 2015 Annual Incentive Plan, the Committee reviewed the specific measures against the CEO's scorecard. • The Committee considered the detailed end-year CRO annual report and consequent recommendations from the Individual Risk Adjustment Committee for in year adjustments. The Committee determined overall pool adjustments leading to a final bonus pool of 50% for the 2015 performance year and also considered and approved specific individual adjustments for MRTs where appropriate. • The Committee reviewed performance against agreed financial and non-financial measures, including application of capital requirements and made appropriate adjustments to bonus pool and individual awards. • For 2015, the Committee reviewed performance and risk events and concluded that no malus or clawback actions were required in relation to deferred and/or vested awards from previous years.

Directors' Remuneration policy

The Co-operative Bank's Remuneration policy for our Executive and Non-Executive Directors was approved by the shareholders at the 2015 AGM. The policy is available in full in last year's Directors' Remuneration report in the Annual Report and Accounts 2014, a copy of which can be obtained by visiting the following website: www.co-operativebank.co.uk/assets/pdf/investorrelations/annual-report.pdf

It is intended that approval of the Remuneration policy will be sought at three year intervals, unless amendments to the policy are required, in which case further shareholder approval will be sought at the appropriate time. There are no amendments proposed to the current policy for 2016.

Annual report on remuneration

The annual report on remuneration sets out how the Bank's policy was implemented in 2015, and how it will be implemented in 2016.

Single total figure of remuneration - Executive Directors

The following table shows a single total figure of remuneration received in 2015 by Executive Directors in respect of qualifying service together with comparative figures for 2014.

Single figure £000s

Audited

Executive Director	Salary	Role Based Allowance	Benefits[3]	Pension	Annual Incentive Plan (AIP)	Legacy LTIP	Total Remuneration
2015							
Niall Booker	1,255	1,285	32	201	502	576[1]	3,851
John Baines	400	350	18	64	100	–	932
2014							
Niall Booker	1,200	1,680	16	192	–	–	3,088
John Baines	100[2]	88	4	16	182[2]	–	390
Rodney Bulmer	97	–	4	15	–	–	116

1. In addition to this amount and as disclosed in our Directors' Remuneration report for 2014, one-third of the Long Term Incentive Plan award granted to Niall Booker in 2013 (representing performance for 2013) remained subject to the original performance measures of The Co-operative Group, with vesting of this one-third at the discretion of The Co-operative Group Remuneration Committee. This one-third was subject to five equally weighted performance measures as determined by The Co-operative Group in 2013: (1) the re-capitalisation of the Bank, (2) the introduction of rigorous cost control measures (including immediately realised cost savings and on-going targeted savings over the longer term), (3) the establishment of an upgraded senior management team and a High Performance Organisation, (4) the establishment of a new Group purpose and strategy, and (5) the safeguarding of the reputation of the Group through the turnaround. The Co-operative Group Remuneration Committee has reported to The Co-operative Bank its decision that 85% of this one-third of the 2013 Long Term Incentive Plan shall vest, resulting in an award to Niall Booker of £340,000 payable by The Co-operative Group, being satisfied in cash and will remain subject to the provisions of the Remuneration Code.
2. John Baines was appointed as an Executive Director on 1 October 2014. Data set out above for 2014 salary, pension and benefits relate to his part year qualifying service. In 2014 the AIP reported here is in respect of his full period of employment in 2014 – beginning 1 May 2014.
3. The benefits figure in 2014 included car cash allowance paid. 2015 benefits include the value of benefits in kind such as private medical insurance, life insurance, health screening and private health insurance.

Additional information in respect of each element of single figure of remuneration

The single total figure for 2015 for Executive Directors is higher than 2014 as Niall Booker was not eligible to receive an annual bonus in 2014 and there was no Long Term Incentive Plan vesting in 2014.

Salary

With effect from 10 June 2015, Niall Booker's annual base salary was increased from £1.20m to £1.30m. The value shown above is on a pro-rated basis. John Baines was appointed Executive Director on 1 October 2014.

Role Based Allowance (RBA)

With effect from 10 June 2015, Niall Booker's Role Based Allowance was reduced from £1.68m to £0.40m per annum. The value shown above is on a pro-rated basis. John Baines is paid a Role Based Allowance of £0.35m per annum.

Pensions

Executive Directors are entitled to a cash allowance in lieu of employer pension contributions.

Benefits

Taxable benefits include car allowance, private medical insurance, life insurance, health screening and private health insurance as applicable.

Long Term Incentive Plan (LTIP)

Legacy arrangements

2013 Co-operative Group Long Term Incentive Plan award for CEO (Group LTIP)

Niall Booker, in his capacity as Chief Executive Officer (CEO) of the Bank and Deputy CEO of The Co-operative Group was granted an award under The Co-operative Group LTIP upon his appointment, for the performance period 2013-2015. The rules of that plan were determined by The Co-operative Group which at the time was the Bank's sole shareholder and his employer.

Following the Bank's separation from The Co-operative Group, in which Niall Booker relinquished his role as Deputy CEO of the Group and became an employee of the Bank it was agreed that one-third of this award, representing performance for 2013, would remain subject to the original Group performance measures. Determination of achievement against these measures remained at the discretion of The Co-operative Group Remuneration Committee. Liability for any amounts relating to achievement against these measures is to be settled by The Co-operative Group at its sole cost.

The remaining two-thirds of the award was accepted by The Co-operative Bank in 2013. The original measures were retained, but performance targets were revised to reflect the Bank's performance for 2014 and 2015.

The overall performance period for the 2013-2015 Long Term Incentive Plan concluded on 31 December 2015. The decision of The Co-operative Bank Remuneration Committee, in respect of the two-thirds of the Long Term Incentive Plan attributable to performance in 2014 and 2015, is disclosed below.

Long Term Incentive Plan performance assessment against Bank's objectives (2014-2015)

The Remuneration Committee considered the performance of the Chief Executive Officer against the measures set for 2014-2015. It recognises the exceptional progress made by the Chief Executive Officer in successfully recapitalising the Bank and executing its orderly separation from the Group in a manner which preserved the unique ethos and brand legacy of both institutions. The Chief Executive Officer established strong relationships with external shareholders and regulators, made considerable progress in strengthening the Executive team, and developed the Revised Plan to return the Bank to a more stable trajectory and positive outlook.

Accordingly, the Remuneration Committee has determined that the award to the Chief Executive Officer for 2014-2015 of the Plan shall be £576,000; representing 72% of the potential outcome for those two years. In accordance with the original terms of the award, it will be satisfied in cash in 2016 and will remain subject to the Remuneration Code.

Financial measures

Performance measures	Weighting (as a % of total opportunity)	Target level of achievement	Performance against targets	Proportion of condition vesting
CET1 Ratio	20%	8.9%	15.5%	100% of condition vesting (40% of total award)
Operating Cost[1]	20%	£504m	£496.4m	

1. Total operating cost excluding Unity Trust Bank (UTB), fair value unwinds, FSCS Levy, project investment costs and conduct risk.

Strategic goals

Performance measures	Weighting (as a % of total opportunity)	Remuneration Committee assessment of actual performance against the condition	Performance against targets	Proportion of condition vesting
Talent	20%	• Consideration of progress in strengthening the Executive team. • Successful recruitment of key talent capable of implementing the plan, and leadership of this team in the execution of that	✓	53% of condition vesting (32% of total award)
Strategy	20%	• Recapitalisation of the Bank and execution of its orderly separation from The Co-operative Group in a manner which preserved the unique ethos and brand legacy of both institutions. • Developed the Strategic Plan to return the Bank to a more stable trajectory and positive outlook.	✓✓	
Reputation	20%	• Established effective relationships with external shareholders and regulators. • Progress in regaining the reputation of the Bank from a customer, employee and regulatory standpoint.	✓✓	
Total outcome under the plan	**100%**			**72%**

Executive Directors' variable pay 2015

Annual Incentive Plan (AIP) awards

This reflects the total Annual Incentive Plan (AIP) awards to be paid in April 2016, based on performance in the year ended 31 December 2015. This includes both the cash element and the portion deferred into shares.

The Executive Directors' AIP awards in respect of performance during 2015 were determined against a basket of financial and strategic metrics, and upon achievement of their personal objectives. Performance results in respect of each element of the AIP are set out in the table below.

Financial measures

Financial measures represented a maximum 50% of total AIP opportunity.

Audited

Financial measures	Weighting (as a % of total opportunity)	Achievement as a % of maximum: Threshold (0%) – Target (50%) – Maximum (100%)	Payout as a % of maximum
Bank-wide underlying income[1]	12.5%	90% (£531.4m) vs. £510.9m	11.3%
Operating Expenses[2]	12.5%	65% (£496.4m) vs. £503.8m	8.1%
CET1 ratio	12.5%	>100% (15.5%) vs. 12.0%	12.5%
Non-core RWAs	12.5%	>100% (£2,769m) vs. £3,586m	12.5%
Total Financial outcome	**50.0%**		**44.4%**

1. Total income (net interest income plus non-interest income excluding gains and losses on asset sales) across core and non-core business, excluding Unity Trust Bank (UTB), fair value unwinds and conduct risk.
2. Total operating expenses excluding Unity Trust Bank (UTB), fair value unwinds, FSCS Levy, project investment costs and conduct risk.

Strategic measures

Strategic measures represented a maximum 50% of total AIP opportunity.

Elements of Scorecard	Weighting (as a % of total opportunity)	Key achievements in the year	Payout as a % of maximum
Risk & Control	20.0%	• Delivery of a number of key strategic projects	8.5%
People	15.0%	• Significant increase in colleague engagement	12.5%
Customer	15.0%	• Improvements to key customer metrics	7.5%
Total Strategic outcome	**50.0%**		**28.5%**

Personal objectives

A summary of the assessment for Niall Booker and John Baines against their specific personal objectives is provided in the following table.

Executive Director	Key achievements in the year
Niall Booker	Highlights for 2015 include: • Sale of Optimum, Tier 2 capital raising, liquidity, Digital, brand improvement • Reduction on cost base
John Baines	Highlights for 2015 include: • Sale of Optimum, cost reduction, Tier 2 capital raising, liquidity improvements and development of Strategic Plan

Specific targets for the strategic measures and personal objectives are not disclosed due to commercial sensitivity.

The 2015 AIP was also subject to an underpin, where the Committee must be satisfied that the Bank's underlying financial performance justified payment. This was assessed by reference to Liquidity Risk Appetite. The Committee was satisfied that this requirement had been met.

Risk adjustment

The Bank is committed to ensuring that there is full alignment between risk, reward and performance when determining variable pay, and that appropriate adjustments are made to remuneration at individual and collective levels where necessary.

During 2015 the Committee undertook a comprehensive review of its end-to-end performance adjustment and bonus setting processes, resulting in a revised and more robust methodology for applying individual and/or collective adjustments to variable pay. A governance structure is now in place with a dedicated review body, the Individual Risk Adjustment Committee, which acts as an advisor to the CEO as he makes proposals to the Remuneration Committee and is comprised of senior representatives from key control functions.

In accordance with this governance structure, the Committee intends that those who are responsible or accountable for conduct and risk matters will be subject to appropriate adjustments to remuneration, including both in-year adjustments to bonuses and reductions to unvested deferred awards over the longer term (i.e. through malus). In line with our regulatory obligations and the Bank's commitment to maintaining and strengthening its focus on risk and conduct matters, the Committee will further embed and extend these principles across the reward framework in 2016.

The overall assessment of Bank performance resulted in 50% of the AIP bonus pool being approved for distribution. Individual awards for the Chief Executive Officer and Finance Director reflected further risk and performance adjustments, as determined by the Remuneration Committee.

Deferral policy

In line with the Remuneration Code, 60% of all 2015 AIP awards to Executive Directors are deferred for up to three years.

Audited

Executive Director	Upfront bonus[1] £000s	Deferred bonus[2] £000s	Total bonus £000s
2015			
Niall Booker	201	301	502
John Baines	40	60	100

1. Upfront bonus includes upfront cash and upfront notional shares deferred for six months.

2. At least 50% of the deferred bonus is delivered to the Executive Directors in the form of shares or share-linked instruments, i.e. notional shares linked to the Bank's share price.

Executive Directors: Other scheme interests awarded during 2015

The Directors' remuneration reporting regulations require inclusion in the single total figure of the value of the Long Term Incentive Plan Award for which the last year of performance ends in the relevant financial year and the vesting outcome is known. For 2015, this is the award to Niall Booker under the 2013 Co-operative Group Long Term Incentive Plan and further details are set out on page 88. The section below sets out other Long Term Incentive Plan schedules in which the Executive Directors participated, the outcome of which remains dependent on future performance.

Long Term Incentive Plan awards granted during 2015

Based on the approval received from the shareholders at the 2015 AGM, the Committee decided to grant awards under the 2015 – 2017 Long Term Incentive Plan to both Niall Booker and John Baines. These awards had a face value at grant date of 100% of their respective salaries as at 31 March 2015. The 2015 Long Term Incentive Plan is subject to the following performance measures.

Performance measures	Weighting	Threshold	Maximum vesting
Cost Income Ratio	25%	25% of award vest for cost income ratio of 74%	Cost income ratio of 64% or below
Absolute TSR per share	25%	25% of award vest for absolute TSR per share of 8% p.a.	Absolute TSR per share of 20% p.a. or above
Total RWAs (Non-core only)	20%	25% of award vest for total RWAs of £1,275m	Total RWAs of £1,097m or below
Total Financial measures	**70%**		
Risk & Control	10%	Performance against strategic measures will be assessed by the Remuneration Committee using individual scorecard ratings ranging from 1 – 10, with 50% of the award vesting at the threshold rating of 5. The detailed targets within each measure are not disclosed as these are deemed to be commercially sensitive. Retrospective disclosure will be provided in the 2018 Directors' Remuneration report, subject to commercial sensitivity no longer remaining.	
People	10%		
Customer	10%		
Total Strategic measures	**30%**		
TOTAL	**100%**		

Note: The weightings disclosed in the 2014 Directors' Remuneration report against Financial and Strategic measures were 60% and 40% respectively. These were amended to 70% (for financial measures) and 30% (for strategic measures) as approved by shareholders in June 2015.

Straight line vesting applies between the threshold and maximum points in respect of the financial measures.

The award is subject to a further condition applied by the Committee to determine if the Bank's underlying financial performance justifies vesting of the plan at the end of the performance period. This further condition applicable to the 2015-2017 Long Term Incentive Plan refers to CET1 ratio.

2014 transitional long term incentive

In recognition of performance during 2014, and in order to satisfy contractual commitments, transitional Long Term Incentive Plan awards were granted to both Executive Directors during 2015. This was disclosed in the 2014 Directors' Remuneration Report and received shareholder approval at the 2015 AGM. The Committee decided to grant transitional Long Term Incentive Plan award to Niall Booker and John Baines at a face value at grant date of 100% of their respective salary.

These awards were made in parallel with the 2015-2017 Long Term Incentive Plan award. The performance measures, targets and timeframes for the transitional Long Term Incentive Plan award are the same as outlined above in respect of the 2015 Long Term Incentive Plan award.

Non-Executive Directors' remuneration – 2015

The table below shows the current fee structure and actual fees paid in 2015 to Non-Executive Directors. No changes have been proposed for the 2016 year.

Audited

£000s	Base fee 2015	Committee Chairman fee[1] 2015	SID fee 2015	Committee member fee[2,3] 2015	Total fees 2015	Total fees 2014
Dennis Holt[4]	**300**	**–**	**–**	**–**	**300**	126
Laura Carstensen	**60**	**24**	**–**	**11**	**95**	47
Richard Coates	**60**	**24**	**–**	**11**	**95**	80
Graeme Hardie	**60**	**24**	**–**	**11**	**95**	80
Maureen Laurie	**60**	**24**	**–**	**11**	**95**	40
William Thomas	**60**	**–**	**–**	**11**	**71**	60
Derek Weir	**60**	**–**	**–**	**11**	**71**	26
Charles Bralver[5]	**40**	**–**	**–**	**11**	**51**	–
Aidan Birkett[6,7]	**30**	**–**	**3**	**4**	**37**	–

Non-Executive Directors are reimbursed for expenses incurred for business reasons. Any tax that arises on the reimbursed expense is paid by the Bank.

Notes:

1. Committee Chairman fee increased from £20,000 to £25,000 effective 31 March 2015. All the fees shown above are calculated on a pro-rated basis to reflect this. The fees are payable only once even if multiple committees are chaired.
2. Committee membership fee of £15,000 introduced with effect from 31 March 2015. The membership fees shown above are calculated on a pro-rated basis. The fees are payable only once even if multiple committees are attended.
3. A Non-Executive Director can be a member of various Committees such as Audit, Remuneration, Nomination, IPO, Values & Ethics and Risk.
4. Dennis Holt was appointed as Chairman with effect from 27 October 2014. His 2014 fees include Non-Executive Director fees for the period from 1 January 2014 to 26 October 2014.
5. Charles Bralver was appointed as a Non-Executive Director with effect from 23 April 2015.
6. Aidan Birkett was appointed as a Non-Executive Director with effect from 1 July 2015, a Committee member with effect from 23 September 2015 and a Senior Independent Director with effect from 27 October 2015
7. Senior Independent Director (SID) is entitled to a fee of £20,000 per annum. The SID fee paid to Aidan Birkett above is calculated on a pro-rated basis.

Payments for loss of office to Executive Directors

There were no payments for loss of office in 2015.

2016 Remuneration policy for Executive Directors

It is proposed to operate our forward-looking Remuneration policy in the following way in 2016:

Base Salary

The Executive Directors' base salaries will remain unchanged under the annual compensation review process as at 1 April 2016.

Name	Annual base salary as at 31 March 2016 £000s	Annual base salary effective 1 April 2016 £000s	% increase
Niall Booker	1,300	1,300	–
John Baines	400	400	–

Role Based Allowances

The Executive Directors' Role Based Allowances (RBA) will remain unchanged in 2016.

Name	Annual Role Based Allowance as at 31 December 2015 £000s	Annual Role Based Allowance effective 1 January 2016 £000s	% increase
Niall Booker	400	400	–
John Baines	350	350	–

Pension and benefits for 2016

Pension and benefits for 2016 will be unchanged and remain in line with the Directors' Remuneration policy approved by the shareholders at the 2015 AGM. A full copy of the policy can be obtained by visiting the website: www.co-operativebank.co.uk/assets/pdf/investorrelations/annual-report.pdf

Variable pay

Our proposed variable pay framework for 2016 is outlined below for annual and long term incentives. As outlined above in 2014, shareholders approved the flexibility to pay variable remuneration up to twice the amount of fixed remuneration, and our framework for 2016 falls within this limit.

Maximum opportunity for 2016	**The maximum total variable pay opportunity for both the Chief Executive Officer and the Finance Director is 200% of base salary.**

Annual Incentive Plan awards for 2016 financial year

The bonus structure will be consistent with the Directors' Remuneration policy approved by the shareholders at the 2015 AGM (link provided above). The maximum opportunity under the annual incentive plan will take into account the variable pay cap outlined above. The performance measures and weightings are shown below.

Performance measures and targets	The 2016 AIP awards will be subject to the performance measures set out below: • Financial measures (50%) • Strategic measures (50%) Payments to Executive Directors are made with reference to achievement of their individual objectives set at the start of the year, and approved by the Remuneration Committee at year end. Before any part of the 2016 AIP award can be considered, the Committee must be satisfied that the Company's underlying financial performance justifies payment. Details of the targets for AIP 2016 are commercially sensitive. Disclosure of the Bank's achievement against the targets will be made in the 2016 Annual Report and Accounts, subject to the commercial sensitivity no longer remaining.

Long Term Incentive Plan – 2016 awards

The Remuneration Committee intends to make a long term incentive award covering the period 2016-18 inclusive.

All Long Term Incentive Plan awards granted in 2016 will be subject to malus and clawback provisions in line with the remuneration policy.

Performance measures and targets	For all Long Term Incentive Plan awards granted in 2016, the performance period will be three financial years from 1 January 2016. The Committee intends that awards made in 2016 will vest by reference to a balanced scorecard of performance measures, listed below: • Financial measures (70%) • Strategic measures (30%) In addition, before any part of the 2016 Long Term Incentive Plan award can vest, the Committee must be satisfied that the Company's underlying financial performance justifies vesting, including achievement of a CET1 ratio hurdle.

Note: The performance measures and weighting used in the 2016 Long Term Incentive Plan is similar to the Long Term Incentive Plan award made to Executive Directors in 2015.

Comparison of Executive Director Remuneration policy with the wider employee population

The Bank has one Remuneration policy that is openly communicated and applied throughout the organisation. Our policy has been designed to support recruitment, motivation and retention and to encourage the highest standards of performance within the Bank's risk appetite. Furthermore, the policy is specifically aligned to the Bank's Values and Ethics policy.

The principles set out in the Remuneration policy inform decisions for all employees, including Executive Directors. The Remuneration Committee takes into account pay levels and benefit arrangements throughout the Bank to ensure the arrangements provided to Executive Directors are appropriate.

Remuneration packages may vary to take account of role-specific factors in different areas of the Bank and are determined by reference to market levels, skills requirements and internal relativities:

- AIP – Corporate performance measures are consistent for Executive Directors and other employees; the level of bonus opportunity differs by role to reflect levels of accountability and contribution to results. Bonus awards payable to employees classified as material risk takers for regulatory purposes are subject to deferral and part-payment in shares/share-like instruments in accordance with regulatory requirements.
- Long Term Incentive Plan – A limited number of senior Executives may be invited to participate in the Bank's Long Term Incentive Plan; having regard to accountability for delivery of the Revised Plan and strategy. The terms of the Long Term Incentive Plan apply equally to all participants, including Executive Directors.

The Remuneration Committee receives and considers internal and external information as appropriate to guide decisions on remuneration including, but not limited to, the results of employee satisfaction surveys and feedback sought from internal stakeholders (such as the CRO and Values and Ethics Committee) and external stakeholders

Consideration of Shareholder views

The Committee is committed to ongoing dialogue with shareholders and seeks the views of significant shareholders when any major changes are being contemplated.

The Committee takes into account the views of significant shareholders when formulating and implementing the Remuneration policy and recognises and incorporates shareholder feedback.

Statement of voting at last AGM

The results of the vote on the Directors' Remuneration report at the 2015 AGM is shown in the table below.

Resolution	Votes for	% of Votes cast	Votes against	% of votes cast	Total votes validly cast	Votes as % of issued ordinary share capital[1]	Votes withheld
2 To receive and approve the Directors' Remuneration report (other than the sections dealing with the Remuneration policy referred to in Resolution 3) for the year ended 31 December 2014	340,944,546	99.5%	1,634,079	0.5%	342,578,625	75.9%	50,000
3 To approve the Directors' Remuneration policy in the form set out in the Directors' Remuneration report for the year ended 31 December 2014	340,944,546	99.5%	1,634,079	0.5%	342,578,625	75.9%	50,000
17 To approve the Long Term Incentive Plan	342,578,625	100.0%	0	0.0%	342,578,625	75.9%	50,000

1. 451,456,510 ordinary shares, being the Bank's issued voting share capital as at 6.00pm on 15 June 2015, the time by which shareholders who wanted to attend and vote at the AGM must have been entered on the Bank's register of members.

Pillar 3 disclosures on Material Risk Takers

The Remuneration Committee is required to oversee remuneration for staff identified as Material Risk Takers.

Under the implementation of the European Capital Requirement Directive (CRD IV), new rules on remuneration were introduced with effect from 1 January 2014, and the definition of Material Risk Takers was revised. As part of these changes, the European Banking Association (EBA) published Regulatory Technical Standards containing qualitative and quantitative criteria to identify staff considered as Material Risk Takers, due to their professional activities having a material impact on the institution's risk profile.

In 2015, 71 Material Risk Takers were identified within the Bank according to the new criteria. This list was approved by the Remuneration Committee. Material Risk Takers are subject to the PRA Remuneration Code provisions which are applied in their remuneration arrangements and include:

- the deferral of at least 40-60% of their variable remuneration over a period of at least three years;
- the delivery of at least 50% of their variable remuneration in the form of shares or share-linked instruments, e.g. cash linked to the Bank's share price; and
- risk adjustment of any variable remuneration award, including: malus/clawback on Annual Incentive Plan, Deferred Bonus plan and Long Term Incentive Plan awards. In particular, for any award made on or after 1 January 2015, clawback may apply for up to seven years following award. Risk adjustment of remuneration, including malus and clawback, is decided by the Remuneration Committee on the basis of information provided by The Co-operative Bank internal control functions, reporting through the risk governance structure and an independent report provided by the Chief Risk Officer.

This section discloses the remuneration awards made by the Bank to Material Risk Takers in respect of the 2015 performance year

1. Aggregate remuneration – by division

	2015	
Division	Number of Material Risk Takers	Total Remuneration[2] £m
Retail Banking[1]	19	10.8
Corporate Functions	52	14.2
Total	**71**	**25.0**

1. CEO included in Retail Banking division, Non-Executive Directors included in Corporate Functions.
2. Total Remuneration is the amount of remuneration paid during the year i.e. pro-rated for joiners and leavers.

2. Aggregate remuneration – Senior Management and other Material Risk Takers

	2015	
	Number of Material Risk Takers	Total Remuneration £m
Senior Management[1]	20	14.5
Other	51	10.5
Total	**71**	**25.0**

1. Senior Management consists of Non-Executive Directors, Executive Directors and Executive Committee members only.

3. Aggregate remuneration – by fixed/variable remuneration

	2015	
	Senior Management £m	Others £m
Total fixed remuneration[1]	9.4	7.5
Total variable remuneration:	5.1	3.0
Cash bonus (AIP)[2]	0.6	0.7
Deferred bonus (DBP)[3]	0.9	0.4
Long Term Incentive Plan (LTIP)[4]	3.6	1.9
Total	**14.5**	**10.5**

1. Includes pension contribution.
2. Consists of up-front cash and notional shares deferred for six months.
3. Consists of cash and notional shares deferred from one to three years with pro-rated vesting.
4. Long Term Incentive Plan for both the Executive Directors include the Long Term Incentive Plan award for 2014 made in the current year.

4. Aggregate remuneration – deferred remuneration

	2015	
	Senior Management £m	**Others £m**
Unvested deferred remuneration from previous years[1]	**1.8**	**1.2**
Deferred remuneration reduced in 2015 through performance adjustments	**–**	**–**
Deferred remuneration awarded in 2015[2]	**4.5**	**2.4**
Deferred remuneration from previous years paid out in 2015[3]	**(0.6)**	**–**
Deferred unvested remuneration outstanding at 31 December 2015	**5.7**	**3.6**

1. As reported in last year's Directors' Remuneration report, £3.0m was the total deferred amount for both Senior Management and Others; and includes the 2013 legacy Group long term incentive awarded to the CEO at a maximum value of £0.8m representing Bank's liability for the two-thirds of the award.
2. Deferred remuneration awarded for performance year 2015 under the Deferred Bonus Plan, 2015 Long Term Incentive Plan and 2014 Transitional Long Term Incentive Plan.
3. Represents the value of the 2013 Group LTIP award vested in respect of performance period 2013-2015. The vested amount would be paid out in early 2016. Further details of the legacy Group LTIP award are provided on page 88.

5. Aggregate remuneration – sign-on and severance payments

	2015		
	Number of beneficiaries	**Senior Management £m**	**Others £m**
Sign-on payment[1]	**4**	**–**	**0.1**
Severance payment[2]	**1**	**0.6**	**–**

1. No sign-on payments were made in 2015. Four buy-out agreements for new hires in 2015 were made, totalling £136k, of which the highest payment was £75k. These payments were made to compensate the employee for forfeited bonus opportunity when joining the Bank.
2. There was one severance payment to an executive in 2015 of £600k.

6. Aggregate remuneration – High earners by band

Number of staff with total remuneration of EUR 1 million or more in 2015, by band[1]	**2015**
€1m – €1.5m	**4**
€1.5m – €2m	**3**
€2m – €2.5m	**1**
€2.5m – €3m	**–**
€3m – €3.5m	**–**
Above €3.5m	**1**

1. In accordance with Article 450 of the Regulation under CRD IV, the reporting of aggregate remuneration - high earners by band is prepared in Euros; using the rates published by the European Commission for Financial Programming and Budget for December 2015 (1 GBP is equal to 1.4227 Euro).

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Risk management

Risk management

For the year ended 31 December 2015

All amounts are stated in £m unless otherwise indicated

Introduction

This section of the Annual Report and Accounts explains Risk Management within the Bank. Within this section we will detail:

- Approach to risk management
- Risk Management Strategy and appetite
- Principal risk categories
- Risk governance structure

Contents

The following sections address the Bank's approach to risk management:

Risk Management objectives and policies

Overview

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

During the year the Bank continued to review its RMF which focused on aligning roles and responsibilities between 1st and 2nd lines of defence, updating the Bank's policy framework and the Bank's committee governance structure. The Bank will continue to review and enhance its RMF with particular reference to these key areas in 2016.

Risks and issues, whether crystallised or emerging inclusive of those observed in relation to the RMF are detailed within the Principal risks and uncertainties.

Approach to Risk Management

Responsibility for risk management resides at all levels of the Bank from the Board and the Executive Committee supported by senior management committees through the organisation to each business area subject to appropriate oversight. In line with this approach the Bank adopts the three lines of defence governance model which is outlined below:

- The Bank's business teams act as first line of defence and are responsible for identifying where a 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 area on a day to day basis, implementing monitoring and control processes to ensure that the Bank's business profile is understood and maintained within Board defined risk appetite.
- The Bank's Risk Framework owners act as the second line of defence. They draft the relevant policies, oversee and challenge the implementation and monitoring of the RMF and consider current and emerging risks across the Bank. They also oversee the appropriate escalation of breaches of appetite, mitigating actions and report these to the mandated Senior Management Committee.
- The Bank's Internal Audit function acts as the third line of defence. They are responsible for independently verifying that the RMF has been implemented as intended across the Bank, and independently challenge the overall management of the framework to provide assurance to the Audit Committee and senior management on the adequacy of both first and second lines.

Risk Management Strategy and Appetite

The Board has primary responsibility for identifying the key business risks facing the Bank, approving the Bank's Risk Management Strategy which includes setting the risk appetite which defines the type and amount of risk that the Bank is prepared to accept both qualitatively and quantitatively in pursuit of its strategic objectives. In addition the Board approves key regulatory documents including the Internal Liquidity Adequacy Assessment Process (ILAAP) and the Internal Capital Adequacy Assessment Process (ICAAP) which also includes appropriate stress testing, scenario analysis and contingency planning allowing it to understand the impact of potentially severe risks to ensure that it remains resilient to them.

The Bank's risk appetite is translated into specific risk measures that are tracked and monitored and reported to the appropriate Risk Committees and the Board. The Bank's Risk Appetite Framework has been designed to create clear links to the Bank's Updated Plan, capital planning, stress testing, job description, objective setting, performance management and the RMF whereby appropriate metrics and limits for each risk category are clearly established and recalibrated in line with the planning process.

Principal Risk Categories

The Bank's principal risks are categorised into capital, liquidity and funding, reputational and operational risks with further sub categories of risk underpinning capital including credit, model, pension, market, strategic and business. The Bank also assesses Operational risks at a more granular level which are considered within this principal risk type.

Subsets of the principal risks are currently categorised as most material to the Bank and these are denoted as such*.

Principal risks	Risk Definitions
Capital risk	The risk the Bank's regulatory capital resources are inadequate to cover its regulatory capital requirements.
Credit risk*	The risk to the Bank's earnings and capital arising from a borrower's failure to meet their legal and contractual obligations. The Bank currently has one principal Credit risk policy that is executed via the RMF through separate 2nd line accountability for Retail, Corporate and Treasury Credit Risk.
Model risk*	The risk of model failure or the inappropriate use of models resulting in potential loss, poor decision making and/or reputational damage.

Risk Management objectives and policies continued

Principal risks	Risk Definitions
Pension risk*	The risk to Bank Capital and Company funds from exposure to defined benefit scheme liabilities (to the extent that liabilities are not matched by scheme assets) and risks inherent in the valuation of scheme liabilities and assets.
Market risk*	The risk of loss as a result of the value of financial assets or liabilities (including off balance sheet instruments) being adversely affected by the movement in market prices, interest rates or exchange rates. This loss can be reflected in the near term earnings by changing net interest income, or in the longer term as a result of changes in the economic value of future cash flows.
Strategic and Business risk*	Any risk to a firm arising from changes in its business, including the acute risk to earnings posed by falling or volatile income and the broader risk of a firm's business model or strategy proving inappropriate due to macroeconomic, geographical, industry, regulatory or other factors.
Liquidity and Funding	The risk that the Bank is unable to meet its obligations as they fall due or can only do so at excessive cost.
Reputational risk	The risk of damage to how the Bank's reputation, brand or image are perceived by its internal or external stakeholders as a result of its conduct, performance, or the impact of operational failures or other external issues.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or external events.
Conduct risk*	The risk that the Bank's behaviours, offerings or interactions will result in unfair outcomes for customers.
Regulatory risk*	The risk that the Bank and subsidiaries breach the letter and spirit of relevant laws, regulations, and codes of practice or standards of good market practice. Changes in the regulatory environment may adversely affect the Bank's ability to deliver its Updated Plan.
People risk*	The risk associated with inappropriate employee behaviour, inadequate resource (people, capability and frameworks), resulting in customer or financial detriment, and legal or regulatory censure.
Anti-Money Laundering risk*	The risk that the Bank may be used to facilitate the laundering of the proceeds of crime, the financing of terrorist activity or breach financial sanction legislation.
Fraud risk*	The risk that the bank is exposed to uncontrolled levels of financial crime resulting in unplanned fraud losses, reduced customer confidence and reputational damage.
Product risk*	The risk that the Bank's products result in unfair outcomes to customers, significant compliance breaches, financial loss, or reputational damage.
Financial Reporting risk*	The risk of reputational damage resulting in loss of investor confidence, prejudicing relationships with the regulatory authorities and/or financial loss caused by incorrect Financial Reporting arising from: the adoption of inappropriate accounting policies; ineffective controls over financial, regulatory, taxation and management reporting; failure to manage the associated risks of changes in financial, regulatory and taxation requirements; and failure to disclose accurate information about the Bank on a timely basis.
Information and Data risk*	The risk associated with theft, loss, or misuse of information or the processing of inaccurate information, resulting in customer or financial detriment, and legal or regulatory censure.
Payment risk*	The risk of failure to correctly make or receive customer payments, respond to customer payment instructions when requested or rectify payment errors for customers, as outlined in terms and conditions, regulatory requirements and payment scheme rules resulting in poor customer outcomes, financial loss to the Bank or customer and/or potential regulatory or scheme fines.
Legal risk*	Legal risk is defined as the risk that the Bank is not compliant with applicable laws, contractual arrangements with customers, suppliers or other third parties are not enforceable as intended, are enforced against the Bank in an unexpected way or do not operate as expected. Legal risk may occur when the Bank's assets are not legally protected (e.g. intellectual property, real estate property) or when litigation by or against the Bank is not appropriately managed to protect the Bank's reputation and achieve the best outcome or the Bank mismanages relationships with competition authorities and breaches competition laws. In each of the legal risks cases identified above, the result that the Bank is exposed to legal and/or regulatory censure, financial loss, and/or reputational damage.
Technology risk*	The risk of financial and non-financial impacts resulting from the lack of effective IT systems operability.
Change risk*	The risk of change not being delivered successfully (Delivery Risks) and/or that the change deliverables adversely impact the Banks risk profile (Associated Risks of Change). This definition covers all change activities including transformation, projects and business funded change activities.
Third Party Supplier risk*	The risk of reputational, financial and non-financial loss associated with all third parties relied upon to provide services and or products which support the operations and performance of the Bank.

Risk Management objectives and policies continued

Principal risks	Risk Definitions
Physical Assets risk*	The risk associated with internal and external threats, either deliberate or accidental, against physical assets, colleagues, and customers that could cause financial and/or non-financial losses, damage to or non-availability of the Bank assets.
Insurance risk*	The risk financial exposures caused by an insured event, will not be payable by our insurance, or events occur where self insurance or external insurance was not available, could cause losses of an unforeseen magnitude.
Business Continuity risk*	Business Continuity Risk is defined as the risk associated with the inability of the Bank to continue delivery of products or services at acceptable predefined levels following a disruptive incident.

The Board is the key governance body and is responsible for the Bank's strategy, performance, and ensuring appropriate and effective risk management. It has delegated responsibility for the day to day running of the business to the Chief Executive. The Chief Executive has established the Executive Committee to assist in the management of the business and deliver against the strategy in an effective and controlled way.

The Board has established Board Committees and senior management committees as well as appropriate forums to oversee the RMF, including identifying the key risks facing the Bank and assessing the effectiveness of any risk management actions.

Committee	Risk focus
Executive Committee (ExCo)	The Executive Committee manages the business in line with risk appetite, and in doing so ensures the implementation of the risk strategy set by the Bank's Board so as to deliver an effective risk management environment.
Transformation Committee (TC)	The Transformation Committee is responsible for ensuring the successful implementation, prioritisation and funding of projects across the Bank in line with the Board's Updated Plan. As such the committee assists the Chief Administrative Officer (CAO) in prioritising projects within available resources and agreed investment budgets, overseeing the Bank's transformation programme funding position policies, processes and standards to effectively manage the Bank's transformation programme risk profile.
Executive People Committee (EPC)	The Executive People Committee is responsible for the review of key people data within the Bank such as headcount, retention, overseeing the hiring of senior roles and all remuneration policies below the Executive level.
Asset and Liability Committee (ALCO)	The Asset and Liability Committee is primarily responsible for overseeing the management of capital, market, liquidity and funding risks. Its responsibilities include identifying, managing and controlling the Bank's balance sheet risks in executing its chosen business strategy, ensuring that the capital and liquidity position of the Bank is managed in line with policy and that adequate capital is maintained at all times, overseeing and monitoring relevant risk control frameworks and recommending relevant principal risk policies, detailed risk appetite limits for approval and approval of all product pricing proposals.
Enterprise Risk Oversight Committee (EROC)	The Enterprise Risk Oversight Committee purpose is to provide a mechanism to ensure all the Bank's risks are reviewed, challenged and approved in line with decisions made at ExCo (with escalation to the BRC where required). The Enterprise Risk Oversight Committee achieves some of its objectives through delegating responsibility to sub-committees: Model risk, Conduct & Regulatory risk, Operational risk and Credit Risk Oversight Committees. The sub-committees will approve, discuss or note papers and escalate to the EROC where relevant or where required by governance. EROC will escalate where appropriate to the Board via the Board Risk Committee.
Investment Planning Committee (IPC)	The Investment Planning Committee is responsible for overseeing and challenging the execution of all significant investments, divestments and major capital expenditure proposals. As such it ensures that all investments are being made in accordance with the Board's Updated Plan and that the investment portfolio remains balanced when considering investment demands against available resources.
Project Oversight Committee (POC)	The Project Oversight Committee is responsible for overseeing and challenging the delivery of the Bank's Change Portfolio ensuring there is clarity of delivery outcomes, that benefits are delivered within agreed time, cost and quality thresholds, that sponsors have the necessary executive support to deliver successfully and that key risks and issues threatening delivery are being effectively managed.
Strategic Transactions Committee (STC)	The Strategic Transactions Committee reviews, challenges and approves (where permitted within the authority delegated to it) strategic transactions designed to achieve a de-leveraging of the balance sheet in line with the strategy outlined by the Board for Non-core assets held within the Corporate CoAM business. In making its decisions it ensures that sanctioned deals are approved in line with delegated financial authorities and risk assessments are carried out by the Chief Risk Officer (CRO) or other directors in the Risk division.

Risk Management objectives and policies continued

Committee	Risk focus
Credit Risk Oversight Committee (CROC)	The Credit Risk Oversight Committee's purpose is to monitor significant credit risks and issues with the entire credit life cycle, the controls and management actions being taken to mitigate them and to hold to account the executives responsible for actions. This includes but is not limited to proposing, monitoring and reviewing the credit risk appetite (current and emerging) of the Bank ensuring that key risk exposures are managed within risk appetite, and reported to EROC, and that appropriate mitigating actions are taken; and that operational adherence to the RMF through a process of ongoing continuous improvement and review of the credit risk strategy is achieved while making recommendations to EROC as appropriate.
Model Risk Oversight Committee (MROC)	The Model Risk Oversight Committee is a sub-committee of EROC and the core objective is to provide oversight and challenge including independent validation of model governance.
Operational Risk Oversight Committee (OROC)	The Operational Risk Oversight Committee oversees the design and maintenance of the Bank's Operational Risk Framework and the risk control frameworks. In addition to this the OROC recommends to the CEO, CRO and the EROC relevant underlying policies and detailed risk appetite limits for approval.
Conduct and Regulatory Risk Oversight Committee (CRROC)	The Conduct and Regulatory Risk Oversight Committee provides oversight of the Bank's Risk Management Framework in respect of regulatory, conduct, fraud, anti-money laundering and product risks.
Technology Steering Committee (TSC)	The Technology Steering Committee acts to support the Chief Information Officer (CIO) in developing and executing the Bank's IT strategy. The TSC provides a forum for Executive input to strategic IT decisions, policy, planning and prioritisation, maintaining alignment between IT strategy and Business strategy. It assesses potential risks and benefits from future technology changes.

A number of senior management committees are supported by either Management Forums or sub-committees. The purpose of these is to assist the senior management committees to exercise their respective mandate. They do not hold any delegated authorities or decision making powers as they are retained by the respective senior management committees. The key forums and sub-committee are:

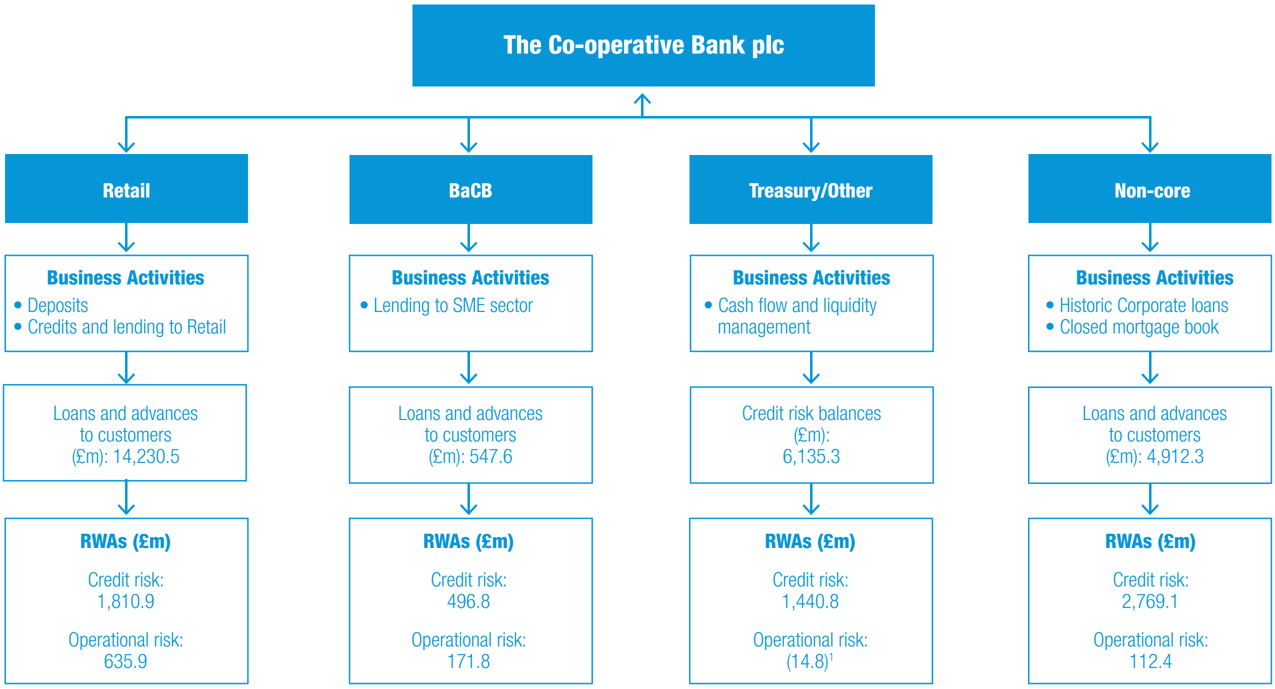
Forums	Risk focus
Liquidity and Market Risk Forum (LMRF)	The Liquidity and Market Risk Forum (LMRF) is a forum reporting to the ALCO. The role of the LMRF is to define the lower level governance requirements for liquidity and market risk across the Bank. The forum oversees and challenges all aspects of liquidity and market risk management and makes appropriate recommendations to ALCO as required.
Capital Management Forum (CMF)	The role of the CMF is to review, challenge and monitor the Bank's capital adequacy, in line with Capital policy and within risk appetite and review of capital adequacy stress testing. The CMF is responsible for making recommendations to ALCO as appropriate.
Secured Funding Review Forum (SFRF)	The primary monitoring of secured funding is via the forum and is responsible for making appropriate recommendations to ALCO as required.
Strategic Asset Review Committee (SAR)	The Strategic Asset Review (SAR) is a committee, established by CoAM Operating Committee for the strategic review of Corporate Performing and Non-performing assets within Corporate CoAM. Lending proposals presented to SAR are sanctioned within the Credit Discretion Matrix.

All amounts are stated in £m unless otherwise indicated

Risk Management objectives and policies continued

Risk Profile of the Bank

This diagram shows the business activities of each of the divisions of the Bank and the RWAs which reside in each division:



Other principal risks are outlined in the principal risks table before

1. The capital requirement for operational risk is calculated using prior years operating income; the reported Treasury income for 2014 was £(42.8)m resulting in a negative calculation of RWA. CRR allows for positive income values in business line activity to be offset by negative income providing the overall total is not less than zero.

All amounts are stated in £m unless otherwise indicated

1. Credit risk

1.1 Overview and credit exposure

Credit risk is part of the principal risk of capital as set out in the Risk Management Framework and is an integral part of the business activities. Credit risk is managed through a framework that sets out policies and procedures covering both its measurement and management. There is a clear segregation of duties between transaction originators in the business and approvers in the Risk function. All credit exposure limits are approved within a defined credit approval authority framework. The Bank manages its credit exposures through diversification across products, geographies, client and customer segments.

The following analysis of credit exposure shows:

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

Cash and balances at central banks are credit exposures with the Bank of England and have been excluded from the analysis.

Audited

31 December 2015	**Loans and advances to banks**	**Loans and advances to customers**	**Investment securities**	**Derivative financial instruments**	**Total**
Analysis of balances in notes	**16**	**17a**	**18**	**19**	
Gross balance	**871.0**	**19,935.6**	**4,894.2**	**370.1**	**26,070.9**
Less: allowance for losses	**–**	**(245.2)**	**–**	**–**	**(245.2)**
	871.0	**19,690.4**	**4,894.2**	**370.1**	**25,825.7**
Analysis of credit risk exposure					
Not impaired	**871.0**	**18,974.2**	**4,894.2**	**370.1**	**25,109.5**
Impaired	**–**	**961.4**	**–**	**–**	**961.4**
	871.0	**19,935.6**	**4,894.2**	**370.1**	**26,070.9**
Credit commitments	**–**	**2,710.2**	**–**	**–**	**2,710.2**
Gross credit risk exposure	**871.0**	**22,645.8**	**4,894.2**	**370.1**	**28,781.1**
Less: allowance for losses	**–**	**(245.2)**	**–**	**–**	**(245.2)**
Net credit risk exposure	**871.0**	**22,400.6**	**4,894.2**	**370.1**	**28,535.9**

31 December 2014	Loans and advances to banks	Loans and advances to customers[1]	Investment securities	Derivative financial instruments	Total
Analysis of balances in notes	16	17a	18	19	
Gross balance	1,608.4	26,240.7	4,422.5	470.7	32,742.3
Less: allowance for losses	–	(539.9)	–	–	(539.9)
	1,608.4	25,700.8	4,422.5	470.7	32,202.4
Analysis of credit risk exposure					
Not impaired	1,608.4	23,827.2	4,422.5	470.7	30,328.8
Impaired	–	2,413.5	–	–	2,413.5
	1,608.4	26,240.7	4,422.5	470.7	32,742.3
Credit commitments	154.9	2,905.2	–	–	3,060.1
Gross credit risk exposure	1,763.3	29,145.9	4,422.5	470.7	35,802.4
Less: allowance for losses	–	(539.9)	–	–	(539.9)
Net credit risk exposure	1,763.3	28,606.0	4,422.5	470.7	35,262.5

1. Includes loans and advances held for sale of £323.4m. Nil for 2015.

Impaired and not impaired balances in the tables above are defined in the sections on Retail credit risk, Corporate credit risk and investment securities credit risk.

1. Credit risk continued

Fair value adjustments

At the time of the merger of Britannia Building Society with the Bank in 2009, the assets and liabilities of Britannia Building Society were acquired at estimated fair values.

For the purposes of internal management reporting of coverage ratios and to better understand peer comparatives, loss provisions are grossed up by the amount of remaining credit fair value adjustments and compared to the gross amounts owed by customers, as shown in the Credit risk management section. The value of the fair value adjustments has significantly reduced due to the deleverage of the Corporate book and the Warwick Finance One and Warwick Finance Two securitisation of the Optimum book. This is discussed further in the detailed financial review.

1.2 Credit risk management

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

- 1.2.1 Loans and advances to customers;
- 1.2.2 Investment securities;
- 1.2.3 Loans and advances to banks; and
- 1.2.4 Derivative financial instruments.

1.2.1 Loans and advances to customers

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

The disclosures in sections Secured residential credit risk, Unsecured retail credit risk and Corporate credit risk are all based on the gross customer balances in the below tables.

The Non-core business continues to carry additional impairment risk given the underlying assets which includes Optimum, a closed book of predominantly interest-only intermediary and acquired mortgage book assets. 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 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. Any significant future impairment of these borrowers would result in a disproportionate impact on the Bank's operating results and financial position. The risk of this occurring has significantly reduced due to the deleverage of the Corporate book and the Warwick Finance One and Warwick Finance Two securitisations of the Optimum book resulting in balances reducing from £10.9bn as at 31 December 2014 to £5.0bn as at 31 December 2015.

The decrease in impairment provisions in the year to 31 December 2015 for the Non-core Corporate division was driven primarily by the successful execution of the Non-core strategy, being driven by deleverage activity and updated collateral values. This resulted in £0.3bn of provisions being written off on loans with no future economic value. This is referred to in more detail in the detailed financial review.

The majority of the Bank's shareholding in Unity Trust Bank has been sold during 2015 and so Unity Trust Bank is not consolidated within the 2015 numbers. In prior years it was accounted for as a subsidiary of the Bank. However, as it operated its own credit processes as a separate bank it was not included in the subsequent 2014 comparatives analysis of credit risk.

The Bank's exposures are predominantly within the UK and so any geographic analysis is only UK based. At 2015 year end the amount of overseas exposure is £168m (£130m Corporate and £38m Unsecured). This represents 0.7% of the total credit risk exposure.

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Audited

	Core				Non-core		
	Retail Banking						
31 December 2015	**Secured**	**Unsecured**	**BaCB**	**Unity Trust Bank**	**Corporate**	**Optimum**	**Total**
Analysis of balances in note 17a							
Gross loans & advances	**13,456.5**	**878.3**	**549.4**	**–**	**2,176.9**	**2,874.5**	**19,935.6**
Less: allowance for losses	**(3.8)**	**(100.5)**	**(1.8)**	**–**	**(125.9)**	**(13.2)**	**(245.2)**
	13,452.7	**777.8**	**547.6**	**–**	**2,051.0**	**2,861.3**	**19,690.4**
Analysis of credit risk exposure							
Not impaired	**13,305.3**	**751.5**	**516.6**	**–**	**1,822.8**	**2,578.0**	**18,974.2**
Impaired	**151.2**	**126.8**	**32.8**	**–**	**354.1**	**296.5**	**961.4**
	13,456.5	**878.3**	**549.4**	**–**	**2,176.9**	**2,874.5**	**19,935.6**
Credit commitments (incl. Derivative & Cont Liab)	**514.1**	**1,810.1**	**180.2**		**205.8**	**–**	**2,710.2**
Gross credit risk exposure	**13,970.6**	**2,688.4**	**729.6**	**–**	**2,382.7**	**2,874.5**	**22,645.8**
Less: allowance for losses	**(3.8)**	**(100.5)**	**(1.8)**	**–**	**(125.9)**	**(13.2)**	**(245.2)**
Net credit risk exposure	**13,966.8**	**2,587.9**	**727.8**	**–**	**2,256.8**	**2,861.3**	**22,400.6**
Reconciliation of acccounting to customer balances							
Gross loans & advances	**13,456.5**	**878.3**	**549.4**	**–**	**2,176.9**	**2,874.5**	**19,935.6**
Fair value adjustments (LEL)	**–**	**–**	**–**	**–**	**0.8**	**15.6**	**16.4**
Other accounting adjustments[2]	**(85.5)**	**(41.4)**	**3.1**	**–**	**(25.5)**	**(3.4)**	**(152.7)**
Gross customer balances	**13,371.0**	**836.9**	**552.5**	**–**	**2,152.2**	**2,886.7**	**19,799.3**

	Core				Non-core		
	Retail Banking						
31 December 2014	Secured	Unsecured	BaCB	Unity Trust Bank	Corporate	Optimum	Total
Analysis of balances in note 17a							
Gross loans & advances[1]	13,570.2	1,067.9	649.1	175.2	4,400.2	6,378.1	26,240.7
Less: allowance for losses	(2.2)	(106.1)	(3.6)	(2.6)	(403.5)	(21.9)	(539.9)
	13,568.0	961.8	645.5	172.6	3,996.7	6,356.2	25,700.8
Analysis of credit risk exposure							
Not impaired	13,424.2	931.9	622.4	165.9	3,184.2	5,498.6	23,827.2
Impaired	146.0	136.0	26.7	9.3	1,216.0	879.5	2,413.5
	13,570.2	1,067.9	649.1	175.2	4,400.2	6,378.1	26,240.7
Credit commitments	346.3	2,013.1	249.8	44.3	251.7	–	2,905.2
Gross credit risk exposure	13,916.5	3,081.0	898.9	219.5	4,651.9	6,378.1	29,145.9
Less: allowance for losses	(2.2)	(106.1)	(3.6)	(2.6)	(403.5)	(21.9)	(539.9)
Net credit risk exposure	13,914.3	2,974.9	895.3	216.9	4,248.4	6,356.2	28,606.0
Reconciliation of acccounting to customer balances							
Gross loans & advances	13,570.2	1,067.9	649.1	175.2	4,400.2	6,378.1	26,240.7
Fair value adjustments (LEL)	3.7	–	–	–	86.5	76.3	166.5
Other accounting adjustments[2]	(2.9)	(42.9)	0.2	–	(65.4)	(4.3)	(115.3)
Gross customer balances	13,571.0	1,025.0	649.3	175.2	4,421.3	6,450.1	26,291.9

1. Includes loans and advances held for sale of £323.4m. Nil for 2015.

2. Other accounting adjustments include accrued interest, interest fair value adjustments and effective interest rate adjustments.

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

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 year to 31 December 2015, 12% of mortgages (2014: 24%) were originated directly and 88% through intermediaries (2014: 76%).

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, these loans have been advanced on a capital and interest payment basis, where the debt is repaid over the term of the loan, or interest only where the capital element of the loan is repayable at the end of the term. All new advances are on a capital repayment basis, with the exception of buy-to-let lending and existing interest only loans for customers moving home.

During the term of the mortgage, interest only mortgages are managed on the same basis as capital and repayment mortgages. The Bank has an ongoing customer contact strategy to identify the repayment plans that are in place for all customers who hold an interest only mortgage.

The table below shows residential mortgage completions in the year, analysed by loan-to-value (LTV) and repayment method:

Audited

	2015			2014		
	Advanced Amount	**Average LTV%**	**Interest Only %**	Advanced Amount	Average LTV %	Interest Only %
Retail prime	**357.1**	**60.8**	**0.9**	291.7	56.2	1.1
Platform prime	**1,962.8**	**73.9**	**–**	771.3	67.4	–
Total prime	**2,319.9**	**71.5**	**0.1**	1,063.0	64.0	0.3
Buy-to-let	**475.2**	**67.0**	**89.6**	169.7	65.0	86.8
Almost prime	**–**	**–**	**–**	0.1	52.2	–
Total Completions	**2,795.1**	**70.7**	**15.4**	1,232.8	64.2	12.2

A focused drive in intermediary introduced mortgages coupled with increased market offerings has led to the level of completions in 2015 being significantly higher than in 2014. Increased lending via the Platform brand has been achieved following a policy change in September 2014 offering LTV's up to 90% (previously 85%) with the level of completions managed via pricing strategy changes.

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

Mortgages originated prior to 2009 by Platform, or acquired by Britannia, are managed as part of the closed Optimum portfolio. These loans include a range of asset types, including prime residential (both income verified and self-certified), buy-to-let and non-conforming mortgages, as discussed above.

The table below shows gross customer balances for residential mortgages analysed by current LTV banding and repayment method.

	31 December 2015				
	Retail Secured		**Optimum**		
	Interest Only	**Other**	**Interest Only**	**Other**	**Total**
Less than 50%	**1,299.5**	**5,097.8**	**288.7**	**165.8**	**6,851.8**
50% to 60%	**560.8**	**1,797.6**	**382.6**	**84.6**	**2,825.6**
60% to 70%	**524.8**	**1,762.4**	**517.3**	**87.7**	**2,892.2**
70% to 80%	**224.1**	**1,204.7**	**562.6**	**71.2**	**2,062.6**
80% to 90%	**70.8**	**684.8**	**418.9**	**22.5**	**1,197.0**
90% to 100%	**37.9**	**88.1**	**205.9**	**3.9**	**335.8**
Greater than 100%	**11.1**	**6.6**	**72.7**	**2.3**	**92.7**
	2,729.0	**10,642.0**	**2,448.7**	**438.0**	**16,257.7**

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

	31 December 2014				
	Retail Secured		Optimum		
	Interest Only	Other	Interest Only	Other	Total
Less than 50%	1,294.6	4,981.5	392.8	375.9	7,044.8
50% to 60%	614.4	1,859.3	542.4	221.8	3,237.9
60% to 70%	533.2	1,929.8	940.1	250.5	3,653.6
70% to 80%	238.7	1,422.6	1,077.2	233.8	2,972.3
80% to 90%	105.1	401.4	1,060.5	151.3	1,718.3
90% to 100%	73.0	64.0	723.4	50.3	910.7
Greater than 100%	34.0	19.4	414.3	15.8	483.5
	2,893.0	10,678.0	5,150.7	1,299.4	20,021.1

Interest only balances are contractually due to mature as shown below:

Audited

	31 December 2015					
	< 1 year	**1-5 years**	**5-10 years**	**10-20 years**	**20+ years**	**Total**
Retail Secured	**104.7**	**309.3**	**527.0**	**1,296.3**	**491.7**	**2,729.0**
Optimum	**51.6**	**141.7**	**315.4**	**1,849.6**	**90.4**	**2,448.7**
	156.3	**451.0**	**842.4**	**3,145.9**	**582.1**	**5,177.7**

	31 December 2014					
	< 1 year	1-5 years	5-10 years	10-20 years	20+ years	Total
Retail Secured	100.7	370.0	575.3	1,436.7	410.3	2,893.0
Optimum	59.9	340.7	659.5	3,870.9	219.7	5,150.7
	160.6	710.7	1,234.8	5,307.6	630.0	8,043.7

Retail secured interest only balances have reduced by 6% during the period, with a shift in LTV distribution largely due to improvements in HPI. Other retail balances have remained broadly stable. A shift towards the lower risk LTV bands is less pronounced for non-interest only balances due to the increase in higher lending via Platform Prime, most notable in LTV band 80-90%.

Total Retail exposure with current LTV less than 50% has remained stable in the year to 31 December 2015 (48%). The average current LTV for this segment of exposures, totalling £6.4bn (2014: £6.3bn) is 22% (2014: 24%).

Optimum balances have significantly declined due to Warwick One and Two securitisations, with a shift towards the lower risk LTV bands due to improvements in HPI.

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

The table below shows gross customer balances for residential mortgages analysed by types of mortgage and average LTV:

Audited

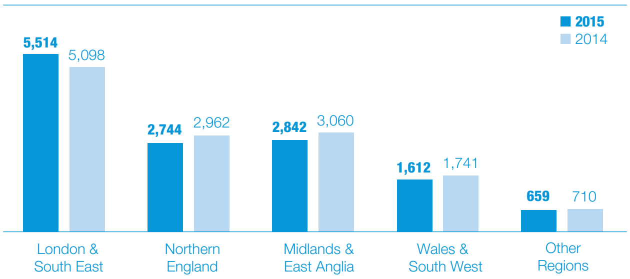
	31 December 2015					
	Retail Secured			Optimum		
	Gross customer balance	Average LTV %	Interest only %	Gross customer balance	Average LTV %	Interest only %
Prime Residential	**12,241.4**	**49.1**	**14.3**	**190.8**	**70.5**	**83.4**
Buy-to-let	**1,034.7**	**56.9**	**88.5**	**984.2**	**65.1**	**94.3**
Self-certified	**61.2**	**39.9**	**87.2**	**830.6**	**66.3**	**86.1**
Almost prime	**32.4**	**44.4**	**33.1**	**464.1**	**77.8**	**76.8**
Non-conforming	**1.3**	**55.8**	**47.1**	**417.0**	**63.6**	**69.6**
	13,371.0	**49.7**	**20.4**	**2,886.7**	**67.6**	**84.8**

	31 December 2014					
	Retail Secured			Optimum		
	Gross customer balance	Average LTV %	Interest only %	Gross customer balance	Average LTV %	Interest only %
Prime Residential	12,658.4	50.2	16.8	566.2	76.4	75.1
Buy-to-let	797.2	55.8	87.1	1,893.1	69.3	92.9
Self-certified	71.7	43.4	85.6	1,701.2	71.0	79.7
Almost prime	42.1	48.5	29.6	770.4	83.2	72.4
Non-conforming	1.6	58.8	46.5	1,519.2	73.7	69.4
	13,571.0	50.5	21.3	6,450.1	73.1	79.9

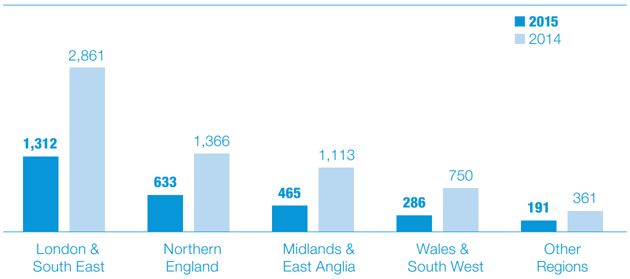
The charts below show gross customer balances analysed by geographical location, within the UK:

Audited

Retail secured



Optimum



All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

There has been a general downward trend in average LTV across both Retail Secured and Optimum as a result of increasing indexed valuations. In Retail Secured this impact has been partially offset by the increased volume of new lending through Platform which has higher average LTV's.

Collateral

Mortgages are secured by a first charge over the property being purchased or remortgaged. Valuation of the property is normally assessed by a Royal Institution of Chartered Surveyors (RICS) certified surveyor from the Bank's approved panel. Valuations may also be assessed through the use of an automated valuation model (AVM).

The Bank reassesses the valuation of collateral for the non-default book on a quarterly basis using a regional property price index. The table below analyses the indexed value of property collateral held against mortgage portfolios:

Audited

	31 December 2015					
	Retail Secured			Optimum		
	Gross customer balance	Collateral	Cover %	Gross customer balance	Collateral	Cover %
Impaired	**151.2**	**150.8**	**99.7**	**296.5**	**293.3**	**98.9**
Not impaired	**13,219.8**	**13,214.3**	**100.0**	**2,590.2**	**2,584.7**	**99.8**
	13,371.0	**13,365.1**	**99.9**	**2,886.7**	**2,878.0**	**99.7**

	31 December 2014					
	Retail Secured			Optimum		
	Gross customer balance	Collateral	Cover %	Gross customer balance	Collateral	Cover %
Impaired	146.1	145.6	99.7	955.8	942.1	98.6
Not impaired	13,424.9	13,416.6	99.9	5,494.3	5,473.1	99.6
	13,571.0	13,562.2	99.9	6,450.1	6,415.2	99.5

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. For the purposes of determining capital and impairment, appropriate forced sale discounts are applied to collateral.

Impairment

Where objective evidence of impairment has been observed as a result of one or more loss events, the impairment held at the balance sheet date is defined as identified impairment. Loans under forbearance are subject to a specific identified impairment assessment. Loans where no objective evidence has been observed are collectively assessed for unidentified impairment (ie where a loss event has occurred, but objective evidence of impairment has not yet been identified).

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Certain loans are separated into discrete pools for the assessment of potential impairment, which has not been specifically identified but which we know has occurred due to specific conditions. These are:

- Loans which are in arrears by less than one monthly instalment; and
- Loans where 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 effective interest rate of the loan to reflect the anticipated time to sale, and taking into account anticipated fees and costs prior to sale.

The shortfall is multiplied by the probability the loan will default and further multiplied by the probability that the loan will be taken into possession to determine the impairment required.

The table shown below reports coverage ratios calculated using:

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

Audited

	31 December 2015		31 December 2014	
	Retail Secured	**Optimum**	Retail Secured	Optimum
Gross loans and advances	**13,456.5**	**2,874.5**	13,570.2	6,378.1
of which impaired	**151.2**	**296.5**	146.0	879.5
Impaired as a % of gross loans and advances	**1.1%**	**10.3%**	1.1%	13.8%
Allowance for losses	**3.8**	**13.2**	2.2	21.9
Coverage	**2.5%**	**4.5%**	1.5%	2.5%

Retail Secured loans and advances have remained largely static over the year reflecting the fact that new advances have been offset by maturities/amortisations. Retail Secured impairment as a percentage of gross loans and advances has remained at a similar level year on year reflecting the lower level of risk within the secured book. The allowance for losses has shown an increase resulting in an upward movement in the coverage %. This has resulted from the removal of the final Merger Fair Value.

The reduction in Optimum impairment provisions in the year to 31 December 2015 was driven primarily by the securitisation of part of the Non-core Optimum portfolio through Warwick Finance One and Warwick Finance Two totalling £3.1bn, improvements in forecast house price movements reducing the anticipated shortfalls on properties expected to roll into default and a reduction in overall asset levels as a result of the run-off of the portfolio, hence reducing the overall allowance for losses required.

The Bank manages recovery of customer arrears on a gross customer balance basis (excluding credit fair value adjustments and other accounting entries). Gross loans and advances to customers comprise mortgages that were acquired by the Bank at discounts to the amounts that were advanced to the mortgagors (including the whole of the Optimum portfolio), and mortgages that were originated by the Bank. However, the mix of the securitisation has also seen the impaired percentage of the loans and advances reduce, whilst the coverage rate has increased primarily due to the remaining levels of credit fair value adjustments.

In order to aid comparability with its peers, and for internal management reporting purposes, the Bank also calculates allowance for losses on the basis of amounts originally advanced, regardless of whether the Bank acquired or originated these mortgages. On this basis the Retail secured allowance for losses is £3.8m (2014: £5.9m) and the coverage ratio is 2.5% (2014: 4.0%). There has been a reduction in allowance for losses and the resulting coverage ratio in the year to 31 December 2015 primarily due to increasing indexed property valuation. The Optimum allowance for losses is £28.8m (2014: £98.2m) and the coverage ratio is 9.2% (2014: 10.3%).

The Retail Secured coverage ratios, based on amounts originally advanced, is restated on 90+ days past due and default balances as follows:

- The retail 90+ days past due and default balance is £52.3m (2014: £46.7m), 0.4% of total customer balances (2014: 0.3%) and the coverage ratio is 7.3% (2014: 12.7%); and
- The Optimum 90+ days past due and default balance is £152.5m (2014: £473.2m), 5.3% of total customer balances (2014: 7.3%) and the coverage ratio is 19.2% (2014: 19.8%).

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

The movements in impaired customer balances, during the year is based on information used for management purposes, are shown below:

Audited

	31 December 2015	
	Retail Secured	**Optimum**
Balance at start of year	**146.0**	**879.5**
Classified as impaired during the year	**63.8**	**95.9**
Transferred to unimpaired during the year	**(33.9)**	**(93.4)**
Net Repayments and other	**(24.7)**	**(585.5)**
Balance at end of year	**151.2**	**296.5**

The reduction in impaired Optimum balance in the year to 31 December 2015 is largely due to net repayments and other which is driven primarily by the securitisation of Warwick Finance One and Warwick Finance Two transactions.

The table below shows the credit quality of customer balances that are not impaired:

Audited

	31 December 2015			31 December 2014		
	Retail Secured	**Optimum**	**Total**	Retail Secured	Optimum	Total
Low to medium risk	**12,913.2**	**2,002.4**	**14,915.6**	13,155.0	4,153.3	17,308.3
Medium to high risk	**306.6**	**587.8**	**894.4**	269.9	1,341.0	1,610.9
	13,219.8	**2,590.2**	**15,810.0**	13,424.9	5,494.3	18,919.2

Low to medium risk is defined as exposures with a PD in the next year of 1% or below. Medium to high risk is defined as exposures with a PD in the next year of greater than 1%. All PDs are calculated using the internal ratings based (IRB) approach under CRD IV. An increase in medium to high risk unimpaired exposures is largely driven by the increase in higher LTV lending in the Platform portfolio.

Modelling of credit risk impairment is subject to a number of sensitivities including:

- change in the indexed collateral value;
- change in the forced sale discount applied; and
- assumptions around discount rate and period.

Changes to the above parameters can have a significant impact on the impairment provision.

Forbearance

Forbearance occurs when, for reasons relating to actual or apparent financial difficulty of the borrower, a temporary or permanent concession is granted. A concession may involve short term restructuring of the payment terms of the loan or an extension of the maturity date. The primary aim of forbearance is to help the borrower through a temporary period of financial difficulty and return the account to a sustainable position where the facility can be serviced through to full repayment. Where the primary aim cannot be achieved, the secondary aim is to maximise recovery of debt.

A number of forbearance options, including concessionary arrangements, are available to borrowers in financial difficulty. These are handled either with customers directly or through a third party whom they have chosen to represent them. Accounts classified as forborne remain so until the period of financial difficulty has passed and the account demonstrated it can operate under sustainable terms.

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

The table below analyses secured residential mortgage balances by type of forbearance and the associated gross impairment coverage (including credit fair value adjustments). An account is defined as forborne for two years from the point where a term extension has been agreed or where the repayment method is switched to interest only.

Unaudited

	31 December 2015				31 December 2014			
Retail Secured	**Non-Impaired**	**Impaired**	**Total**	**Impairment coverage**	Non-Impaired	Impaired	Total	Impairment coverage
Concessions	**4.3**	**5.2**	**9.5**	**–**	5.8	4.5	10.3	–
Arrangements	**7.1**	**11.2**	**18.3**	**(0.1)**	14.2	18.7	32.9	(0.4)
Term extensions	**3.9**	**0.1**	**4.0**	**–**	123.7	0.4	124.1	(0.3)
Assisted Voluntary Sale	**–**	**0.2**	**0.2**	**–**	–	0.4	0.4	–
Interest only switches	**0.5**	**–**	**0.5**	**–**	8.3	0.8	9.1	(0.2)
Capitalisations	**0.1**	**–**	**0.1**	**–**	0.1	–	0.1	–
	15.9	**16.7**	**32.6**	**(0.1)**	152.1	24.8	176.9	(0.9)

	31 December 2015				31 December 2014			
Optimum	**Non-Impaired**	**Impaired**	**Total**	**Impairment coverage**	Non-Impaired	Impaired	Total	Impairment coverage
Concessions	**2.1**	**4.3**	**6.4**	**(0.2)**	8.4	8.2	16.6	(0.3)
Arrangements	**12.1**	**30.5**	**42.6**	**(2.0)**	47.9	121.9	169.8	(7.6)
Term extensions	**–**	**–**	**–**	**–**	7.2	0.3	7.5	(0.1)
Assisted Voluntary Sale	**–**	**0.4**	**0.4**	**–**	0.1	1.1	1.2	(0.1)
Interest only switches	**–**	**–**	**–**	**–**	3.7	1.2	4.9	(0.2)
Capitalisations	**–**	**–**	**–**	**–**	0.1	0.1	0.2	–
	14.2	**35.2**	**49.4**	**(2.2)**	67.4	132.8	200.2	(8.3)

Retail forbearance balances have reduced by £144.3m (82%) in the year primarily due to the expiry of forbearance treatments (mainly term extensions). Whilst there has been a reduction in the level of forbearance treatment from the start of 2014, it is the enrichment of data made available from December 2013, which is a key driver in the reduction of forbearance term extensions. Improved data has enabled the Bank to differentiate between genuine forbearance initiated term extensions and those that were a result of customer lifestyle choice.

Optimum forbearance balances have reduced by £150.8m (75%) in the year to 31 December 2015 primarily due to the securitisations of Warwick Finance One and Warwick Finance Two transactions.

Unsecured retail credit risk

Acquisition and account management

The Bank offers unsecured lending through loans, credit cards and overdrafts. Customers' applications for credit are assessed using a combination of credit scoring and policy rules. Credit cards and overdrafts are subject to ongoing account management to determine any increase or decrease in credit limit that should apply as well as to manage over limit authorisations.

The portfolio risk is reassessed monthly using behavioural scorecards to determine the amount of capital required to be held for individual exposures.

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

The following table shows unsecured lending gross customer balances (including undrawn commitments) by product type:

Audited

	31 December 2015	31 December 2014
Loans	**288.0**	393.8
Professional and career development loans	**79.3**	84.8
Credit Cards	**1,981.8**	2,248.6
Overdrafts	**297.9**	310.9
	2,647.0	3,038.1

Total unsecured balances, including undrawn commitments have reduced by 13% during the period. This is largely driven by a reduction in loan balances (27%) due to assets amortisation and low volumes of new business during 2015. Credit card exposure has declined by 12% driven primarily by customer management limit strategies along with a reduction in balance.

Impairment

An impairment provision is recognised for the following categories:

- 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 the emergence of delinquencies, the probability of default and the discounted cash flow of recoveries from default; and
- individual impairment – for exposures meeting the individually significant asset definition an individual assessment is carried out.

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

Audited

	31 December 2015	31 December 2014
Gross loans and advances	**878.3**	1,067.9
of which impaired	**126.8**	136.0
Impaired as a % of gross loans and advances	**14.4%**	12.7%
Allowance for losses	**100.5**	106.1
Coverage	**79.3%**	78.0%

During 2015 gross loans reduced by £189.6m. This reduction is primarily from the stronger performing loans book resulting in a reduction in asset quality and therefore leads to an increase in the impaired percentage of gross loans from 12.7% to 14.4%. However, the coverage ratio has remained broadly level at 79.3%.

Forbearance

Forbearance occurs when, for reasons relating to actual or apparent financial difficulty of the borrower, a temporary or permanent concession is granted. A concession may involve short term restructuring of the payment terms of the loan or an extension of the maturity date. The primary aim of forbearance is to help the borrower through a temporary period of financial difficulty and return the account into a sustainable position where the facility can be serviced through to full repayment. Where the primary aim cannot be achieved, the secondary aim is to maximise recovery of debt.

A number of forbearance options, including concessionary arrangements, are available to borrowers in financial difficulty. These are handled either with customers directly or through a third party whom they have chosen to represent them. Accounts classified as forborne remain so until the period of financial difficulty has passed and the account demonstrated it can operate under sustainable terms.

1. Credit risk continued

Corporate credit risk

Acquisition and account management

The Bank operates a lending policy that requires borrowers to meet criteria as laid down in individual sector strategy guidelines and strict policy with regards to single name and sector concentrations. First line relationship managers submit recommendations for any new money, renewal of facilities or amendments to existing lending to the appropriate sanctioning authority.

Corporate Credit Risk Underwriting (CCRU), which is an independent function, review's and risk assess BaCB proposals before facilities are sanctioned within delegated lending authority. CCRU uses 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.

Non-core CoAM lending decisions are made by the respective Strategic Asset Review (SAR) group. The CoAM strategy is executed through high risk (default and watchlist) and performing SAR groups. SAR lending discretion is determined by the Head of CCRU or in his absence Deputy Head of CCRU. SAR meetings comprise of first and second line business and credit risk representatives where the majority of decisions are taken to set run-off or exit strategies. On occasion these strategies do require additional lending to protect value in the work out of a customer asset. Beyond the delegated lending discretion of the CCRU member in attendance at SAR, for certain levels of exposure, e.g. new loans, the SAR group makes recommendations to a higher sanctioning authority, e.g. Chief Risk Officer for approval.

Monitoring of portfolios and impairment provisioning governance is in place across the portfolios. Individual cases which show signs of unsatisfactory performance are managed through the SAR process to restore them to good health or, where this is not possible, take actions to effect recovery.

In addition, the first line Operating Committees for BaCB and Corporate CoAM, the CRMF and ERC (and by exception the BRC) receive regular reports on the performance of the portfolio.

BaCB

The criteria for the BaCB portfolio is a combination of a maximum turnover of £25m for a single legal entity (SLE), maximum exposure of £10m at connection level which may comprise of several SLEs that are directly connected or share common directors/collateral and risk rating being good, strong or standardised. BaCB also encompasses charities and co-operatives (irrespective of size).

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

The BaCB portfolio represents 24% of Corporate gross customer balances and commitments but has reduced during 2015 due to a combination of market inactivity and repayment. The majority of BaCB rated customers are rated as strong or good (68%), with 25% rated via the standardised approach.

The BaCB portfolio represents a number of industry sectors, with larger concentrations evident in both the Property and construction (27%), Retail and wholesale trade sectors and services (both 13%).

The Bank has a £60.1m balance for group tax relief recoverable from The Co-operative Group. The debt is not a loan and is treated as an Other Asset on the balance sheet. It is not therefore subject to the same credit process for Corporate BaCB loans as described within this section. However, it is considered within the overall exposure to The Co-operative Group connection. On this basis it has not been included in the tables and information to avoid any distortion of the information. However it should be noted that the debt is still assessed for impairment alongside other Co-operative Group lending.

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 an insufficient number of customers and/or low defaults. These typically belong to public sector entities (the Bank has largely exited this sector in 2015), renewable energy sectors, and to the following customer types within other sectors: energy efficiency schemes, leveraged etc., of which we have a relatively small portfolio.

The tables below show the distribution of the BaCB customer balances (including commitments) by sector and risk grade, where PD grades have been mapped to regulatory slotting categories.

Audited

31 December 2015	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
BaCB							
Accommodation, food and licensed services	**14.6**	**31.6**	**11.3**	**4.3**	**–**	**0.1**	**61.9**
Care	**6.1**	**8.5**	**20.0**	**4.7**	**–**	**3.8**	**43.1**
Education	**47.4**	**0.3**	**1.2**	**2.1**	**–**	**–**	**51.0**
Financial Services	**15.7**	**32.8**	**12.3**	**0.2**	**1.4**	**0.1**	**62.5**
Housing associations	**2.5**	**29.4**	**0.6**	**–**	**–**	**–**	**32.5**
Manufacturing	**1.2**	**10.7**	**0.8**	**0.2**	**–**	**0.1**	**13.0**
Motor trade and garages	**0.6**	**3.4**	**0.7**	**0.2**	**–**	**–**	**4.9**
Professional Services	**6.9**	**5.1**	**1.8**	**0.2**	**–**	**0.2**	**14.2**
Property and Construction							
Commercial investment	**13.9**	**2.3**	**112.4**	**9.7**	**1.5**	**2.1**	**141.9**
Residential investment	**0.5**	**–**	**37.2**	**2.2**	**–**	**0.1**	**40.0**
Commercial development	**4.4**	**–**	**2.7**	**–**	**–**	**–**	**7.1**
Residential development	**0.5**	**0.1**	**4.3**	**0.5**	**–**	**–**	**5.4**
Public sector entities	**1.0**	**–**	**–**	**–**	**–**	**–**	**1.0**
Retail and wholesale trade	**1.3**	**91.1**	**0.5**	**6.0**	**–**	**–**	**98.9**
Services	**62.4**	**11.7**	**18.6**	**2.4**	**0.1**	**0.5**	**95.7**
Transport, storage and communication	**1.2**	**5.5**	**0.9**	**–**	**–**	**–**	**7.6**
Utilities	**0.1**	**0.9**	**–**	**–**	**–**	**–**	**1.0**
Business banking	**–**	**20.8**	**20.1**	**5.0**	**0.8**	**0.3**	**47.0**
Other	**2.1**	**1.9**	**–**	**–**	**–**	**–**	**4.0**
Total BaCB	**182.4**	**256.1**	**245.4**	**37.7**	**3.8**	**7.3**	**732.7**

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

31 December 2014	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
BaCB							
Accommodation, food and licensed services	18.7	12.4	5.9	4.5	–	–	41.5
Care	12.5	12.1	18.5	1.6	–	–	44.7
Education	56.5	2.9	3.7	–	–	–	63.1
Financial services	14.2	26.2	13.9	1.2	0.1	–	55.6
Housing associations	2.0	26.7	0.8	0.3	–	–	29.8
Manufacturing	3.9	12.8	4.4	0.9	–	0.1	22.1
Motor trade and garages	0.8	4.9	2.2	0.4	–	–	8.3
Professional services	10.8	7.1	2.1	1.0	–	0.2	21.2
Property and construction:							
Commercial investment	3.5	5.2	146.3	6.4	0.9	1.6	163.9
Residential investment	4.0	0.1	34.7	1.8	–	–	40.6
Commercial development	–	–	6.4	–	–	–	6.4
Residential development	0.5	–	6.6	0.6	–	–	7.7
Public sector entities	0.2	–	–	–	–	–	0.2
Retail and wholesale trade	1.5	49.4	4.7	123.5	–	–	179.1
Services	71.4	12.8	32.5	3.1	0.1	0.3	120.2
Transport, storage and communication	1.8	7.2	0.3	–	–	–	9.3
Utilities	0.1	0.8	–	0.1	–	–	1.0
Business banking	0.3	41.7	6.1	3.4	0.3	0.5	52.3
Other	2.3	2.3	–	0.1	–	–	4.7
Total BaCB	205.0	224.6	289.1	148.9	1.4	2.7	871.7

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Corporate CoAM

The Corporate CoAM portfolio represents 76% of Corporate gross customer balances and commitments, with 72% of the Corporate CoAM portfolio balances being rated as either strong or good. These strong and good balances are driven predominantly by Housing Association and PFI customers, which in turn represent 29% and 30% of total Corporate CoAM balances. These sectors along with the property and construction sector at 25% are the sectors with the highest concentration of balances within the Corporate CoAM portfolio.

The reduction in Corporate CoAM exposures during 2015 reflects the continued deleveraging in line with the Bank's risk appetite. It is most evident in Commercial Property Investment, PFI, Renewable Energy and Housing associations sectors. Commercial property investment has also seen the most significant reduction in exposures in the default category, with Residential investment the second most significant; due to the majority of the Bank's defaulted book being in the property sector.

In the year to 31 December 2015, the Bank has reduced its single name concentration risk.

As at 31 December 2015, only five connections (2014: 13) were on book with individual exposure exceeding £50m totalling £330m (2014: £904m). As a group of assets this represents 14% of the total Corporate portfolio (2014: 17%). All connections are performing in the low risk Housing Association sector.

The tables below show the distribution of the CoAM balances (including commitments) by sector and risk grade, where PD grades have been mapped to regulatory slotting categories.

Audited

31 December 2015	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
Corporate CoAM							
Accommodation, food and licensed services	9.5	15.1	5.2	7.6	–	43.4	80.8
Care	21.0	27.5	–	5.1	–	26.3	79.9
Education	18.3	0.1	2.3	–	–	0.2	20.9
Financial Services	0.1	–	2.8	0.4	–	1.0	4.3
Football Clubs	–	18.7	–	–	–	1.0	19.7
Housing associations	4.5	685.0	–	–	–	0.3	689.8
Manufacturing	0.6	–	–	0.9	–	–	1.5
Motor trade and garages	–	–	–	–	–	0.8	0.8
PFI	–	47.1	641.7	–	–	18.4	707.2
Professional Services	1.0	–	–	0.1	–	1.1	2.2
Property and Construction							
Commercial investment	8.6	24.0	177.1	34.9	39.4	133.5	417.5
Residential investment	3.7	–	37.3	23.9	13.0	9.3	87.2
Commercial development	–	–	9.3	3.7	0.7	57.9	71.6
Residential development	0.1	–	2.2	0.8	1.1	1.7	5.9
Public sector entities	14.2	–	–	–	–	–	14.2
Renewable energy	123.3	–	–	–	–	0.1	123.4
Retail and wholesale trade	0.1	1.3	–	1.3	0.1	3.1	5.9
Services	0.9	7.2	1.6	2.7	0.1	4.3	16.8
Transport, storage and communication	0.7	–	–	1.7	–	0.3	2.7
Utilities	–	2.2	–	–	2.4	0.9	5.5
Business banking	–	–	–	–	–	–	–
Other	–	–	–	–	–	0.2	0.2
Total Corporate CoAM	206.6	828.2	879.5	83.1	56.8	303.8	2,358.0
Total BaCB and Corporate CoAM	389.0	1,084.3	1,124.9	120.8	60.6	311.1	3,090.7

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

31 December 2014	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
Corporate CoAM							
Accommodation, food and licensed services	67.3	20.3	26.7	18.2	13.8	80.0	226.3
Care	62.7	10.1	0.3	30.2	–	42.7	146.0
Education	15.9	10.1	–	0.4	–	0.1	26.5
Financial Services	5.2	–	6.1	1.5	–	2.1	14.9
Football Clubs	–	19.4	–	–	0.1	1.2	20.7
Housing associations	5.0	866.7	1.0	–	–	0.3	873.0
Manufacturing	1.8	4.1	0.1	0.9	0.1	0.6	7.6
Motor trade and garages	–	10.1	0.1	0.5	0.5	2.1	13.3
PFI	–	76.9	1,094.4	–	–	–	1,171.3
Professional Services	9.2	–	8.8	2.3	–	1.8	22.1
Property and Construction							
Commercial investment	1.9	15.2	415.7	44.4	84.7	661.0	1,222.9
Residential investment	1.4	–	51.4	39.1	1.4	102.4	195.7
Commercial development	45.8	–	10.7	7.1	38.9	67.7	170.2
Residential development	0.2	–	3.9	1.5	0.5	7.9	14.0
Public sector entities	117.5	–	–	–	–	–	117.5
Renewable energy	499.8	–	–	–	–	9.3	509.1
Retail and wholesale trade	1.4	1.6	2.7	0.7	0.1	6.4	12.9
Services	22.0	16.9	2.0	7.8	0.6	28.5	77.8
Transport, storage and communication	1.1	0.1	0.7	4.6	–	3.3	9.8
Utilities	7.6	–	0.2	–	–	4.0	11.8
Business banking	–	–	–	–	–	0.2	0.2
Other	0.4	0.1	0.4	–	–	0.1	1.0
Total Corporate CoAM	866.2	1 051 6	1 625 2	159.2	140.7	1,021.7	4,864.6
Total BaCB and Corporate CoAM	1,071.2	1,276.2	1,914.3	308.1	142.1	1,024.4	5,736.3

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Collateral BaCB and Corporate CoAM

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 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, cash cover and guarantees (often supported by tangible security where appropriate, including property, life policies and stocks and shares).

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.

Valuations are performed under Bank instruction by an approved panel of external valuers. When cases are placed into the Recoveries team and a LPA (Law of Property Act) Receiver is appointed then the valuation used will be an Expected Outcome Statement (EOS).

Property valuations are obtained when the facility is first approved. Our lending procedures typically require collateral to be revalued every two years or more frequently in higher risk situations. This is typically annually or when a material change has occurred that is likely to affect the value and/or recoverability of the debt. For sectors such as Housing Associations, which have exhibited zero defaults historically, revaluations would be required every three years or more. In certain circumstances, such as syndicates, the multi bank facility letter may preclude revaluations at the customer's expense, of all the assets as frequently as this and a decision is required by all banks involved to decide if they require the updates more frequently.

In addition, the values are indexed for risk assessment and capital calculation using appropriate regional and asset type indexes where available, otherwise the national average index is applied.

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

Audited

	31 December 2015			31 December 2014		
	Exposure	**Collateral**	**Impairment Provision**	Exposure	Collateral	Impairment Provision
BaCB						
Non-default loans with <1 year until refinancing and all defaulted regardless of term						
Less than 50%	**27.9**	**27.9**	**–**	27.4	27.2	0.1
50% to 60%	**3.5**	**3.5**	**–**	3.1	3.1	–
60% to 70%	**1.0**	**1.0**	**–**	1.7	1.7	–
70% to 80%	**0.3**	**0.3**	**–**	–	–	–
80% to 90%	**–**	**–**	**–**	0.9	0.9	–
90% to 100%	**–**	**–**	**–**	–	–	–
Greater than 100%	**0.3**	**0.1**	**0.1**	0.1	0.1	–
Unsecured	**38.9**	**–**	**1.0**	88.5	–	1.2
	71.9	**32.8**	**1.1**	121.7	33.0	1.3
Non-default loans with >1 year until refinancing and all non-loan non-defaulted regardless of term						
Less than 50%	**230.6**	**230.6**	**–**	253.3	253.3	0.1
50% to 60%	**86.7**	**86.7**	**–**	87.3	87.3	–
60% to 70%	**65.9**	**65.9**	**–**	48.7	48.7	–
70% to 80%	**10.6**	**10.5**	**–**	38.3	38.3	–
80% to 90%	**12.1**	**12.1**	**–**	11.6	11.5	–
90% to 100%	**0.7**	**0.7**	**–**	1.8	1.7	–
Greater than 100%	**20.2**	**12.8**	**0.1**	26.8	17.4	0.4
Unsecured	**234.0**	**–**	**0.6**	282.2	–	1.1
	660.8	**419.3**	**0.7**	750.0	458.2	1.6
	732.7	**452.1**	**1.8**	871.7	491.2	2.9

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Audited

	31 December 2015			31 December 2014		
	Exposure	**Collateral**	**Impairment Provision**	Exposure	Collateral	Impairment Provision
Corporate CoAM						
Non-default loans with <1 year until refinancing and all defaulted regardless of term						
Less than 50%	**34.6**	**34.3**	**0.3**	33.5	32.5	1.0
50% to 60%	**94.0**	**91.8**	**2.2**	72.4	70.3	2.0
60% to 70%	**33.0**	**26.4**	**6.6**	86.5	85.8	0.7
70% to 80%	**14.3**	**14.2**	**0.1**	44.3	41.2	3.1
80% to 90%	**20.9**	**16.8**	**4.0**	106.9	89.8	17.1
90% to 100%	**64.3**	**38.3**	**25.9**	88.4	77.8	10.6
Greater than 100%	**126.1**	**70.2**	**51.9**	576.6	311.2	227.8
Unsecured	**50.0**	**–**	**31.1**	264.3	–	193.8
	437.2	**292.0**	**122.1**	1,272.9	708.6	456.1
Non-default loans with >1 year until refinancing and all non-loan non-defaulted regardless of term						
Less than 50%	**312.8**	**312.8**	**–**	361.9	361.8	0.1
50% to 60%	**367.8**	**367.8**	**–**	377.4	377.4	–
60% to 70%	**241.6**	**241.6**	**0.1**	543.7	542.9	0.8
70% to 80%	**142.9**	**142.9**	**–**	307.1	306.5	0.6
80% to 90%	**53.5**	**53.4**	**0.2**	34.9	34.6	0.3
90% to 100%	**24.4**	**24.4**	**–**	96.1	92.3	3.9
Greater than 100%	**62.1**	**27.3**	**0.1**	116.3	52.4	1.1
Unsecured	**715.7**	**–**	**3.4**	1,754.3	–	9.1
	1,920.8	**1,170.2**	**3.8**	3,591.7	1,767.9	15.9
	2,358.0	**1,462.2**	**125.9**	4,864.6	2,476.5	472.0

Collateral is constrained to a maximum of 100% of the exposure to each customer to correctly reflect the maximum protection available to the Bank. For the purposes of determining capital and impairment appropriate forced sale discounts are applied to collateral.

BaCB balances (including commitments) reduced by £139m (16%) in the year to 2015. The majority of this reduction is from unsecured loans (£98m), which results in collateral coverage increasing to 62% (2014: 56%) CoAM balances (including commitments) reduced by £2.5bn (52%) in the year, driven primarily by deleverage and write-off strategy. £1.8bn of this decrease relates to unsecured loans (£1.3bn) and loans with LTV greater than 100% (£505m), where previously significant impairment provisions had been raised.

As at 31 December 2015 £6.3m (2014: £25.4m) of the above collateral is not held as first charge.

Impairment of BaCB and CoAM

Watchlist accounts are considered as being at risk and require close control, but not sufficiently so to warrant the raising of specific bad and doubtful debt provision or meeting the regulatory definition of default. The movement to watchlist is based on a number of potential triggers identifying situations where there is cause for concern and also a review of ongoing viability.

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

The Bank also reviews on a monthly basis through the Corporate Impairment and Default Group (and quarterly through the Impairment Charge Forum), high risk loans (including those accounts subject to forbearance) and considers the potential loss which may arise were the borrowers to fail (notwithstanding that continued trading remains the expectation).

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Corporate customers may be treated as impaired when one or more of the defined Impairment trigger events is evident. The impairment trigger events include but are not limited to:

- loss of significant tenant;
- inability to refinance;
- significant financial difficulty;
- past due greater than 30 days;
- probable bankruptcy;
- granting of concessions; or
- forbearance.

A credit risk impairment charge is required on some of, or 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, entity and the existence or otherwise of a contracted sale. In some cases, often following an independent business review by a firm of accountants, calculation of the credit risk impairment is based on an up to date assessment 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 effective interest rate are less than the current carrying amount.

The collective unidentified impairment provision (CUIP) provides cover for the non-defaulted portfolio using a formulaic approach based on default experience across the portfolio. This reflects trigger events that have occurred but have not yet been identified and cannot therefore be allocated to individual loans.

Audited

	31 December 2015		31 December 2014	
	BaCB	**Corporate CoAM**	BaCB	Corporate CoAM
Gross loans and advances	**549.4**	**2,176.9**	649.1	4,400.2
of which impaired	**32.8**	**354.1**	26.7	1,216.0
Impaired as a % of gross loans and advances	**6.0%**	**16.3%**	4.1%	27.6%
Allowance for losses	**1.0**	**118.4**	1.4	386.8
	3.0%	**33.4%**	5.2%	31.8%
Collective allowance for losses	**0.8**	**7.5**	2.2	16.7

BaCB gross loans and advances have fallen over the period reflecting a mix of cases that have re-banked and maturities/amortisations that have not been replaced with new advances. With impaired balances showing a small increase this has led to an overall increase in the proportion of impaired to gross loans and advances from 4.1% to 6.0%. However, the coverage ratio has fallen with an overall reduction in the allowance for losses due to write offs in the business banking book, whilst minimal new charges have been incurred.

The gross loans and advances balance on Corporate CoAM has significantly decreased over the year reflecting the significant deleverage activity from sales (including asset sales), re-banking and non performing workouts (including the writing off of accounts with no future economic benefit). The mix of deleverage activity has led to a reduction in the Impaired percentage from 27.6% to 16.3%. This has also led to a significant reduction in the allowance for losses mainly driven through the writing off of accounts. However, the overall coverage ratio has risen slightly to 33.4%. The collective allowance for losses on Corporate CoAM has also reduced primarily as a result of lower balances.

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

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

Audited

	31 December 2015		31 December 2014	
	BaCB	Corporate CoAM	BaCB	Corporate CoAM
Balance at start of year	**26.7**	**1,216.0**	15.6	1,977.8
Classified as impaired during the year	**27.9**	**118.0**	190.9	259.9
Transferred to unimpaired during the year	**(8.0)**	**(111.1)**	(57.4)	(59.4)
Amounts written off	**–**	**(363.1)**	–	(178.2)
Net repayments and other	**(13.8)**	**(505.7)**	(122.4)	(784.1)
Balance at end of year	**32.8**	**354.1**	26.7	1,216.0

The main reduction is in net repayments which is due to deleverage activity in Corporate CoAM. The other reduction is driven through write offs which mainly represent cases where following the completion of deleverage activity no further economic benefit can be identified. During 2015 a number of high value cases reached this point following extensive activity to obtain the maximum return for the Bank.

Forbearance

Forbearance facilities may be made available to customers in arrears, financial difficulty, those unable to meet outstanding financial commitments or covenants to the Bank. The identification of financial difficulty is a key part of the process of deploying forbearance. An account is considered as forborne for the duration of the plan or no less than one year from commencement of the plan or forbearance action.

Such concessions typically include but are not limited to:

- restructuring, waiving or reserving rights in the event of covenant breaches;
- postponement of principal payments;
- restructures of principal payments;
- extension of loan maturity dates;
- 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 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:

Unaudited

	31 December 2015			31 December 2014		
	Forborne	Non-Forborne	Total	Forborne	Non-Forborne	Total
BaCB						
Default	**–**	**7.2**	**7.2**	1.5	1.4	2.9
On watchlist	**3.7**	**24.9**	**28.6**	4.0	23.7	27.7
Neither default nor watchlist	**1.4**	**695.5**	**696.9**	8.1	833.0	841.1
	5.1	**727.6**	**732.7**	13.6	858.1	871.7
Corporate CoAM						
Default	**102.4**	**201.5**	**303.9**	418.6	607.5	1,026.1
On watchlist	**31.1**	**33.2**	**64.3**	125.4	99.6	225.0
Neither default nor watchlist	**11.8**	**1,978.0**	**1,989.8**	50.4	3,563.1	3,613.5
	145.3	**2,212.7**	**2,358.0**	594.4	4,270.2	4,864.6
	150.4	**2,940.3**	**3,090.7**	608.0	5,128.3	5,736.3

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Forborne exposures have reduced by £458m in the year to 31 December 2015. This is largely driven by the write off of accounts (£261m), along with other deleverage activity (£98m) in the Corporate CoAM portfolio. The remaining movement is due to the expiry of existing forbearance treatments (£114m) offset by loans identified as forborne in 2015 (£14m).

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

1.2.2 Investment securities

The following tables analyse the gross balance by type of investment security:

Audited

31 December 2015	**Investment securities** Loans & receivables	**Investment securities** Available for sale	**Investment securities** Fair value through profit or loss	**Total**
Analysis of balance in note 18				
Gross Balance	**15.0**	**4,296.8**	**582.4**	**4,894.2**

31 December 2014	Investment securities Loans & receivables	Investment securities Available for sale	Investment securities Fair value through profit or loss	Total
Analysis of balance in note 18				
Gross Balance	18.1	3,167.5	1,236.9	4,422.5

No allowance for losses have been recognised for investment securities in either 2015 or 2014. All are classified as low to medium risk.

Collateral

There are policies in place with regard to the management and valuation of collateral. Repos and secured lending positions are revalued daily and margin calls on collateralised swaps are made dependent on the counterparty. Eligible financial collateral for CRD IV reporting purposes typically include gilts held under reverse repo agreements, cash held under both repo agreements and collateralised swap arrangements. At the year end there were no gilts held under reverse repo agreements. The Bank did hold some non-UK Sovereign bonds as collateral for derivative exposures.

Guarantees relied upon are either parental guarantees held against subsidiary exposures within Bank groups or sovereign guarantees.

Impaired assets

Investment securities are considered past due when 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.

Not impaired assets

The Bank only invests in treasury assets which comply with the Credit risk policy and Treasury Credit Risk Control Standard. Within the Treasury investment security portfolio 100% (2014: 100%) of exposures have an external credit rating equivalent to Fitch A or above.

1.2.3 Loans and advances to banks

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

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

1.2.4 Derivative financial instruments

The Bank enters into collateral agreements to mitigate credit risk from derivative counterparties. The majority of the Bank's collateral agreements are bi-lateral. The Bank uses a central clearing counterparty to clear its derivatives. Most derivatives that are subject to collateral agreements are collateralised using cash. Some derivatives linked to funding programmes can place government securities, cash, or other eligible securities as collateral as agreed by rating agencies and subject to ratings triggers.

Occasionally the Bank enters into unilateral agreements for certain derivatives; these are used for credit risk mitigation in securitisation structures.

For non-collateralised derivatives, the Bank uses an internal credit rating approach to adjust fair values for credit risk of the counterparty. The Credit Value Adjustment (CVA) was £3.2m (2014: £3.9m).

Audited

	31 December 2015		31 December 2014	
	Derivative notional (net)	**Derivative fair value (net)**	Derivative notional (net)	Derivative fair value (net)
Interest rate				
Bi-lateral collateral agreements	**14,351.0**	**(266.5)**	12,930.5	(399.3)
One way collateral	**2,088.5**	**11.4**	3,005.6	(5.0)
No collateral agreement	**681.2**	**121.3**	1,049.8	165.8
Foreign exchange				
Bi-lateral collateral agreements	**110.0**	**1.6**	440.4	(11.7)
One way collateral	**1,058.4**	**158.2**	1,058.4	169.2
No collateral agreement	**68.3**	**(1.9)**	0.4	–
	18,357.4	**24.1**	18,485.1	(81.0)

The above table has been re-presented in order to separately identify one way collateral agreements.

Further disclosures on derivatives is contained in note 19.

1.3 Wholesale credit risk

The Bank remains a UK focused retail and commercial operation with limited sovereign exposures to Eurozone governments. Limits are in place to manage Treasury credit risk concentrations. These limits are monitored along with related country limits with more granular limits to cover asset class, sector exposures and counterparty groups, to prevent unacceptable concentrations.

As at 31 December 2015 the Bank had a £260m (2014: £297m) gross exposure to the Government of Finland.

The Bank held no other material non-UK sovereign debt (2014: £nil).

1.3.1 Direct exposures

During 2015, exposures to financial institutions in European countries were broadly consistent with the year end with a total gross exposure outstanding at 31 December 2015 of £235m (2014: £274m). Post credit risk mitigation the net exposure was £235m (2014: £274m).

Within the Treasury portfolio there are a number of risk mitigation techniques available including netting and collateralisation agreements. Other methods such as disposal and credit derivatives are used periodically to mitigate the credit risk associated with particular transactions.

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 portfolio and watchlists monthly for appropriate risk status bandings and any associated management actions. As at 31 December 2015 there were no red (highest risk) Eurozone exposures outstanding (2014: £nil).

1. Credit risk continued

1.3.2 Indirect exposures

The Bank's Treasury monitoring extends beyond direct risk incurred through counterparty trading to the underlying exposures which Treasury's counterparties may maintain on their own balance sheets. In analysing each counterparty's secondary exposure, the Bank assess's the vulnerability and impact on that counterparty 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.

Indirect sovereign exposure exist to the governments of France and Germany through government debt securities held as collateral against a series of currency swaps transacted in support of the Leek 18 securitisation.

2. Liquidity and funding risk

2.1 Overview Unaudited

The Bank's management of liquidity and funding risk aims to ensure that at all times there are sufficient liquid resources, both as to amount and quality to cover cash flow mismatches and fluctuations in the Bank's funding profile in order to meet financial obligations as they fall due even during periods of stress. This is achieved through the management and stress testing of the Bank's cash flows and the setting of appropriate risk limits to maintain a prudent funding mix, maturity profile and level of high quality liquid assets.

To manage its liquidity and funding risk the Bank monitors the following:

- funding and cashflow profile
- maturity concentrations
- total liquid asset portfolio
- asset encumbrance
- stress testing the Bank's liquidity position to ensure it can withstand various stress scenarios
- assessing market conditions for early signs of stress
- contingency planning for unexpected events to ensure continued access to liquidity in the event of market disruption or specific events impacting the Bank

The Bank has a strong funding base which continues to be predominantly funded by retail and corporate deposits. Over the course of the year the Bank continued to actively manage its liquidity position, maintaining a regulatory liquidity buffer, and restructuring existing exposures to further improve the funding profile and ensure its financial obligations as and when they fall due. In the year to 31 December 2015 the Bank's liquid asset ratio was 15.6% (2014: 17.4%).

2.2 Liquidity risk management framework Unaudited

The Board determines and approves the Liquidity Risk Appetite (LRA) of the Bank. It also reviews and approves the Bank's Liquidity and Funding Risk Management Policy (LFRMP) framework and delegates to ALCO the responsibility for complying with the framework which in turn delegates to the LMRF which oversees the management of liquidity and funding risks. Treasury are responsible for ensuring that all liquidity and funding risk measures are managed within policy and risk appetite. The Treasury Risk team provides review and challenge of policies and procedures relating to liquidity and funding risk.

The Bank sets formal limits within the LFRMP to maintain liquid assets within the LRA set by the Board. The LRA requires the Bank to maintain sufficient liquid assets to survive a defined stress scenario selected from a range of scenarios over a 90 day period, the severity of which is set in relation to both the external environment it operates in and the Bank's business activities. On 1 October 2015 the Liquidity Coverage Ratio (LCR) became the PRA's primary regulatory standard for liquidity, replacing the previous BIPRU 12 regime. The LCR measures the amount of high quality liquid assets relative to estimated net stressed cash outflows within a 30 day period. The PRA has set a minimum requirement of 80% from October 2015 rising thereafter to 100% from 1 January 2018. As at 31 December 2015 the Bank's LCR (Pillar 1 and Pillar 2 risks) was in excess of 100%.

The Basel Committee on Banking Supervision published its final recommendations for the implementation of the Net Stable Funding Ratio (NSFR) in October 2014, proposing an implementation date of 1 January 2018, by which time banks are expected to meet an NSFR ratio of 100% from this point onwards. As at 31 December 2015 the Bank's NSFR exceeds 100%.

Liquidity management information is provided on a regular basis to the LMRF, ALCO and the Board which details the Bank's compliance with its core liquidity risk metrics, which include:

- customer loan/deposit ratio, 98.5% (2014: 96.6%) – the ratio of customer loans to customer deposits;
- encumbrance ratio, 21.8% (2014: 25.9%) – Per the EBA definition, Asset Encumbrance ratio = (Carrying amount of encumbered assets and collateral)/(Total assets and collateral), where an asset is considered as encumbered if it has been pledged or if it is subject to any form of arrangement to secure, collateralise or credit enhance any transaction from which it cannot be freely withdrawn.

  To allow comparison with 2014 the encumbrance ratio above is calculated on a point-in-time basis. The median based encumbrance ratio is 24.5% and this measure will be utilised going forward; and
- internal liquidity stress tests – the survival period of the Bank under an applicable stress scenario

LMRF oversees the operational liquidity management and convenes at least once a month. A range of indicators, details of cash flows and media coverage are monitored to attempt to detect early signs of liquidity stress either in the market or events that are specific to the Bank. The LMRF, ALCO and the Board discuss the actual liquidity position and projected position incorporating business plans. More frequent meetings are held if necessary, i.e. when the markets have a heightened period of stress or liquidity shortage.

The Bank maintains a Contingency Funding Plan (CFP) approved by ALCO and the Board which details the procedures and a range of available actions that the Bank could deploy in the event of a liquidity or funding stress, thereby allowing adequate liquidity resources to be maintained. The CFP is reviewed every six months and tested at least annually. In the event that the CFP is deployed following endorsement from ALCO, then the CEO will convene the Crisis Management Team (CMT) which will become the main management committee that assumes responsibility for delivering the CFP, engaging other business areas of the Bank and third parties. The Bank also has a recovery plan which describes potential actions that could be used in a more stressful scenario.

All amounts are stated in £m unless otherwise indicated

2. Liquidity and funding risk continued

2.3 Liquidity risk policies Unaudited

Liquidity risk policies are developed by the LMRF, ALCO and the Board. The Bank's liquidity management policies are reviewed and approved annually by the Board and compliance is reviewed by LMRF, 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's risk appetite is met.

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. The Bank's Liquidity Management Framework is designed in line with FCA, PRA, EBA regulations and industry guidelines. This will continue to be updated to reflect evolving regulatory change.

2.4 Liquid asset portfolios Unaudited

Total liquidity resources as at 31 December 2015 were £11,402.8m (2014: £12,120.4m). The table below analyses the Bank's liquidity portfolio by product and unencumbered liquidity value. The Bank categorises its liquidity portfolio into primary and other liquid assets. Primary liquid assets includes cash and balances at central banks, gilts and other high quality government bonds and all other liquid assets including self issued retained securitisations (contingent liquidity portfolio).

	31 December 2015	31 December 2014
Operational balances with central banks	**2,329.3**	4,487.4
Gilts	**1,450.2**	1,246.7
Central government and multilateral development bank bonds	**760.2**	819.5
Total primary liquid assets	**4,539.7**	6,553.6
Other liquid assets	**1,386.6**	14.3
Contingent liquidity	**5,476.5**	5,552.5
Total liquidity	**11,402.8**	12,120.4
Average balance	**11,203.9**	12,015.8

The Bank uses any combination of these asset pools to manage liquidity, with primary liquidity used predominantly for short term cash flow movements, while other liquidity is used for creating longer term liquidity. Regular realisation through repo transactions and outright sales provide assurance that these asset pools remain sufficiently liquid. The overall quantum of liquid assets fell slightly in 2015 following an increase in 2014 due to an injection of cash through the capital raising in May 2014. The secondary liquidity portfolio reflects own assets eligible for discounting at central banks, which has increased in 2015.

Funding and liquidity strategy focuses on maintaining a high percentage of liquid assets that are eligible to be included in the Liquid Assets Buffer (LAB). The table below shows in addition to the liquid assets listed above other non-liquid assets. In 2015 the remaining two bonds have matured to leave the balance at nil.

	31 December 2015	31 December 2014
Short term deposits	**–**	–
Other public sector securities	**–**	2.5
Floating rate notes	**–**	31.0
Fixed rate notes	**–**	–
Other securities and commodities	**–**	–
Total non-buffer assets	**–**	33.5

All amounts are stated in £m unless otherwise indicated

2. Liquidity and funding risk continued

2.4.1 Wholesale funding Unaudited

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

	31 December 2015	31 December 2014
Preference shares and subordinated debt	**457.0**	196.4
Secured funding	**2,091.0**	2,521.8
Repos	**671.3**	500.6
Market borrowing	**10.9**	46.0
MTNs	**404.9**	832.9
Total wholesale funding	**3,635.1**	4,097.7

The reduction of the wholesale funding reflects the repayment of a number of secured funding liabilities in 2015, alongside Medium Term Notes (MTNs). This is offset by a £250m Tier 2 subordinated debt issuance during the year. The Bank has £511.0m of gilt repo's within the Repo line.

The following table sets out the Bank's contractual wholesale funding by maturity, with the Leek notes being disclosed based on call dates:

	31 December 2015	31 December 2014
Repayable in less than 1 month	**522.5**	84.8
Repayable between 1 and 3 months	**159.7**	334.4
Repayable between 3 and 6 months	**352.4**	–
Repayable between 6 and 9 months	**243.3**	–
Repayable between 9 and 12 months	**433.0**	389.8
Repayable between 1 and 2 years	**746.9**	1,028.1
Repayable between 2 and 5 years	**259.0**	942.1
Repayable in more than 5 years	**918.3**	1,318.5
Total external funding	**3,635.1**	4,097.7

All amounts are stated in £m unless otherwise indicated

2. Liquidity and funding risk continued

2.5 Liquidity gap Unaudited

Details of contractual maturities for assets and liabilities underpin the management of liquidity risk, however, management recognises that customer behaviour differs to contractual maturity, therefore as part of the planning process, behavioural run-off of customer assets and liabilities over time are estimated. The assumptions used to create these estimates and the estimates themselves are approved by ALCO as part of its responsibility to approve the Bank's financial plans.

Gross cash flows include interest and other revenue cash flows. The table for 2015 has enhanced disclosures by increasing the number of time maturities, with more analysis of the shorter maturity periods. The following table is an analysis of gross undiscounted contractual cash flows of financial assets and liabilities held at the balance sheet date:

31 December 2015 Contractual cash flows	Carrying value	Gross nominal flow	Less than 1 month	1-3 month	3-6 month	6-9 month	9-12 month	1-2 years	2-5 years	Over 5 years
Assets										
Cash and balances at central banks	2,678.5	2,678.5	2,678.5	–	–	–	–	–	–	–
Loans and advances to banks	871.0	871.0	520.0	351.0	–	–	–	–	–	–
Loans and advances to customers	19,784.4	31,203.9	602.2	311.5	398.6	395.3	442.7	1,636.7	4,854.8	22,562.1
Investment securities										
Loans and receivables	15.0	18.4	–	–	–	–	–	0.2	0.5	17.7
Available for sale	4,296.8	5,515.2	9.1	233.0	24.7	159.7	21.8	253.0	1,140.1	3,673.8
Fair value through profit or loss	582.4	590.0	3.3	1.3	1.9	2.0	30.7	11.2	515.6	24.0
Derivative financial instruments	370.1	666.7	8.1	11.0	40.3	14.7	79.1	123.3	137.1	253.1
Other assets	430.1	–	–	–	–	–	–	–	–	–
Total recognised assets	29,028.3	41,543.7	3,821.2	907.8	465.5	571.7	574.3	2,024.4	6,648.1	26,530.7
Liabilities										
Deposits by banks	725.9	725.9	566.2	159.7	–	–	–	–	–	–
Customer accounts	22,732.0	22,836.6	15,938.3	1,473.6	975.4	1,644.4	870.2	1,322.4	448.0	164.3
Customer accounts – capital bonds	77.4	59.1	–	13.2	17.0	9.5	10.1	9.3	–	–
Debt securities in issue	2,554.3	2,866.3	10.4	18.6	385.1	262.2	473.1	827.6	129.4	759.9
Derivative financial instruments	346.9	766.1	9.8	19.1	29.1	29.0	26.9	94.9	192.1	365.2
Other borrowed funds	459.9	743.9	3.6	7.8	10.9	21.8	10.9	44.0	371.3	273.6
Other liabilities	768.6	–	–	–	–	–	–	–	–	–
Total recognised liabilities	27,665.0	27,997.9	16,528.3	1,692.0	1,417.5	1,966.9	1,391.2	2,298.2	1,140.8	1,563.0
Unrecognised loan commitments	2,710.2	2,710.2	2,375.4	334.8	–	–	–	–	–	–
Total liabilities	30,375.2	30,708.1	18,903.7	2,026.8	1,417.5	1,966.9	1,391.2	2,298.2	1,140.8	1,563.0

In 2015 this table has been extended to show all the maturity term profiles within the EDTF recommendations. This reflects the repayment pattern for 2015. 2014 tables have remained unchanged.

All amounts are stated in £m unless otherwise indicated

2. Liquidity and funding risk continued

31 December 2014 Contractual cash flows	Carrying value	Gross nominal flow	Less than 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
Assets							
Cash and balances at central banks	4,765.3	4,765.3	4,765.3				
Loans and advances to banks	1,608.4	1,608.4	1,238.4	370.0			
Loans and advances to customers	25,849.3	33,816.8	947.2	308.6	1,520.9	8,193.7	22,846.4
Investment securities							
Loans and receivables	18.1	21.8	–	–	0.1	0.6	21.1
Available for sale	3,167.5	3,366.2	89.1	166.9	117.4	1,703.8	1,289.0
Fair value through profit or loss	1,236.9	1,268.6	1.5	9.0	66.8	1,166.1	25.2
Derivative financial instruments	470.7	766.3	10.9	13.1	48.2	370.8	323.3
Other assets	466.7	–	–	–	–	–	–
Total recognised assets	37,582.9	45,613.4	7,052.4	867.6	1,753.4	11,435.0	24,505.0
Liabilities							
Deposits by banks	615.4	619.9	103.9	336.8	2.9	176.3	–
Customer accounts	29,614.0	29,974.1	19,117.1	933.6	7,130.5	2,606.2	186.7
Customer accounts – capital bonds	263.8	213.7	8.4	59.2	86.4	59.7	–
Debt securities in issue	3,443.6	4,379.3	94.2	745.3	478.5	2,400.8	660.5
Derivative financial instruments	551.7	1,088.4	14.1	26.4	123.5	390.4	534.0
Other borrowed funds	196.4	410.1	1.9	4.5	17.1	90.8	295.8
Other liabilities	883.5	–	–	–	–	–	–
Total recognised liabilities	35,568.4	36,685.5	19,339.6	2,105.8	7,838.9	5,724.2	1,677.0
Unrecognised loan commitments	3,017.5	3,017.5	2,872.6	85.3	–	59.6	–
Total liabilities	38,585.9	39,703.0	22,212.2	2,191.1	7,838.9	5,783.8	1,677.0

2.6 Encumbrance Unaudited

An asset is defined as encumbered if it has been pledged as collateral against an existing liability or to collateralise an exposure that the Bank may have, restricting access to that asset in the event of resolution or bankruptcy. An encumbered asset would be no longer available to the Bank for use in secured funding, to satisfy collateral needs or to be sold to reduce the funding requirement. The table below is shown on a median basis reflecting the move in 2015 to reporting on this basis.

	Encumbered Assets				Unencumbered Assets	
31 December 2015	As a result of covered bonds	As a result of securiti-sations	Other	Total		Total
Equity investments	–	–	–	–	55.6	**55.6**
Debt securities	–	**481.0**	**1,310.5**	**1,791.5**	3,102.7	**4,894.2**
Other assets	**1,288.3**	**1,872.1**	**2,173.6**	**5,334.0**	18,744.5	**24,078.5**
Assets of the reporting institution	**1,288.3**	**2,353.1**	**3,484.1**	**7,125.5**	21,902.8	**29,028.3**

The comparative 2014 table is shown on a point in time basis (31 December 2014).

	Encumbered Assets				Unencumbered Assets	
2014 Point in Time	As a result of covered bonds	As a result of securiti-sations	Other	Total		Total
Equity instruments				–	2.8	**2.8**
Debt securities		**489.3**	**1,155.2**	**1,644.5**	2,778.0	**4,422.5**
Other assets	**1,133.2**	**3,291.1**	**3,694.4**	**8,118.7**	25,038.9	**33,157.6**
Assets of the reporting institution	**1,133.2**	**3,780.4**	**4,849.6**	**9,763.2**	27,819.7	**37,582.9**

3. Market risk Unaudited

3.1 Overview

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

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

The Bank's only Pillar 1 market risk requirement is in relation to net currency positions, however it is below a threshold such that the Bank is not required to calculate Pillar 1 RWAs in respect of this. The Bank is however subject to market risk requirements under the PRA's Pillar 2 framework, which is captured as part of its ICG requirement.

3.2 Market risk management framework

The Treasurer is the Risk Owner for market risk and is accountable for the management of market risk in line with the Bank's policy, control standard and risk appetite. Day-to-day responsibility is delegated to the Head of Treasury Dealing who manages the Bank's liquidity portfolio and carries out hedging activities to minimise interest rate risk across the whole balance sheet. All market risk is transferred to the Treasury Dealing function to ensure risk is contained and managed effectively. Hedging strategies primarily involve the use of interest rate swaps, although assets and liabilities are netted where risk can be effectively managed.

The Treasury Risk Director is the Risk Framework Owner for market risk and as such is responsible for setting the framework and policy by which the Treasurer manages the risk. A second line oversight function supports the Treasury Risk Director by monitoring the management of market risk to ensure compliance with the Bank's policy, control standard and risk appetite. A second line reporting function provides independent reporting and analysis of the Bank's exposures.

Responsibility for monitoring key market risk metrics and ensuring that the market risk profile is aligned to the Board risk appetite rests with the Bank's ALCO which meets on a monthly basis. The Committee also approves all behavioural assumptions used in the management of market risk. The Liquidity & Market Risk Forum supports the ALCO by reviewing current and potential future market risk position, identifying emerging market risks and required management actions. It also oversees the technical approaches to managing the Bank's market risks, including any changes to methodologies, models and systems/infrastructure.

3.3 Market risk appetite

The Bank's primary objective is to minimise the sensitivity at product, balance or business level of net interest income and then its economic value of its equity base to changes in interest rates. This is translated into a maximum amount of capital that the Bank deems necessary to hold to support the level of market risk exposure and the risk that those exposures may pose to the Bank's future financial performance.

The Bank assesses each of the market risk drivers and establishes a set of limits. In order to quantify the amount of capital the Bank requires against each source of market risk an internal assessment of a rate stress based on historical interest rate data is applied to the limit position. In this context the market risk appetite is expressed as an overarching amount of capital at risk which is underpinned by a number of primary and secondary risk metrics. Primary risk metrics are set against each of the key drivers of market risk and adherence to these limits is central to maintaining market risk within overall appetite. Secondary risk metrics are also used, which provide operational early warning indicators, that may impact exposure which is assessed via primary risk metrics.

3.4 Primary risk metrics and sources of market risk

The key drivers of market risk that the Bank faces and the metrics used to manage those risks are:

Interest rate risk

The primary risk metric employed by the Bank to manage directional interest rate risk and yield curve risk is the sensitivity of the Bank's net interest rate exposure to a one basis point parallel shift in interest rates (PV01). Limits are set at an overall level for directional interest rate risk and against individual time buckets for yield curve risk.

To supplement the gapped and overall PV01 limits noted above, stress testing of exposures against historical yield curve shifts is undertaken on a monthly basis. This assesses the sensitivity to the most extreme curve steepening and curve flattening movements, to a 99% confidence, seen over a one month period during the previous five years.

A key aspect in the management and measurement of interest rate risk is the behaviouralisation of certain elements of the Bank's balance sheet. Behavioural assumptions are limited to the treatment of non-interest bearing balances and expectations with regard to customer prepayments within the Bank's residential mortgage and unsecured loan portfolios. The Bank periodically analyses its current account portfolio in order to identify a stable, non-interest bearing 'core' element compared to the more volatile, rate sensitive and transitory balances. A behavioural duration is applied to the former while the latter are assumed to reprice within one month. Other non-maturity deposits are not subject to a behavioural adjustment and are assumed to reprice within one month.

Similar assumptions are made for other non-interest bearing balance sheet items such as non-dated capital all of which are reviewed and approved by the Bank's ALCO on a semi-annual basis.

In addition to the balance sheet items noted above interest rate risk is primarily driven by the Bank's holding of fixed rate assets within its liquidity asset buffer, the sale of fixed rate mortgages and savings products to its customer base and the degree to which these are hedged using the derivative instruments.

All amounts are stated in £m unless otherwise indicated

3. Market risk continued

Risk exposures are formally calculated at least monthly. Interest rate risk and effectiveness of hedging is monitored at a minimum weekly using gap positions, incorporating new business requirements. Draw down risk, in particular for fixed rate mortgages, is managed through weekly tranche meetings. The Treasury team undertakes hedges for interest rate risk using derivative instruments and investment securities to external wholesale markets.

Basis risk

The definition of basis risk is the risk of loss as a result of the balance sheet being adversely affected by the movement between different index rates.

Basis risk in the Bank balance sheet is mainly driven by a mix of exposures to LIBOR, base rate and administered rate. LIBOR exposures are created through the Bank's holdings of LIBOR linked assets such as MBS and as a result of hedging fixed rate retail products. Reserve balances at the Bank of England combined with tracker mortgages generate a base rate asset with administered rate exposures generated by mortgages and savings products.

Basis risk is managed using an earnings at risk based metric, focusing in detail on the sensitivity of changes in interest rates on net interest income over a one year period. The assumed potential loss of earnings reflects the downside risk comparing the prevailing relevant spreads against their historical extremes. The estimated earnings at risk is then expressed as a percentage of the forecasted net interest income over the next twelve months.

Basis risk is monitored by LMRF and ALCO monthly with action taken as required.

Sovereign Swap spread risk

Swap spread risk is defined as the risk between the fixed rate element of the swap agreement and the benchmarked treasury instrument that an organisation is exposed to. These assets are used for liquidity purposes within the Treasury portfolio.

The Bank manages swap spread risk by calculating on a daily basis the sensitivity of its hedged fixed rate bond portfolio to a one basis point divergence in yields between the fixed rate bond and its hedge (PV01).

Foreign exchange risk

The Bank's exposure to foreign exchange risk is primarily limited to customer hedging transactions and positions entered via natural customer flow only. Therefore, to manage this risk an overall maximum notional net sterling position limit is set for both intra-day and overnight exposures. This is supported by applying sub-limits to currencies by tier to reflect their liquidity.

Where the Bank has originated non-sterling debt securities or short term borrowings both currency and interest rate risk is mitigated using off setting assets or derivative instruments such as cross currency swaps.

	31 December 2015					31 December 2014				
	£	**$**	**€**	**Other**	**Total**	£	$	€	Other	Total
Assets										
Cash and balances at central bank	**2,678.5**	**–**	**–**	**–**	**2,678.5**	4,765.3	–	–	–	4,765.3
Loans and advances to banks	**805.8**	**34.4**	**29.6**	**1.2**	**871.0**	1,550.2	31.2	26.0	1.0	1,608.4
Loans and advances to customers[1]	**19,643.7**	**27.1**	**19.5**	**0.1**	**19,690.4**	25,631.6	22.3	36.2	10.7	25,700.8
Fair Value adjustments for hedged risk	**94.0**	**–**	**–**	**–**	**94.0**	148.5	–	–	–	148.5
Investment securities										
Loans and receivables	**15.0**	**–**	**–**	**–**	**15.0**	18.1	–	–	–	18.1
Available for sale	**4,296.8**	**–**	**–**	**–**	**4,296.8**	3,166.7	0.8	–	–	3,167.5
Fair value through profit or loss	**582.4**	**–**	**–**	**–**	**582.4**	1,236.9	–	–	–	1,236.9
Derivative financial instruments	**370.1**	**–**	**–**	**–**	**370.1**	470.7	–	–	–	470.7
Other assets	**430.1**	**–**	**–**	**–**	**430.1**	466.4	–	0.3	–	466.7
Total assets	**28,916.4**	**61.5**	**49.1**	**1.3**	**29,028.3**	37,454.4	54.3	62.5	11.7	37,582.9
Liabilities										
Deposits by banks	**715.4**	**–**	**10.5**	**–**	**725.9**	601.0	–	14.4	–	615.4
Customer accounts	**22,684.0**	**17.6**	**28.8**	**1.6**	**22,732.0**	29,571.2	16.8	25.0	1.0	29,614.0
Customer accounts – capital bonds	**77.4**	**–**	**–**	**–**	**77.4**	263.8	–	–	–	263.8
Debt securities in issue[2]	**1,466.4**	**549.6**	**538.3**	**–**	**2,554.3**	1,809.5	603.2	1,030.9	–	3,443.6
Derivative financial instruments	**346.9**	**–**	**–**	**–**	**346.9**	550.5	–	1.2	–	551.7
Other borrowed funds	**459.9**	**–**	**–**	**–**	**459.9**	196.4	–	–	–	196.4
Other liabilities	**770.3**	**0.4**	**(2.1)**	**–**	**768.6**	883.5	–	–	–	883.5
Total liabilities	**26,520.3**	**567.6**	**575.5**	**1.6**	**27,665.0**	33,875.9	620.0	1,071.5	1.0	35,568.4
Net assets	**2,396.1**	**(506.1)**	**(526.4)**	**(0.3)**	**1,363.3**	3,578.5	(565.7)	(1,009.0)	10.7	2,014.5

1. In 2014 the loan and advances to customers included assets held for sale of £323.4m – see note 17 for further details

2. The debt securities are shown gross of the Fair Value Adjustment for the Dollar and Euro values.

At 31 December 2015, the Bank's open currency position was £(0.7)m (2014: £(0.6)m). The Bank manages its currency positions against both an overall limit and individual currency limits.

3. Market risk continued

Credit spread risk

Credit spread risk is defined as the risk of loss from changes in the credit spread on wholesale assets.

The Bank's non-sovereign term exposures are primarily to holdings of mortgage backed securities issued by Warwick Finance One and Warwick Finance Two plc which reflect the retained elements from the deleveraging of the Bank's Non-core assets. Given that the Bank does not seek to actively transact in this type of asset, each purchase is individually agreed by and a maximum notional limit set. The potential risk from these holdings is assessed against historical spread movements of similar securitisation transactions.

Other sources of market risk – **unaudited**

Other sources of market risk include:

- Directional risk – The sensitivity to the overall direction of interest rate movements;
- Yield curve risk – The sensitivity to the relative movement of interest rates at different maturities on the yield curve;
- Prepayment risk – The risk that an asset or liability repays more quickly or slowly than anticipated, resulting in a mismatch between the asset, liability and associated hedge;
- Pipeline risk – The risk that the sales profile for new fixed rate products do not match hedging assumptions, resulting in a mismatch between amount of product sold and that hedged, which can result in a hedge rebalancing cost;
- Explicit option risk – The sensitivity to overall direction of interest rates, speed of change of interest rates and market prices for positions which contain explicit options e.g. caps, floors, swaptions;
- Repricing and implicit optionality in products – The risk that options embedded or implied within retail or commercial products have an impact on market value or earnings with changing interest rates;
- Illiquidity risk – The Bank's risk appetite for market risk considers an illiquidity risk which is reflected in the assumed holding period it uses to assess its capital requirements for market risk.

	31 December 2015	31 December 2014
Total PV01 (£k)	**76.0**	(141.4)
Average PV01 for the year (£k)	**(94.2)**	17.6
Largest Positive PV01 for the period (£k)	**128.0**	167.8
Largest Negative PV01 for the period (£k)	**(348.2)**	(141.4)
Average basis risk (% of annual NII)	**3.4%**	4.4%
Swap spread PV01 (£k)	**(1,043.0)**	(1,235.4)
Average swap spread PV01 (£k)	**(1,014.1)**	(1,256.3)
MBS Holding (£m)	**1,614.0**	16.2
Average MBS Holding (£m)	**857.2**	16.2
FX notional (£m)	**(0.7)**	(0.6)
Average FX notional (£m)	**(0.7)**	(0.1)

The table illustrates the PV01, Basis risk, Swap spread and FX risk metrics on the Bank's balances. The PV01 is primarily driven by the non-sensitive balances offset by corresponding asset or derivative positions. During 2015 the largest absolute PV01 of £(348k) reflected a timing mismatch between agreement and completion of the disposal of £323m of corporate assets and associated hedges. Given that a price had been fixed for the sale of the derivatives the Bank unwound the opposing derivatives to protect its economic position. Excluding this transaction the Bank's PV01 ranged from £133k to £(149k).

The Bank's basis risk exposure in terms of potential earnings at risk has remained relatively unchanged year on year. However, during 2015 the deleveraging of the Bank's non-conforming mortgage portfolio and subsequent purchase of LIBOR linked MBS has seen a net base rate asset/LIBOR liability position transition into a net LIBOR asset/base rate liability. Swap spread risk has reduced through 2015 due to lower absolute holdings. MBS holdings have increased markedly due to the purchase of Warwick securities noted above.

4. Pension risk

4.1 Overview

Pension risk occurs in defined benefit schemes when the market value of the scheme's assets is considered to be insufficient to meet its liabilities, resulting in a deficit which the employer is legally obliged to fund. The scheme's liabilities are calculated using a discount rate referenced to UK Government bond yields and are an estimate of its long term obligations. Uncertainty in the estimated size of the liabilities and volatility in future investment returns from the assets may cause adverse movements in the pension fund deficit. The key risk factors that can have a positive or negative impact on the deficit are:

- Long term interest rates – A decrease in long term interest rates will cause the value of the scheme's liabilities to increase.
- Inflation – Where a scheme's benefits have an inflation link an increase in inflation will cause the scheme's liabilities to increase. This may be offset where the scheme's assets are also linked to inflation (e.g. index-linked gilts and inflation swaps).
- Longevity risk (life expectancy) – The valuation of pension scheme liabilities is reliant on scheme member longevity and liabilities may substantially increase should longevity increase more than expected.
- Asset volatility – Changes in the value of the scheme's assets compared to that of its liabilities can create significant volatility in the estimated deficit. This is particularly prevalent in schemes with significant equity holdings where equity returns underperform the bond yields used to discount scheme liabilities.

In 2015 the Bank closed its defined benefit scheme and removed the link to final pensionable salary for both Pace and Britannia Pension Scheme members. Colleagues have been provided with defined contribution pension options for all future service. This action will assist in containing the Bank's exposure to pension risk going forward. During 2016 consideration will be given to strategies for separation of the Bank's share of the Pace scheme from that of The Co-operative Group.

Controls are applied to mitigate these risks and a monthly pension risk report is made to Bank Asset and Liability Committee and Enterprise Risk Oversight Committee to monitor pension risk and decide if further action is necessary. These reports take account of the risk reporting delivered to pension scheme Trustees. The Bank is able to engage directly with the Trustees of the Britannia Pension Scheme and can influence the Trustees of Pace through its relationship with the sponsor, The Co-operative Group.

The HR Director chairs a monthly pension steering group and pension risk is discussed at a number of Executive and Board Committees on a regular basis.

For further information see note 34 of the accounts.

5. Regulatory risk

5.1 Regulatory environment

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

Changes to regulations

As the Bank must comply with wide ranging legal and regulatory (including liquidity and capital) requirements and supervision, 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. These changes may negatively affect the Bank's business. In addition, failure to comply with these 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 negative effect on the Bank's business. The regulatory risk team is responsible for identifying and communicating changes to regulation. Adoption of these changes is owned and managed by the first line.

5.2 Regulatory risk management

The regulatory risk function is responsible for monitoring and reporting on regulatory risk across the Bank and facilitates production of regulatory, conduct, anti-money laundering and financial crime risk reporting to CRROC, EROC and BRC.

6. Conduct risk

6.1 Overview

The Bank manages conduct risk in a way that is consistent with its overall risk appetite and aligns with its strategy. Conduct risk encompasses the principle of treating customers fairly and putting customers at the centre of what we do – it 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, e.g., products and services not meeting the needs of its customers, sales processes resulting in poor advice or incorrect information, or failing to deal with a complaint appropriately. When assessing conduct risk there will often be a closely linked regulatory requirement arising from the FCA rules and guidance that are concerned with the conduct of business regulation.

At the end of 2015, the Bank has conduct risk provisions of £355.7m, to cover the costs relating to PPI mis-selling, breaches of the technical requirements of the Consumer Credit Act, interest rate swap mis-selling, packaged accounts and other provisions, further detail of which is provided in note 32 to the accounts.

7. People risk

7.1 Overview

People Risk is overseen by the HR Director, with responsibility held by the Executive teams and wider business. Key people policies and interventions are governed by the Executive People Committee.

A number of key initiatives have been undertaken in 2015 to tackle People Risk issues. The Culture Programme seeks to improve colleague engagement, reinforcing the Co-operative Bank Values and Culture, and embedding these into people policies and processes. The current phase focuses on specific, executive sponsored work streams including customer, leadership and risk management. Employee engagement levels have improved significantly throughout 2015.

Employee turnover levels remain elevated, reflecting the buoyancy of the external market. The Employee Value Proposition is under ongoing development, and 2015 saw the launch of the new employer brand and employee recognition programme.

Building capability remains critical, with good progress made in strengthening the Bank's talent profile and succession planning.

8. Strategic and business risk

8.1 Overview

A failure to successfully implement or a delay in implementing the Bank's turnaround strategy may adversely impact the Bank's business, operating results, financial condition and prospects, its regulatory capital position and its ability to comply with its regulatory capital requirements.

There is a risk that this strategy may be unachievable due to the level of complex and overlapping changes required on multiple axes whilst seeking to strengthen the Bank's brand, reputation and customer satisfaction and its relationship with its employees. Recent action has been taken to restructure the project portfolio to focus on those projects most critical to the success of the Bank strategy.

Strategic and business risk is managed through EROC. ExCo and the Board via consideration of risks to the strategy caused by changes in the external environment and assessment of forecast plan progress on a continual basis. Any required actions to address strategic risk are agreed on a regular basis and monitored through EROC.

9. Reputational risk

9.1 Overview

Reputational risk can arise as a result of any other principal risk crystallising therefore, the significant initiatives covered in all other sections are relevant to managing reputational risk. In addition, responsibility for overseeing reputational risk has transferred to the Bank's second line risk team and work is on-going to define an appropriate policy and key risk indicators. The Bank launched a revised Ethical Policy based on responses provided in the customer poll conducted in 2014, and used the principles to guide the development of a new overdraft proposition launched during the year.

10. Operational risk

10.1 Overview

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

The Bank assesses various sub categories of operational risk which cover legal and regulatory, conduct, information security, financial crime and people risks. Further details of regulatory, conduct and people risks are provided above.

The Bank also manages and monitors operational risks associated with property and physical security, insurance, business processes, financial regulating and change.

10.2 Operational Risk Framework

The management of operational risk is designed to assist the Bank in understanding its operations in the context of a Board approved risk appetite, particularly with regard to reducing capital requirements, meeting regulatory expectations and reducing operational losses. The approved Operational Risk Framework has remained stable since early 2013 and continues to be embedded in line with good practice and regulatory guidance. This framework is designed to provide assurance over the system of risk management and internal control. Methods and approaches continue to be embedded within the business and there is significant focus on this activity. This is supported by the implementation of a revised Operational Risk Management System which is currently being implemented and will be finalised by mid 2016.

Operational risks are identified, managed and mitigated through ongoing risk management practices including material Bank level risk assessments, risk event reporting, operational loss data analyisis, a detailed risk and control self assessment process, a consistently applied risk acceptance process, monitoring of key metrics, scenario analysis and continuous training. Material operational risks are reported through an appropriate governance structure with regular meetings to monitor the development and effectiveness of the operational risk processes and material risks within the Bank.

10. Operational risk continued

Operational Risk processes have been embedded within the Bank, however Operational Risk levels remain elevated due to the manual processes, legacy systems and processes for which remediation continues. Further information can be found in the Risk management and Principal risks and uncertainties Sections of the Annual Report and Accounts.

10.3 Corporate Insurance programme

The Bank has a structured programme designed to transfer the impact of specific operational risks in line with the appetite of the organisation and industry best practice. For example:

- Insurance of the Bank's buildings and assets;
- Protection and revenue in the event of business interruption following damage to the Bank's buildings or assets;
- Protection against impacts of financial crime;
- Professional indemnity and directors and officers liability cover;
- Motor, employer, product and public liability insurance;
- Pension Trustee Liability Insurance; and
- Travel and Personal Accident Insurance.

10.4 Responsibilities

Key executives each have a nominated risk representative at the Operational Risk Oversight Committee, responsible for ensuring the consistent application of the operational risk framework in their division. Operational risk is considered in a number of distinct themes for internal management, monitoring and reporting. These have already been described in detail in Risk profile section of the Bank.

11. Model risk Unaudited

11.1 Overview

Model risk is defined within the Bank's Model risk policy as the risk of model failure or the inappropriate use of models and their outputs resulting in potential loss, poor decision making, regulatory fine or censure and/or reputational damage. The risks include, for example, models that become unfit for their intended use as a result of changes in market conditions; and/or via changes to regulation. Model risk is further discussed in the Principal Risks and Uncertainties section.

The scope includes all models used within the Bank for measurement or to facilitate management decisions which meets the definition within the Model risk policy and Control Standards, including those models developed by third parties.

12. Capital Management

Unaudited

Capital is held by the Bank to protect its depositors, to cover its inherent risks, to absorb unexpected losses, and to support the development of the business.

The Bank manages and calculates its capital in accordance with CRD IV, implemented in the European Union through publication of Capital Requirements Regulation (CRR) and a further iteration of the Capital Requirements Directive (CRD). Together this package of requirements is known as CRD IV and came into force from 1 January 2014. The European Banking Authority is providing technical standards relating to CRD IV some of which are not yet finalised. CRD IV disclosures in this document are based on the Bank's interpretation of published rules.

All CRD IV disclosures are shown on a transitional and fully loaded basis, except for the leverage ratio which is only calculated on a fully loaded basis. Through its Policy Statement PS7/13, the PRA implemented CET1 deductions and prudential filters in full. On the 31 December 2015 the Bank's fully loaded and transitional positions are the same following the reduction of the Bank's Unity Trust Bank shareholding to 6.7%.

Throughout 2015 the Bank has continued to make progress towards improving its capital position and reducing its overall risk profile. In May 2015 the Bank closed its inaugural whole structure securitisation of part of its Non-core Optimum residential mortgages portfolio through the issuance of notes and residual certificates by Warwick Finance Residential Mortgages Number One plc. A further whole structure securitisation by Warwick Finance Residential Mortgages Number Two plc followed in September.

Warwick Finance One and Two comprised of portfolios totalling £3.1bn, of residential mortgages, issuing rated Residential Mortgage Backed Securities (RMBS) and residual certificates to investors. The transaction satisfies significant risk transfer requirements under CRR in relation to the securitised portfolio. The Bank retained 65% of the Class A notes on settlement of Warwick Finance One and 80% of the Class A notes on settlement of Warwick Finance Two. The Class A Note retentions are the only positions retained by the Bank within the Warwick Finance capital structures. The Bank retains 5% of the original mortgage pool from which Warwick One and Two assets were selected enabling the Bank to meet CRR retention requirements for originators of securitisations.

The Bank is seeking to enhance its credit modelling capability in a number of key portfolios and is in discussion with the PRA with regards to the approval and implementation of these enhancements during 2016.

A major element of these enhancements relates to how the Bank determines LGD for retail secured mortgages.

In June 2013 the Bank initially assessed the impact of potential enhancements which drove a £1.0bn increase in the underlying RWAs calculated using the current models. The increase related to the Optimum portfolio and a £1.0bn adjustment had been included within the Optimum RWAs. This is referred to as a temporary adjustment.

Following the significant deleverage of the Optimum balances within 2015, the Bank judged it appropriate to reduce the temporary adjustment from £1.0bn to £0.3bn in order to ensure that the Optimum RWAs are more reflective of the underlying credit quality of the portfolio. The PRA has not objected to this change.

When the new LGD model is fully implemented, the remaining £0.3bn of the temporary adjustment is expected to be removed in full with the new model directly calculating the appropriate LGD and corresponding RWAs for all the Bank's secured portfolios.

The Bank continues to meet its Pillar 1 capital requirements under normal economic conditions. This is the minimum required under the CRR. The PRA provides Individual Capital Guidance (ICG) for each bank. This represents guidance on the capital (Pillar 2a) a firm should hold in excess of Pillar 1.

Through most of 2015, the Bank was compliant with its ICG. However, due to the Bank's ongoing losses this ICG position should be regarded as having been a temporary situation as the Bank has insufficient capital to meet its ICG obligations. The Bank is not expected to be sustainably ICG compliant until 2019.

The Bank does not currently have sufficient capital resources to withstand a severe stress scenario under its current in force PRA Buffer. The Bank's Updated Plan has been accepted by the PRA and the Bank expects to remediate this position by 2020. This is driven by further reductions in Non-core RWAs, the implementation of cost reduction initiatives and profit generation in the later stages of the Plan.

The Bank is mindful of the capital implications of the Bank of England's minimum requirement for own funds and eligible liabilities (MREL) regime and the increased debt issuance this will drive, for the banking industry in general but also for the Bank.

The Bank of England published a consultation paper in December 2015 proposing a methodology for setting a firm's individual MREL requirement at a minimum of 2 x (Pillar 1 + Pillar 2a).

The Bank's Updated Plan (2016-2020) incorporates MREL qualifying issuance commencing in 2018 which is the Board's current view of the earliest time when such issuance may be feasible. The PRA and the Bank of England have indicated their strong preference that the Bank incorporates an earlier profile of MREL issuance than currently contemplated by the Bank's Updated Plan. Such expectations have been confirmed by the Regulators as not intended yet to represent the formal setting of a required MREL issuance plan and the Bank of England has stated that it will consult with the Bank before setting binding requirements, which it will be able to do at any point following publication of its MREL policy (expected to be sometime in 2016). Refer to page 33 of the Principal Risk and Uncertainties that discusses MREL in further detail.

The PRA has engaged the Bank throughout 2015 regarding its overall compliance with CRR and its Credit risk modelling capability. Subsequently, the PRA has set the Bank an additional CRR-related Pillar 2a capital requirement in the form of a fixed add on, in order to cover any potential risk in this area. This Pillar 2a capital requirement was not included within the Bank's ICG requirements at 31 December 2015 however it will be included in the Bank's requirement going forward. It is the Bank's intention, subject to model output, to have the add on removed by the end of 2017 at the latest.

12. Capital Management continued

Key capital highlights are:

- Fully-loaded CET1 ratio has increased by 2.5% to 15.5% at 31 December 2015 (31 December 2014: 13.0%), predominantly driven by a decrease in RWA's of £5.2bn following significant deleveraging of Non-core, offset by a £484.9m reduction in CET1.
- Fully-loaded leverage ratio has decreased 0.4% to 3.8% (2014: 4.2%) reflecting a decrease in exposure of £8.7bn to £30.1bn and a decrease in Tier 1 of £487.2m.
- Throughout most of 2015 the Bank was compliant with its ICG, being the PRA's statement as to the regulatory capital it expects the Bank to hold. Due to the on-going losses this position should be regarded as a temporary situation, as the Bank is not expected to be sustainably compliant until 2019.
- The Bank's Updated Plan which has been accepted by the PRA anticipates that the Bank will meet the 7% CET1 ratio throughout the planning period and will have sustainably met ICG by 2019, subject to adhering to compliance with CRR.
- The Bank's Updated Plan aims to build a sustainable Core Bank, and is designed to create a surplus to the PRA buffer by 2020.
- The Bank anticipates that its leverage ratio will be sustainably above 3.0% by 2020, however it is expected to reduce in the intervening period.

12.1 Risks

The Bank faces risks that may adversely impact the Bank's ability to comply with its regulatory capital requirements, these include:

- deteriorating 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 higher than expected impairments which would adversely impact the Bank's operating result and retained earnings;
- The Bank requires the regulators' continued acceptance of the Bank's inability to meet regulatory requirements including CRR, ICG, PRA buffer compliance and other threshold conditions. To the extent this support is not forthcoming, the Bank does not perform in line with its Updated Plan or regulatory capital requirements are increased for any reason, additional CET1 capital may be required over and above that included in the Updated Plan in order for the Bank to remain a going concern, and the PRA or FCA could exercise their powers under the Banking Act of 2009;
- the inability of the Bank to deleverage its Corporate CoAM assets in a controlled and capital efficient manner may have a negative impact on the Bank's operating result, financial position and its regulatory capital position. In addition, any greater than expected costs or delays in deleveraging the Corporate CoAM assets may divert funding from and adversely impact the longer term development and growth of the Core business; and
- the inability of the Bank for whatever reason to execute its Updated Plan.

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

12.2 Capital Stress Testing

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

- Strategic Plan;
- ICAAP; and
- forecasting exercises.

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

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

Individual business areas prepare business plans as part of the Strategic Planning process. Stress testing models are utilised to stress business plans over a forward looking planning horizon.

Stress testing results are prepared on both a pre and post management action basis, and compared to both risk appetite and minimum regulatory requirements. Review and challenge of stress testing results are undertaken by the business and the second line of defence as part of the Bank's RMF. For more information see the Risk Framework section.

The Bank also undertakes reverse stress testing to assess the point at which the Bank is likely to fail on both an individual and combined event basis.

The Co-operative Bank was a participant in the Bank of England 2014 UK concurrent stress test of the eight major UK banks and building societies. This was designed specifically to assess resilience to a very severe housing market shock and to a sharp rise or change in interest rates. This was not a forecast or expectation by the Bank of England regarding the likelihood of a set of events materialising, but a coherent severe 'tail risk' scenario.

Results of this exercise were published on 16 December 2014 and can be found on the Bank of England website: www.bankofengland.co.uk

As a result of the stress test the Bank submitted a Revised Plan which was accepted by the PRA in December 2014. This Plan was designed to enable the Bank to withstand a severe stress by the end of the planning horizon.

12. Capital Management continued

Following the stress assessment the Bank was not included in the 2015 Bank of England stress test, as this test was designed to assess resilience to a deterioration in global economic conditions. The Bank was not included as a result of the size of the Bank's balance sheet, which is significantly smaller than the other Banks that were included in the stress test; therefore the resilience of the Bank is unlikely to affect the resilience of the financial system as a whole.

Following the approval of the Bank's Updated Plan the Bank's risk appetite is to ensure that the Bank is capital resiliant and sustainably achieves its ICG by 2019 and PRA compliance by 2020.

All amounts are stated in £m unless otherwise indicated

12. Capital Management continued

12.3 Capital resources Unaudited

	31 December 2015		31 December 2014	
	Transitional	**Fully Loaded**	Transitional	Fully Loaded
Common Equity Tier 1 (CET1) Capital: instruments and reserves				
Permanent share capital and the related share premium account	**1,759.5**	**1,759.5**	1,759.5	1,759.5
Retained earnings	**(273.1)**	**(273.1)**	(36.7)	(36.7)
Available for sale and cash flow hedge reserves	**90.2**	**90.2**	83.6	83.6
Minority interests	**–**	**–**	6.1	10.6
Other reserves[1]	**410.0**	**410.0**	410.0	410.0
CET1 capital before regulatory adjustments	**1,986.6**	**1,986.6**	2,222.5	2,227.0
CET1 capital: regulatory adjustments				
Prudent valuation	**(0.8)**	**(0.8)**	(0.4)	(0.4)
Intangible assets (net of related tax liability)	**(142.8)**	**(142.8)**	(103.7)	(103.7)
Deferred tax assets not arising from temporary differences	**(4.0)**	**(4.0)**	–	–
Cash flow hedge reserves	**(34.6)**	**(34.6)**	(59.0)	(59.0)
Expected loss shortfalls	**(30.0)**	**(30.0)**	(191.5)	(191.5)
Losses for the year[2]	**(623.3)**	**(623.3)**	(236.4)	(236.4)
Unrealised gains or losses on available for sale assets (revaluations reserve)	**–**	**–**	(24.6)	–
Total regulatory adjustments to CET1	**(835.5)**	**(835.5)**	(615.6)	(591.0)
CET1 capital	**1,151.1**	**1,151.1**	1,606.9	1,636.0
Additional Tier 1 (AT1) capital: instruments				
Minority Interests[3]	**–**	**–**	22.9	2.3
AT1 capital before regulatory adjustments	**–**	**–**	22.9	2.3
Total regulatory adjustments to AT1 capital	**–**	**–**	–	–
Total Tier 1 capital (T1 = CET1 + AT1)	**1,151.1**	**1,151.1**	1,629.8	1,638.3
Tier 2 (T2) capital: instruments and provisions				
Capital instruments	**448.4**	**448.4**	196.4	196.4
Minority interests	**–**	**–**	0.8	3.0
Credit risk adjustments	**–**	**–**	52.2	52.2
T2 capital before regulatory adjustments	**448.4**	**448.4**	249.4	251.6
Total regulatory adjustments to T2 capital	**–**	**–**	–	–
T2 capital	**448.4**	**448.4**	249.4	251.6
Total capital (TC = T1 + T2)	**1,599.5**	**1,599.5**	1,879.2	1,889.9

1. Other reserves relate to the capital redemption reserve created as a result of the Bank's Liability Management Exercise in 2013.
2. A reconciliation of statutory to regulatory loss is included on page 143.
3. Under CRD IV the amount of minority interest which can be recognised by the Bank is allocated between the different tiers of capital. Minority interest represents the share of the capital and reserves of Unity Trust Bank that is attributable to third party investors, the Bank no longer consolidates Unity Trust Bank following the sale of the majority of its shareholding, resulting in the Bank holding 6.7% as at 31 December 2015.

All amounts are stated in £m unless otherwise indicated

12. Capital Management continued

12.4 Capital ratios and risk weighted assets Unaudited

	31 December 2015		31 December 2014 Restated	
	Transitional	**Fully Loaded**	Transitional	Fully Loaded
Capital ratios and buffers				
Common Equity Tier 1	**15.5%**	**15.5%**	12.7%	13.0%
Tier 1	**15.5%**	**15.5%**	12.9%	13.0%
Total capital ratio	**21.6%**	**21.6%**	14.9%	15.0%
Risk Weighted Assets				
Credit risk	**6,517.6**	**6,517.6**	11,500.4	11,500.4
Market risk	**–**	**–**	–	–
Operational risk	**905.3**	**905.3**	1,131.8	1,131.8
Total risk weighted assets	**7,422.9**	**7,422.9**	12,632.2	12,632.2
Segmental analysis of credit Risk Weighted Assets				
Core				
Retail	**1,810.9**	**1,810.9**	1,866.6	1,866.6
BaCB	**496.8**	**496.8**	760.0	760.0
Treasury/other	**1,440.8**	**1,440.8**	1,723.8	1,723.8
Total Core	**3,748.5**	**3,748.5**	4,350.4	4,350.4
Non-core				
Corporate CoAM	**1,793.1**	**1,793.1**	3,624.0	3,624.0
Optimum	**976.0**	**976.0**	3,526.0	3,526.0
Total Non-core	**2,769.1**	**2,769.1**	7,150.0	7,150.0
Total credit Risk Weighted Assets	**6,517.6**	**6,517.6**	11,500.4	11,500.4

Fully-loaded CET1 ratio has increased 2.5% to 15.5% at 31 December 2015 (31 December 2014: 13.0%), predominantly driven by a decrease in RWA's of £5.2bn following significant deleveraging of Non-core, offset by a £484.9m reduction in CET1.

The decrease in CET1 reflects a £623.3m regulatory loss for the year, partially offset by a £161.5m reduction in the CET1 deduction for expected loss shortfall. The reduction in expected loss shortfall is driven by a change in methodology to reflect European Banking Authority (EBA) guidance which allows netting of expected loss shortfall for exposures in default. The Bank previously calculated expected loss shortfall on an individual customer basis for exposures in default with no netting applied between customers. The calculation of expected loss shortfall is calculated separately for defaulted and non-defaulted exposures per CRR requirements.

The £2.5bn RWA reduction within the Non-core Optimum portfolio is primarily driven by the securitisation of £3.1bn of residential mortgages in 2015 coupled with the £0.7bn reduction in the RWA temporary adjustment. The £1.8bn RWA reduction in Corporate CoAM is driven by ongoing deleveraging activity. Please refer to the detailed financial review section for further information.

Credit risk RWAs remained relatively stable in Retail, primarily following a reduction in the unsecured exposure offset by additional intermediary mortgage balances.

Operational risk RWAs have decreased by £226.5m following the annual recalculation of the Pillar 1 operational risk requirement subsequent to the 2014 year end results.

The Bank successfully raised £250m of Tier 2 capital in 2015 which will help the Bank comply with minimum capital regulatory requirements and expectations. The Bank's fully loaded total capital ratio increased by 6.6% to 21.6% at 31 December 2015.

All amounts are stated in £m unless otherwise indicated

Overview | Strategic report | Corporate governance | **Risk management** | Financial statements | Other information

12. Capital Management continued

12.5 Reconciliation of equity per balance sheet to total capital

Balance sheet presentation	Balance per accounts	Regulatory presentation	Regulatory Balance treatment	Cash flow hedge reserve	Regulatory treatment of deferred tax assets	Expected Losses	Prudent valuation in trading book	Capital Resources Transitional Rules
		Equity						
Ordinary share capital	**22.6**	Paid up capital instruments	**22.6**	**–**	**–**	**–**	**–**	**22.6**
Share premium account	**1,736.9**	Share premium	**1,736.9**	**–**	**–**	**–**	**–**	**1,736.9**
Retained earnings	**(896.4)**	Retained earnings	**(273.1)**	**–**	**–**	**–**	**–**	**(273.1)**
		Regulatory losses for the period	**(623.3)**	**–**	**–**	**–**	**–**	**(623.3)**
Available for sale reserve	**55.6**	Available for sale reserve	**55.6**	**–**	**–**	**–**	**–**	**55.6**
Cash flow hedging reserve	**34.6**	Cash flow hedging reserve	**34.6**	**(34.6)**	**–**	**–**	**–**	**–**
Capital redemption reserve	**410.0**	Other reserves	**410.0**	**–**	**–**	**–**	**–**	**410.0**
		Total equity	**1,363.3**	**(34.6)**	**–**	**–**	**–**	**1,328.7**
		Non-equity						
Other borrowed funds	**448.4**	Capital instruments	**448.4**	**–**	**–**	**–**	**–**	**448.4**
Intangible assets	**142.8**	Intangible assets (net of related tax liability)	**(142.8)**	**–**	**–**	**–**	**–**	**(142.8)**
Deferred tax assets	**7.6**	Deferred tax assets not arising from temporary differences	**7.6**	**–**	**(11.6)**	**–**	**–**	**(4.0)**
Impairment[1]	**(240.4)**	Expected loss shortfall	**240.4**	**–**	**–**	**(270.4)**	**–**	**(30.0)**
		Prudent valuation	**–**	**–**	**–**	**–**	**(0.8)**	**(0.8)**
		Total Non-equity	**553.6**	**–**	**(11.6)**	**(270.4)**	**(0.8)**	**270.8**
		Total balances subject to own funds calculations	**1,916.9**	**(34.6)**	**(11.6)**	**(270.4)**	**(0.8)**	**1,599.5**

1. Only impairment relating to exposures calculated under the IRB approach to credit risk are applicable for the calculation of expected loss shortfall. Therefore the impairment number included in the table above relates to IRB exposures only and is a subset of the Bank's total impairment included within the balance sheet.

12.6 Reconciliation of statutory to regulatory loss for the year

	31 December 2015	31 December 2014
Statutory loss for the period	**(622.8)**	(225.2)
Statutory loss attributable to minority shareholders	**(0.5)**	(1.4)
Discounted cash flows for ordinary shares not recognised until cash consideration paid	**–**	(9.8)
CET1 capital before regulatory adjustments	**(623.3)**	(236.4)

All amounts are stated in £m unless otherwise indicated

12. Capital Management continued

12.7 Fully-loaded leverage ratio

	31 December 2015	Restated as at 31 December 2014[1]
Derivative exposures	**344.5**	509.1
Securities financing transactions (SFTs)	**86.1**	190.5
Other assets	**28,980.3**	37,557.3
Off-balance sheet items	**938.6**	957.0
Regulatory deductions and other adjustments	**(212.2)**	(354.6)
Total fully loaded leverage exposure	**30,137.3**	38,859.3
Fully-loaded CRD IV Tier 1 Capital	**1,151.1**	1,638.3
Fully loaded leverage ratio[1]	**3.8%**	4.2%

1. The leverage ratio has been calculated using the exposure basis within the European Commission delegated act. Further information on the leverage ratio calculation can be found in the Bank's Pillar 3 disclosures.

The fully-loaded leverage ratio decreased by 0.4% to 3.8% (2014: 4.2%). The leverage ratio is calculated as Tier 1 capital divided by adjusted balance sheet exposures. The reduction in the ratio reflects a £487.2m decrease in total Tier 1 capital which is offset by the impact of a £8.7bn decrease in regulatory leverage exposure as a result of the securitisation of the Optimum portfolio and reflecting the Bank's overall deleveraging strategy.

The Bank anticipates that its leverage ratio will be sustainably above 3.0% by 2020, however it is expected to reduce in the intervening period.

Financial statements

Independent auditor's report to the members of The Co-operative Bank plc only

Our opinion on the financial statements is unmodified

We have audited the financial statements of The Co-operative Bank plc (the "Company") and its subsidiaries (together, the "Bank") for the year ended 31 December 2015 set out on pages 160 to 277. In our opinion:

- the financial statements give a true and fair view of the state of the Bank's and of the Company's affairs as at 31 December 2015 and of the Bank's loss for the year then ended;
- the Bank's financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRSs as adopted by the EU");
- the Company's 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,
- these financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Bank's financial statements, Article 4 of the IAS Regulation.

We emphasise one matter – Going concern

In forming our opinion on the financial statements, which is unmodified, we have considered the adequacy of the disclosures made in part 1.2 of the Basis of Preparation note of the financial statements on page 168 concerning the Bank's and Company's ability to continue as going concerns. In that section the Directors set out the risks associated with the successful execution of the Bank's 2016 – 2020 Strategic Plan (the "Bank's Updated Plan"). These matters represent material uncertainties which may cast significant doubt upon both entities' ability to continue as going concerns. These financial statements do not include the adjustments that would result if either the Bank or the Company were unable to continue as a going concern.

What have we audited?

We have audited the financial statements of the Company and the Bank for the year ended 31 December 2015, which comprise:

- the Bank income statement;
- the Bank statement of comprehensive income;
- the Bank and Company balance sheet;
- the Bank and Company statement of cash flows;
- the Bank and Company statement of changes in equity;
- the Bank and Company accounting policies and the related notes set out on pages 166 to 242 and pages 244 to 277.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the EU and, as regards the 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. 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 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.

Our assessment of risks of material misstatement

The following risks had the greatest effect on our overall audit strategy; on the allocation of resources on the audit; and on directing the efforts of the engagement team:

- Going concern
- The Bank's control environment
- Financial Statement Close Process ("FSCP")
- Loan loss impairment
- Provisions for liabilities and charges related to conduct risk and related to the risk of non-compliance with the provisions of the Consumer Credit Act ("CCA")
- Fair value of derivatives with higher estimation uncertainty and hedge accounting
- Release of fair value adjustments in relation to Leek notes
- Income recognition from EIR accounting
- Separation from The Co-operative Group ("TCG")
- Accounting for material transactions

We classified the first two risks, "Going concern" and "The Bank's control environment", as pervasive matters and treated them accordingly during our audit as described below. The other risks were seen as highlighting matters that gave rise to a more specific risk of material misstatement within the financial statements.

All of these risks are generally consistent with the nature of the significant risks considered during our 2014 financial year audit with the following exceptions:

- In line with the Bank's Plan[1], a number of complex transactions have been executed during the year. The primary drivers of these transactions have been to implement changes to the Bank's operating infrastructure, reduce risk weighted assets, or reduce operating costs. The scale and complexity of these transactions in aggregate led to a significant audit risk for the 2015 financial year: "Accounting for material transactions"; and,
- Wherever possible we have refined the significant risks to focus on those specific areas that give rise to the matter. For example, in the prior year we had a significant risk of "Release of fair value adjustments" whereas for the current year that significant risk has evolved to "Release of fair value adjustments in relation to Leek notes"

In addressing these risks, we undertook the procedures below which were designed in the context of the materiality of the financial statements as a whole. Consequently, we do not express any opinion on any individual area taken in isolation.

In addition, we noted four fraud risk factors present in each of these risks to varying degrees, being:

- Management override;
- Misappropriation of assets;
- Revenue recognition; and,
- Fraudulent financial reporting.

Our work in each area considered these matters to the degree appropriate.

1 The Bank manages to a rolling five year Strategic Plan. The original Plan giving rise to the significant amount of change highlighted here was the 2015-2019 Plan which was superseded by the 2016-2020 Plan.

Taking the two pervasive matters and then the risks of material misstatement in turn:

Issue	Our response to the issue	What we concluded to the Audit Committee
Going Concern Please refer to page 64 (Audit Committee report) and pages 168 to 171 (Basis of Preparation note) **The risk:** As described in the basis of preparation note, the going concern status of the Bank is dependent on successful execution of the Bank's 2016 – 2020 Updated Plan. Successful execution of the Bank's Plan has risks and uncertainties associated with it which indicate the existence of a material uncertainty which may cast doubt on the ability of both the Bank and Company to continue as going concerns. The key risks inherent in the Bank's Plan include, inter alia: • the ability of the Bank to avoid further regulatory action from either the Prudential Regulation Authority (the "PRA") or from the Financial Conduct Authority (the "FCA"), including by continuing to deliver against that plan, successfully rolling out the Bank's Risk Management Framework and by improving its capital modelling capabilities; • the regulators' continued acceptance of the Bank's Plan which forecasts shortfalls against ICG and the PRA buffer, includes a period of non-compliance with IRB modelling requirements under CRR, and addresses the current breach of FCA non-financial resources threshold conditions relating to the Bank's IT infrastructure; • the ability of the Bank to comply with future MREL requirements which may require the Bank to raise additional capital or issue MREL-eligible debt; • remediation of the Bank's IT systems and infrastructure which are outdated, poorly controlled and have a lack of proven end to end disaster recovery capabilities. In January 2015, the Bank entered into a major contract with a third party to remedy some of these key issues through outsourcing the Bank's enterprise computing services. This project carries significant execution risk; • the Bank has entered into an outsourcing contract with a third party for the provision of mortgage processing. This creates execution risk as the processes and data transfer to the third party supplier and the Bank begins to manage data and information flows from the third party relationship; • the Bank's ability to separate its operations from its former parent, The Co-operative Banking Group Limited, and its ultimate former parent, TCG, with both of which it shares premises, systems and services;	**Our response:** Our audit procedures have included, amongst others, understanding and questioning the assumptions and milestones in the Bank's Plan, such as those around remediation of the Bank's IT infrastructure, continued deleveraging of non-core assets, reduction in the Bank's cost base and future return to profitability. This included assessing management's process for setting the Bank's Plan, monitoring progress against it and evaluating that progress. Our challenge was undertaken with reference to our knowledge of the Bank and experience of the wider UK banking sector. We also gained an understanding of the key aspects of the financial and business planning process upon which the Bank's going concern assessment is based, assessing reasonableness of the design of the process and testing whether it incorporates appropriate and sufficient senior management and Board review and approval. We also considered the reasonableness and consistency of application of key assumptions, including those related to deleveraging, to profit and cost initiatives, and to the overall economic outlook. We reviewed and objectively challenged management's estimates of the costs associated with the Bank's commitment to separate from TCG and obtained supporting evidence for management's estimates of those costs such as agreeing to third party contracts. The Bank's IT infrastructure contains a number of known control deficiencies including a lack of proven disaster recovery capability. This is an area in which both the PRA and FCA are holding the Bank to delivery of a remedial plan. The project to remediate this matter is the Enterprise Services Programme which we considered as part of our response to the significant risk related to *Separation from TCG*. Given the regulator's focus in this area, the results of our work in relation to the Enterprise Services Programme were also relevant and considered in formulating our conclusions on going concern. In considering the ability of TCG to honour its commitments to the Bank, we assessed the Directors' investigations and conclusions into the current position of TCG and its ability to fulfil its operational commitments. This included considering the Bank's assessment of TCG's operational service provision during the year and the Bank's consideration of any material risks to the continuation of those services, as well as reviewing various underlying agreements and independent confirmations.	We concluded that the referenced disclosures appropriately reflect the Directors' assessment of the Bank's position in relation to going concern. This conclusion is supported by our discussions with both regulators and also with the Bank's executive management and Board. We understand the regulators are holding the Bank to delivery of its Plan and the remediation actions therein, and that they remain focused on the roll out of the Bank's Risk Management Framework and on the Bank's actions to improve its internal modelling capabilities. We included an emphasis of matter in this Audit Report highlighting that the matters described in these disclosures represent material uncertainties which may cast significant doubt upon both entities' ability to continue as going concerns and that these financial statements do not include the adjustments that would result if either the Bank or the Company were unable to do so.

<table>
<tr><th>Issue</th><th>Our response to the issue</th><th>What we concluded to the Audit Committee</th></tr>
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- The Bank participates in TCG's defined benefit pension scheme (Pace). As long as the Bank remains a participating employer in Pace, the Bank could be 'last man standing' in the event of the failure of one or more of the other participating employers meaning that some or all of Pace's liabilities would need to be borne by the Bank;
- the ability of the Bank to continue to implement and achieve the milestones and results set out in the plan, taking account of the stresses that could adversely affect that plan such as achieving separation of business operations from TCG and the associated costs, including future pension funding obligations;
- the ability of TCG to meet its operational commitments to the Bank; and,
- the ability of the Bank to appropriately refresh both its Board and senior management team as the need arises whilst executing the Plan.

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When reviewing the Bank's assessment of its ability to withstand stressed conditions as defined by the PRA we considered market conditions and the Bank's plans to achieve further deleverage and retained earnings growth. Our review was undertaken in the light of the Bank's 2015 performance versus the 2015 – 2019 Revised Plan.

We regularly met with both the PRA and the FCA during the course of our work to understand their approach to the areas where they are currently holding the Bank to delivery of its Plan, as referred to on page 32.

We also assessed whether the Bank's disclosures in relation to going concern adequately reflected the associated principal risks.

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The Bank's control environment

Please refer to pages 66 and 67 (Audit Committee report)

The risk: We continued to identify weaknesses in the Bank's control environment in excess of what would be considered normal in the banking industry. This limited the opportunities that we had to place audit reliance on the design, implementation and operating effectiveness of the key controls that management relies on for the proper functioning of the Bank's systems and processes. This is because the control environment currently involves an extensive use of manual controls such as end user computing rather than automated system-based controls, and the retained evidence supporting the operation of these manual controls is frequently inadequate. This approach substantially increases operational risk, and required us to adopt increased substantive testing procedures in most areas of the Bank's operations.

Furthermore, as mentioned elsewhere in the Annual Report and Accounts ("ARA"), the Bank's deployment of an effective Risk Management Framework is incomplete in key areas. There are weaknesses in the availability, quality and use of data from source systems for use in financial models; and there has been a loss of corporate knowledge following significant changes in personnel in key areas of the business.

As the robustness of financial reporting depends on the correct functioning of the underlying operational and financial IT systems, as well as on the effectiveness of the Bank's wider control environment, we deemed this matter to be a pervasive risk.

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Our response: Our audit approach included an assessment of the quality and effectiveness of the key internal controls that management relies on for financial reporting.

We planned our audit to place reliance, where both possible and appropriate, on those internal controls including general IT controls where these could be determined as operating effectively.

Where we were unable to place such reliance we addressed the increased pervasive risk by designing and then undertaking audit procedures to obtain a greater proportion of evidence from substantive testing, for example, third party evidence, detailed testing of inter-system reconciliations between key systems for financial reporting, and increased sample sizes for our tests of balances.

We used IT specialists within our audit team to conduct our IT procedures which included, amongst others, testing general IT controls relating to system access and change management, and testing controls over specific IT applications which are required to operate effectively to mitigate the risk of misstatement within the financial statements.

For many IT systems which are key for financial reporting, the controls were not operating effectively. We considered the impact of such ineffective operation on the Bank's financial information and, where relevant, extended the scope of our work by identifying and testing compensating manual controls or reduced our control reliance by undertaking additional substantive procedures.

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We highlighted to the Audit Committee that for many of the Bank's IT systems, the controls continued not to be operating effectively.

We also highlighted that this had led to us extending the scope of our work by identifying and testing compensating manual controls and that we had necessarily reduced our control reliance by undertaking further additional substantive testing.

In this way we had sought to address the increased pervasive risk by selecting audit procedures to obtain a greater proportion of evidence from substantive testing, for example, third party evidence, reconciliations between financial systems and increased sample sizes for those substantive tests.

We satisfactorily obtained the necessary audit evidence from our additional substantive work.

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Issue	Our response to the issue	What we concluded to the Audit Committee
Financial Statement Close Process Refer to pages 66 to 67 (Audit Committee report) **The risk:** The Bank's Financial Statement Close Process ("FSCP"), including the ledger close process and the consolidation, remains heavily reliant on manual processes and the use of spreadsheets. The Bank commenced a Finance Transformation Project ("FTP") during 2015 to improve processes within the FSCP. Whilst this programme continues through its implementation phases, a large number of manual adjustments needed to be posted directly into either the legacy ledgers, into the new Single General Ledger ("SGL"), or into the consolidation workings spreadsheet for the current year end. As a result there is a risk that the primary financial statements and/or related disclosures may be misstated. This is therefore deemed a significant audit risk.	**Our response:** After assessing design and implementation, and testing operating effectiveness of the key controls over management's process for preparing and operating the FSCP we chose to adopt a primarily substantive approach with lower testing thresholds for our audit. This was due to the control environment being in a nascent state given the amount of change arising due to the FTP. Our testing included: • reconciling the opening balances for each entity back to the prior year audited financial statements and to the new SGL; • reviewing and investigating recurring manual journals and the consolidation journals posted in prior periods by considering the nature of these journals to understand whether their posting is still required in the current year and that they are being posted for the correct amounts; • reconciling and substantiating material intercompany adjustments; • testing that material topside adjustments have been reviewed and approved by senior management prior to posting as this is a key control that the Bank relies on in connection with the accuracy of compilation of the financial statements. We then considered whether such journals have appropriate supporting evidence, were posted appropriately and are consistent with our conclusions on the judgements and estimates made by management; • reviewing and investigating a sample of manual journals recognised across the year to ensure that these journals are appropriately posted and evidenced; and, • examining management's reconciliations between source systems and the general ledger. We adopted a similar approach for the notes to the accounts by considering their preparation and testing that they agree to the Bank's underlying records and transactions.	We concluded to the Audit Committee that the heavy manual reliance seen within the Bank's FSCP is unusual in the banking industry. We also commented that the first phase of the implementation of the new SGL in February 2016, only marginally reduced the level of manual intervention in the current process. The many year-end adjustments, the preparation of the Bank's consolidation and the preparation of the notes to the accounts remained to be manually populated at the current year end. The planned decommissioning of multiple ledgers and the proposed implementation of a new automated consolidation tool is a key forthcoming stage in the FTP. Ongoing monitoring and senior management oversight is required as progress is achieved and new processes become embedded in the Bank's FSCP. Overall, despite the presence of the many manual work-arounds, the Bank had satisfactorily managed the reporting risk within the FSCP.
Loan Loss Impairment Refer to page 64 (Audit Committee report), pages 180 to 182 (Critical Judgements and Estimates note), Risk Management section, and pages 196 to 198 (financial disclosures) **The risk:** The Bank continues to deleverage its lending portfolio by selling or securitising loans. As a result, there is a risk that the specific and collective loan loss provisions may not appropriately reflect the implications of this strategy on the forecasts of recoverable cash flows and the discounts to market values at the time of sale, including costs to sell.	**Our response:** We assessed the design and implementation, and tested the operating effectiveness of key controls over management's processes for establishing and monitoring the levels of both specific and collective provisions. This included management's corporate loan review process, incorporating the Strategic Asset Review, Corporate Impairment and Defaults Group and Deep Dive review exercise. We also tested the Bank's governance and oversight controls over the various collective models.	We concluded to the Audit Committee that the provision levels held by the Bank in relation to Loan Loss Impairment were reasonably estimated and that the disclosures presented were materially in compliance with IFRS. We highlighted to the Audit Committee that: • The level of estimation uncertainty in the corporate loan portfolio has reduced due to active management; the resolution of default cases and through portfolio sales;

<table>
<tr><th>Issue</th><th>Our response to the issue</th><th>What we concluded to the Audit Committee</th></tr>
<tr><td>As regards the retail lending portfolios, the concerns over the Bank's control environment noted above lead to an increased risk that inappropriate or incomplete data is being used in the Bank's collective provisioning models.

The portfolios giving rise to the greatest risk of material misstatement are those subject to potential collateral shortfalls, in particular, the corporate and Optimum books. Optimum is a closed mortgage book of predominantly interest-only, intermediary sourced and acquired assets. During the year the Bank completed the securitisation of two tranches of Optimum mortgage loans which has reduced this risk. With respect to the corporate loan book, the Bank has continued its managed reduction of asset balances.

Estimating the Bank's provisions for impairment losses is highly subjective, requires management and the Directors to exercise significant judgement, and incorporates the use of assumptions. There is also a risk of management override of controls associated with loan loss impairment.

Due to the materiality of the provisions and level of judgement involved, this is considered a significant audit risk.</td><td>Our substantive audit procedures over the collective provision models included assessing, challenging and substantiating the key assumptions, such as:
• emergence periods;
• probabilities of default;
• collateral valuations;
• loss rates;
• recovery rates; and
• discount rates.

We assessed these assumptions through substantiating to historical data and with reference to our knowledge of the Bank's portfolios. In relation to the discount rates and the indexing of collateral valuations, we verified that the Bank's models incorporate appropriate and accurate data. In terms of the emergence periods employed, we considered relevant external benchmarks in assessing their appropriateness in addition to comparing to the Bank's own historical data.

The Bank applies a number of overlays to the collective provision models in order to adjust for shortfalls in risk models. We reviewed the identified overlays for completeness using our knowledge and experience across the banking sector and tested each significant overlay for appropriateness of methodology and accuracy of calculation.

When undertaking our assessments of a sample of specific loan loss provisions, we considered the Directors' strategies for the Bank's non-core portfolios, including whether the assumptions as to recoverability were consistent with those stated strategies, and expectations and timing of the future cash flows arising from the realisation of security held for individually assessed loans.

Our approach included the use of our own valuation specialists to assess and benchmark the key assumptions underpinning a sample of collateral valuations using our knowledge and expectations of the UK market.

We tested relevant credit risk data for completeness of capture and accuracy of extraction from the underlying Bank systems and also compared the inputs into the impairment models.

In addition, we tested the logic of the model calculations and changes to the prior year model using our in-house model validation team.

We considered whether the Bank's disclosures are compliant with the relevant accounting standards and whether they appropriately reflect the exposure to credit risk – please refer to the Risk Management section.</td><td>• The provision and estimation uncertainty associated with the Optimum portfolio has reduced significantly due to the securitisations completed in the year;
• Data flows into the collective provision models were found to be materially complete and accurate;
• The assumptions incorporated within the collective provision models were found to be reasonable and supported by historical data;
• Key controls identified were found to be designed and operating effectively; and
• The assessment of a sample of specific loan loss provisions, including the independent valuation of collateral, found that management's estimates were reasonable and the collateral held was appropriately valued.</td></tr>
</table>

Independent auditor's report to the members of The Co-operative Bank plc only continued

Issue	Our response to the issue	What we concluded to the Audit Committee
Provisions for liabilities and charges related to conduct risk and related to the risk of non-compliance with the provisions of the Consumer Credit Act ("CCA"). Please refer to page 64 (Audit Committee report), pages 182 to 183 (Critical Judgements and Estimates note) and pages 208 to 209 (financial disclosures) **The risk:** The Bank carries a large number of provisions for various matters including those related to the conduct of the Bank towards its past and present customers such as: • mis-selling Payment Protection Insurance ("PPI") and packaged accounts; • technical breaches of the CCA; and, • actions detrimental to mortgage customers. The assessment of present obligations for customer redress requires significant judgement due to uncertainties over whether an obligation exists and the subjective assumptions used in the quantification of potential redress levels. In particular, the identification of compliance or conduct issues relating to mortgage customer detriment and packaged current accounts is highly judgemental, as is the identification of affected populations. As regards PPI, the FCA's related Consultation Paper ("CP") of Q4 2015 led to banks needing to reassess their provision models in the light of expectations of the introductions of both a 2 year time bar and of a revised approach to the consideration of product commission levels – the latter relates to a court case commonly known as "Plevin". In relation to the CCA, the impact of highly technical aspects of the Act can materially impact the Bank's ability to collect interest from customers. There is a heightened risk relating to the completeness of the data retained by the Bank, as well as with the complexity of modelling such provisions, as the issues being provided for generally have a number of inter-dependent variables that could all materially affect the outputs. In addition, disclosures in relation to customer redress need to appropriately reflect both the application of judgement by the Directors in estimating those required provisions, as well as contingent liabilities. Due to the materiality of the potential redress for the items highlighted above this is considered a significant audit risk.	**Our response:** Our audit procedures have included, amongst others, considering how management establishes completeness of identified issues and the adequacy of provisions recognised. Our audit focused particularly on the Bank's processes for identifying possible customer redress issues and the integrity of data used to quantify the obligations arising. Specifically, to assess the completeness of the issues being provided for and the populations of customers impacted by each issue, we: • reviewed the external legal opinions obtained by the Bank as part of the Bank's process of deciding what matters create obligations for customer redress; • examined regulatory guidance and press releases to the market such as the FCA's CP in relation to PPI; • reviewed correspondence between the regulators and the Bank; and, • obtained written representations from the Directors as regards the completeness of issues provided for and the data used within significant provisioning judgements. The Bank incorporated an allowance for data gaps and model risk in the above provisions. We assessed the reasonableness of the data gaps by validating the missing fields at account level within the data sets and comparing them to those used in management's calculation. In addition, we performed two-way data testing between source systems and models. We also assessed the key assumptions being used in the models, including expected claim and uphold rates, redress levels and operating costs, and compared them to our own expectations based on the Bank's historical experience, current trends and our industry knowledge. We also considered the sensitivity of the level of provisions to changes in these assumptions when scoping and performing our audit procedures and when forming our judgements on the adequacy of provisions. We evaluated whether there was sufficient evidence to support management's assumptions. We also considered whether the Bank's disclosures in relation to customer redress provisions appropriately reflected the application of judgement by the Directors in estimating those required provisions and in identifying any potential contingent liabilities.	We highlighted to the Audit Committee that the Bank's estimates were in line with industry practice as a whole. However, the following factors amongst other matters, highlight this as the most subjective area of accounting estimation within these financial statements: • the continued presence of data gaps; • uncertainty surrounding how the market will react to the FCA's forthcoming guidance when it is finalised in relation to both Plevin and to the proposed time-barring of complaints; and, • the fact that in a number of areas the Bank's estimates continue to be model based and derived from historical customer claim patterns as opposed to being based on actual current pay out experience. As a result there remains a risk that actual outcomes will not match current best estimated predictions. For the key judgements used in PPI and CCA, we found that the sensitivities at 31 December were acceptable.

<table>
<tr><th>Issue</th><th>Our response to the issue</th><th>What we concluded to the Audit Committee</th></tr>
<tr><td>

Fair value of derivatives with higher estimation uncertainty and hedge accounting

Refer to page 65 (Audit Committee report), page 184 (Critical Judgements and Estimates note) and page 202 (financial disclosures)

The risk: The Bank has a portfolio of derivative financial instruments which are used for hedging purposes, many of which are designated in hedge accounting relationships. Some derivative instruments, including certain cross currency, interest rate and index swaps are more complex in nature than others, and the Bank's valuation systems for these instruments require the use of manual data inputs to calculate fair values at period ends. These valuation processes carry higher inherent risk of error as a result.

Based on the results of our audit of the 2014 financial statements, we identified that these fair values can be susceptible to inaccurate data inputs, or inadequacies in the valuation methodologies applied.

The Bank applies hedge accounting at a portfolio (macro) level for both fair value and cash flow hedge accounting relationships and at a micro level for fair value accounting relationships. The application of hedge accounting under IAS 39 can be complex and requires that the Bank values hedged items for hedged risks only and then accurately identifies all sources of hedge accounting ineffectiveness that arise. A number of material errors were uncovered in our prior year audit in relation to the correct application of hedge accounting, and when combined with the higher inherent risk presented by the Bank's valuation processes for more complex derivatives, we determined this to remain an area of significant audit risk for the current year's audit.

</td><td>

Our response: We assessed the design and implementation, and tested the operating effectiveness of certain controls over management's process for monitoring the Bank's treasury related activities.

In order to assess the valuation risk, the portfolio was divided into instruments of lower and higher estimation uncertainty. A greater extent of testing was performed on instruments assessed to have higher estimation uncertainty associated with their valuation.

Our audit procedures included, for a sample of higher estimation uncertainty financial instruments: (a) validation of the trade data within the Bank's systems for completeness and accuracy against original trade confirmations; and (b) performance of an independent valuation by our in-house derivative valuation experts. Further, we:

- assessed the valuation methodologies and assumptions used by the Bank against our expectations of generally accepted valuation techniques; and
- assessed the reasonableness of the market data used by the Bank as model inputs against standard market data sources including swap curves, implied volatility and FX rates; the proxy rates used in place of market data; and the resulting curves derived from the market data including discount factors and forward curves.

In relation to hedge accounting, we assessed the hedge documentation, hedge relationship and the hedge designation for compliance with the requirements of IAS 39.

We also considered management's oversight of the risks arising in this area. We then tested the valuations of the hedged risks within hedged items on a sample basis, and considered whether the Bank had identified those sources of hedge accounting ineffectiveness that we would expect to be recorded based on our experience of the sources of ineffectiveness observed in the market.

We tested the Bank's calculations of hedge accounting effectiveness to assess whether the Bank had appropriately calculated hedge ineffectiveness to be recorded in the income statement and to assess whether there were any hedge relationships that should have been discontinued.

</td><td>

We concluded to the Audit Committee that the fair value of derivatives with higher estimation uncertainty and the valuation of hedged items for hedged risks were materially correct and in accordance with IFRS 13 *Fair Value Measurement*.

Appropriate market data had been used as inputs to these financial instrument valuations, and we identified no significant differences between the higher estimation uncertainty derivative balances reported by the Bank and the results of our testing of valuations.

We concluded that the Bank has appropriately applied the hedge accounting provisions of IAS 39, that hedge ineffectiveness recorded in the income statement is materially correct and that that there were no hedge relationships that should have been discontinued.

</td></tr>
</table>

Issue	Our response to the issue	What we concluded to the Audit Committee
Release of fair value adjustments relating to Leek notes Refer to page 65 (Audit Committee report), page 184 (Critical Judgements and Estimates note) and page 236 (financial disclosures) **The risk:** At the time of the merger of The Co-operative Bank and Britannia Building Society in 2009, the Bank was required to make certain adjustments to the carrying value of acquired assets and liabilities in order to record them at their fair values. For financial assets and liabilities, these adjustments are generally released to the income statement over the behavioural lives of the assets and liabilities through their effective interest rate. The significant adjustments now remaining relate to the Leek Notes. This is the generic term used to describe the asset backed paper originally issued by the legacy Britannia Building Society. Judgement is required in relation to the circumstances and conditions which indicate that the timing of the release of fair value adjustments to the income statement may need to be revised. This can arise should there be revisions to management's assumptions of when the notes will be called before contractual maturity. Due to the materiality of the fair value adjustments which relate to the Leek notes on the balance sheet, and the need for significant judgement to be used when determining changes in behavioural lives of the acquired notes, this was identified as a significant risk.	**Our response:** The Bank calculates the amount of fair value adjustments to be unwound in each period through cash flow models. We compared the current period models to those audited in previous periods to vouch consistency of data within the models and also of the judgements made in respect of the behavioural lives of the Leek notes. In addition, we tested the models for clerical accuracy and consistency. We considered whether judgements made in respect to the call dates of the Leek notes, which determine the amount to be unwound in each period, were consistent with our knowledge of the Bank's Plan. We used our knowledge of the characteristics of the Leek notes to form independent expectations of the amount to be recorded in the income statements and investigated variances between our expectations and the Bank's reported movements. We also considered the adequacy of the disclosures related to fair value adjustments of the Leek Notes within the financial statements.	We concluded to the Audit Committee that management's assessment that the behavioural lives of the Leek notes are consistent with the prior year was both appropriate and consistent with our knowledge of the Bank's Plan. As a result the unwind profile of the notes was unchanged and there is a clear pattern of amortisation through to the scheduled call dates. We were therefore satisfied that the amounts being unwound to the income statement were fairly recorded.
Income recognition from EIR accounting Refer to page 65 (Audit Committee report), page 184 (Critical Judgements and Estimates note) **The risk:** The Bank operates a number of models to estimate its income under the Effective Interest Rate ("EIR") accounting method. EIR spreads across the life of a financial instrument the costs incurred and fees received that are in substance an integral part of the overall yield. The EIR method also seeks to recognise interest at a constant rate across the expected life of a mortgage loan rather than at, for example, a lower rate in an initial fixed or discounted rate period and then a higher variable rate in the period that follows. The method involves various calculations and judgements in both determining an instrument's initial EIR and recording the present value of adjustments arising under the method in subsequent periods when cash flows are reforecast. EIR models are most sensitive to changes in the estimates of the behavioural lives of mortgages and future interest rate expectations. Modelled forecast cash flows may be inaccurate either due to the use of inaccurate data, inappropriate formulae or incorrect assumptions being used.	**Our response:** We assessed the effectiveness of management's processes for setting and updating EIR assumptions and methodologies. Our audit procedures have included, amongst others, challenging management's assumptions used within the Bank's EIR accounting models. For example, we assessed the consistency of forecast standard variable rates with market derived base rate forecasts and the Bank's expectations of future interest margins, and we compared customer redemption assumptions with the recent customer redemption behaviours observable in the Bank's portfolios. We considered the appropriateness of these assumptions in light of our knowledge of the Bank's portfolios, market conditions and observed practice in the UK mortgage sector. Management utilises various models to calculate required EIR adjustments. The assumptions which are input into the models are derived from management's analysis of customer behaviours and forecast exogenous factors.	We concluded to the Audit Committee that the EIR adjustments made to mortgage portfolios were materially correct. We considered management's process and determined that the approach taken results in a reasonable and appropriate outcome in the context of current observable market behaviours and economic conditions. We also highlighted that there is a high degree of subjectivity in management's assumptions concerning behavioural lives and future rates of interest. We were satisfied that the assumptions made by management are reasonable in the context of the Bank's mortgage portfolios and current market conditions.

Issue	Our response to the issue	What we concluded to the Audit Committee
Due to the complexity of calculation; the degree of judgement that needs to be exercised by management around forecast future cash flows; weaknesses in the Bank's data; and, the number of different products the Bank has across its various lending portfolios, this is considered a significant audit risk.	We tested the completeness and accuracy of data within these models through sample testing from model to source systems and vice-versa. We tested the logic of the EIR model calculations through independent recalculation of EIR adjustments to assess both the compliance of the Bank's modelling techniques with the requirements of IAS 39 and also the reasonableness of management's assumptions. We also considered the completeness and accuracy of the disclosure of the sensitivities impacting EIR within the financial statements.	
Separation from TCG Please refer to page 65 (Audit Committee report), page 184 (Critical Judgements and Estimates note) and page 208 (financial disclosures). **The risk:** In 2014, the Bank began to separate its operations from TCG. The Bank continues to be reliant on TCG in a number of areas; the key example of which would be the provision of IT infrastructure until the Bank successfully transfers operation of its systems to its new outsourced service provider. Due to the complexity of such infrastructure, separation may result in additional expenses being incurred by the Bank or significant operational losses arising in the event that it is not executed in accordance with the current plan. The Directors have exercised significant judgement in assessing and measuring the impacts of separation, with the two most significant of such judgements being: • the identification of material obligations resulting from the ongoing Enterprise Services Programme, including the determination of whether such expenses should be capitalised, provided for up-front or expensed as they arise; and, • the pension obligations potentially arising from the separation process associated with The Co-operative Group Pension Scheme (known as "PACE"). The magnitude of potential misstatement is high and there is potential for management override to take place through the assumptions made; as such this is considered to be a significant audit risk.	**Our response:** We considered the separation commitments entered into by the Bank and related documents, and evaluated the extent to which potential obligations are recorded and disclosed in line with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. We challenged the assumptions made and key judgements applied by management in the identification and measurement of obligations and also identified where management override of assumptions could take place. We then considered the implications of this on these higher risk areas. Our procedures included obtaining evidence for the valuation and completeness of commitments from contractual documents and the Bank's Plan; testing a sample of the valuation of costs incurred in the period; challenging the projected cost through our understanding of the Enterprise Services Programme status; understanding the impact of actual spend upon original budgets, and reviewing committee minutes and legal correspondence. We assessed whether accounting for PACE as a defined contribution plan continued to be appropriate and in accordance with IAS 19 *Employee benefits*. We assessed the adequacy of disclosures concerning additional liabilities that could arise when the impact on these pension arrangements of separation from TCG becomes clearer. We also assessed the adequacy of the Bank's disclosures in respect of the impact of its planned separation from TCG.	We concluded to the Audit Committee that the separation provision (including accounting for the PACE pension scheme) was reasonable. We highlighted to the Audit Committee that, based on the results of our procedures, obligations are recorded completely and accurately, and are disclosed in line with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. We also advised that the assumptions applied in the provision are reasonable. We highlighted that accounting for PACE as a defined contribution pension plan in the current year remained appropriate and in accordance with IAS 19 *Employee benefits*. Finally, in our view the disclosure of the impact of the Bank's separation from TCG was fairly presented.

Issue	Our response to the issue	What we concluded to the Audit Committee
Accounting for material transactions Please refer to page 64 (Audit Committee report), page 185 (Critical Judgements and Estimates note) and pages 225 and 242 (financial disclosures) **The risk:** In line with the Bank's Plan, the Bank has executed a number of complex transactions and agreements for which determining the appropriate accounting treatment is inherently subjective, requires the exercise of a high degree of judgment, or is subject to significant levels of estimation uncertainty. The transactions considered in the period include: • Material outsourcing arrangements relating to the Bank's mortgage processing operations and IT infrastructure; • Securitisation of two tranches of Optimum mortgage loans; • Issuance of Tier 2 subordinated debt ; and, • Sale of renewable energy asset finance loans. Separate to the Bank's Plan, the fair valuation of the Bank's membership of Visa Europe was also considered. Each of these transactions was material in terms of their impact on the Bank's income statement or Statement of Financial Position. Due to the complexity of these accounting considerations in aggregate, this is considered a significant audit risk.	**Our response:** We assessed the adequacy of management's processes for identifying material and complex transactions. Our audit procedures included, amongst others, challenging the assumptions and judgements made by management in determining the appropriate accounting treatment in accordance with applicable IFRSs. We assessed whether the conclusions reached by the Bank were consistent with the underlying agreements and commercial factors applicable to each of the transactions. We assessed whether the accounting entries made by management were consistent with the accounting analyses and tested the quantum of the adjustments to supporting documentation. Where adjustments were derived from models and/or required estimation, we challenged and assessed the appropriateness of assumptions made by management. We assessed the adequacy of disclosures made in relation to material transactions.	We concluded to the Audit Committee that the accounting judgements made by management were aligned with the requirements of IFRS. We also highlighted to the Audit Committee that the outsourcing agreements involved a degree of judgement in identifying whether specific assets were being constructed for the Bank, and whether these assets should be recognised on the Bank's balance sheet. We concluded that management's judgement had been reasonable in this regard. Furthermore, we observed that the mortgage outsourcing contract included the sale of the subsidiary company to the outsourcing counterparty. The fair value of this entity was subject to a high degree of estimation uncertainty resulting from unobservable inputs into management's valuation model including judgements with respect to cash flow forecasts and the selection of an appropriate discount rate. We were satisfied that the judgements made by management were reasonable, the accounting for this transaction was appropriate and the valuation deemed reasonable. The key judgement in respect to the Optimum deleveraging was whether or not the structure of the securitisation resulted in the Bank being able to derecognise the underlying portions of the mortgage portfolio. We were satisfied that management's analysis of the transaction appropriately concluded that the transaction met the derecognition criteria contained within IAS 39. We were satisfied with the accounting treatment of the Tier 2 subordinated debt issued, including its classification and valuation as of year-end. We were satisfied that the appropriate derecognition criteria were met in the disposal of renewable energy asset finance loans and that the provision recognised in the prior period was appropriately utilised. The valuation of the Bank's membership in Visa Europe as at 31 December 2015 was subject to a degree of estimation uncertainty due to the pending purchase of this equity interest by Visa Inc. We were satisfied that management's assessment of the fair value of its Visa Europe membership as at 31 December 2015 was reasonable.

Our application of materiality

We apply the concept of materiality in both planning and performing the audit, and in evaluating the effect of identified misstatements on our audit, on the financial statements and on forming our audit opinion.

Audit materiality

We define audit materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Audit materiality provides a basis for determining the nature and extent of our audit procedures.

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole. We determined audit materiality for the Bank to be £16m (2014: £20m) which was 1% of the Bank's projected total year end equity at the time of assessment. 1% of this measure is at the lower end of our normal range. The reason for selecting this measure as the basis for our audit materiality consideration is that the Bank's stated focus is to both maintain and restore capital and it is not expected to return to profitability in the short term. We also see this as the main focus for the users of the Financial Statements given the importance of regulatory capital to the Bank's solvency.

This level of audit materiality then provided the basis for:

- determining the nature, timing and extent of our risk assessment procedures;
- identifying and assessing the risk of material misstatement; and,
- determining the nature, timings and extent of our audit procedures.

During the course of our audit, we reassessed our initial audit materiality and maintained it at the level of £16m (2014: £20m) as, after discussion with the key stakeholders, we concluded the difference between expected and actual total year end equity was not significant enough to warrant a change. We note that the £16m level maintained equated to 1.2% of the actual year end equity balance.

Performance materiality

We define performance materiality as the level of materiality that we use at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds audit materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality should be set at 50% (2014: 50%) of our audit materiality, namely £8m (2014: £10m). 50% is at the conservative end of the normal range we use which is 50% to 75%. We have set performance materiality at this percentage due to the issues highlighted above as regards the Bank's overall poor control environment and also with regard to the level of audit differences encountered in the prior year.

Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for the two components is based on their relative scale and risk to the Group as a whole and our assessment of the risk of misstatement in those components.

In the current year, performance materiality allocated to each of the two components was £0.8m (2014: £1m).

Reporting threshold

Our reporting threshold is defined as the amount below which identified misstatements are considered to be clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.8m (2014: £1m), which is set at 5% of our audit materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Respective responsibilities of the Directors and of ourselves as auditor

As explained more fully in the Directors' Responsibility Statement set out on page 80, 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.

What does an audit of financial statements involve?

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Bank and Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors; and
- the overall presentation of the financial statements.

In addition, we read all of the financial and non-financial information in the ARA to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

An overview of the scope of the audit

As highlighted, audit materiality for the financial statements as a whole was set at £16m.

The Bank is principally managed from one location in Manchester, with certain functions such as treasury and some corporate activities operated from London. These functions and operations were subject to full scope audit procedures by the primary audit team, and comprise 96% (2014: 98%) of the Bank's operating income, 100% (2014: 100%) of the Bank's loss before taxation and 99.8% (2014: 98%) of the Bank's total assets.

Two legal entities were considered separately. These entities are: Britannia International Limited ("BINT"), which is based in the Isle of Man and has prepared financial information on a break-up basis as at 31 December 2015; and, Unity Trust Bank plc ("UTB") of which the Bank owns 6.7% (2014: 26.7%).

In 2014 the Bank consolidated UTB by virtue of controlling the majority of appointments to the UTB board. Subsequent to the disposal of a 20.0% shareholding by the Bank and the removal of the Bank's ability to appoint members to the UTB board in December 2015, UTB is no longer consolidated but is instead accounted for as an equity investment. These two entities are not audited by Ernst & Young LLP, and account for 4% (2014: 2%) of the Bank's operating income and 0.2% (2014: 2%) of the Bank's total assets and were subject to specific scope audits. These audits covered net interest income, loss before taxation, loans and advances to customers and total assets in the case of BINT and solely net interest income and loss before taxation relevant to the period of consolidation for UTB.

The audits undertaken for group reporting purposes at the non-EY components of the Bank were performed to a materiality level that we had set, being £0.8m as highlighted above. Detailed audit instructions were sent to the auditors of the two components. These instructions specified the significant audit areas that should be covered by these audits (which included the relevant risks of material misstatement detailed above) and set out the information required to be reported back to us. We then discussed the findings and conclusions with the non-EY component auditors as necessary.

Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

We have nothing to report in respect of the matters on which we are required to report by exception

Under the ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the Directors' statement that they consider the ARA taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Bank's performance, business model and strategy; or
- the Corporate Governance section of the ARA describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

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 Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the 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 and Directors' statement in relation to going concern as if the Company were required to comply with the Listing Rules. Under the terms of our engagement we are required to review:

- the Directors' statements in relation to going concern, set out on page 50, and longer-term viability, set out on page 64; and
- the part of the Corporate Governance Statement on page 53 relating to the Company's compliance with the provisions of the UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Statement on the Directors' Assessment of the principal risks that would threaten the solvency or liquidity of the entity

Under the ISAs (UK and Ireland) we are required to give a statement as to whether we have anything material to add or to draw attention to in relation to:

- the Directors' confirmation in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the disclosures in the annual report that describe those risks and explain how they are being managed or mitigated;
- the Directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements; and
- the Directors' explanation in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing material to add or to draw attention to not otherwise highlighted herein.

Peter Wallace (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
31 March 2016

Notes:

1. The maintenance and integrity of The Co-operative Bank plc web site is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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The Bank financial statements

The Bank income statement

For the year ended 31 December 2015

All amounts are stated in £m unless otherwise indicated

	Note	2015	2014 Re-presented
Interest receivable and similar income	7	**821.6**	1,064.8
Interest expense and similar charges	7	**(522.4)**	(706.8)
Net interest income		**299.2**	358.0
Fee and commission income	8	**131.9**	197.3
Fee and commission expense	8	**(60.1)**	(74.9)
Net fee and commission income		**71.8**	122.4
Other operating expense	9	**(130.3)**	(13.5)
Operating income		**240.7**	466.9
Operating expenses			
Operating expenses	10	**(765.7)**	(852.6)
Provision for customer redress	32	**(134.9)**	(52.3)
Total operating expenses		**(900.6)**	(904.9)
Operating loss before impairment losses		**(659.9)**	(438.0)
Impairment gains on loans and advances	17	**48.6**	173.2
Operating loss		**(611.3)**	(264.8)
Share of post-tax profits from joint ventures	36	**0.7**	0.6
Loss before taxation		**(610.6)**	(264.2)
Income tax	12	**(12.2)**	39.0
Loss for the financial year		**(622.8)**	(225.2)
Attributable to:			
Equity shareholders	13	**(623.3)**	(226.6)
Non-controlling interests		**0.5**	1.4
		(622.8)	(225.2)
Loss per share (basic and fully diluted)	13	**(138.05)p**	(61.48)p

The income statement has been re-presented for 2014 to reflect a change in accounting policy applied in the year regarding the re-classification of hedge ineffectiveness, gains and losses from forward contracts, options, futures, and the translation of foreign currency assets and liabilities from net trading income and net interest income to other operating expense.

The notes on pages 166 to 242 form part of these financial statements.

The Bank statement of comprehensive income

For the year ended 31 December 2015

All amounts are stated in £m unless otherwise indicated

	Equity shareholders 2015	**Non-controlling interests 2015**	**Total 2015**	Equity shareholders 2014	Non-controlling interests 2014	Total 2014
(Loss)/profit for the year	**(623.3)**	**0.5**	**(622.8)**	(226.6)	1.4	(225.2)
Other comprehensive income that may be recycled to profit and loss:						
Changes in cash flow hedges						
Net changes in fair value recognised directly in equity	**(47.6)**	**(0.1)**	**(47.7)**	43.1	(0.1)	43.0
Transfers from equity to income or expense	**26.2**	**–**	**26.2**	11.5	–	11.5
Income tax	**(3.0)**	**–**	**(3.0)**	(8.7)	–	(8.7)
Changes in available for sale assets						
Net changes in fair value recognised directly in equity	**19.1**	**–**	**19.1**	63.8	–	63.8
Transfers from equity to income or expense	**17.5**	**–**	**17.5**	(12.5)	(0.3)	(12.8)
Income tax	**(5.6)**	**–**	**(5.6)**	(12.6)	0.1	(12.5)
Other comprehensive income for the financial year, net of income tax	**6.6**	**(0.1)**	**6.5**	84.6	(0.3)	84.3
Total comprehensive income for the financial year	**(616.7)**	**0.4**	**(616.3)**	(142.0)	1.1	(140.9)

The notes on pages 166 to 242 form part of these financial statements.

The Bank balance sheet

At 31 December 2015

All amounts are stated in £m unless otherwise indicated

	Note	2015	2014
Assets			
Cash and balances at central banks	15	**2,678.5**	4,765.3
Loans and advances to banks	16	**871.0**	1,608.4
Loans and advances to customers	17a	**19,690.4**	25,377.4
Fair value adjustments for hedged risk	17b	**94.0**	148.5
Investment securities – loans and receivables	18a	**15.0**	18.1
Investment securities – available for sale	18b	**4,296.8**	3,167.5
Investment securities – fair value through income or expense	18c	**582.4**	1,236.9
Derivative financial instruments	19	**370.1**	470.7
Non-current assets classified as held for sale	14	**3.4**	387.3
Equity shares	20	**55.6**	2.8
Investments in joint ventures	36	**4.9**	5.3
Investment properties	22	**2.1**	2.1
Property, plant and equipment	23	**46.1**	67.5
Intangible assets	21	**142.8**	103.7
Other assets	24	**124.1**	187.6
Prepayments and accrued income	25	**43.5**	12.2
Current tax assets		**–**	0.6
Deferred tax assets	33	**7.6**	21.0
Total assets		**29,028.3**	37,582.9
Liabilities			
Deposits by banks	26	**725.9**	615.4
Customer accounts		**22,732.0**	29,614.0
Customer accounts – capital bonds	27	**77.4**	263.8
Debt securities in issue	28	**2,554.3**	3,443.6
Derivative financial instruments	19	**346.9**	551.7
Other borrowed funds	29	**459.9**	196.4
Other liabilities	30	**68.8**	157.8
Accruals and deferred income	31	**152.5**	16.0
Liabilities directly associated with non-current assets classified as held for sale	14	**–**	7.9
Provisions for liabilities and charges	32	**499.2**	617.5
Current tax liabilities		**0.3**	0.3
Deferred tax liabilities	33	**47.8**	84.0
Total liabilities		**27,665.0**	35,568.4
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	38	**22.6**	22.6
Share premium account	38	**1,736.9**	1,736.9
Retained earnings		**(896.4)**	(273.1)
Available for sale reserve		**55.6**	24.6
Capital redemption reserve		**410.0**	410.0
Cash flow hedging reserve		**34.6**	59.0
		1,363.3	1,980.0
Non-controlling interests		**–**	34.5
Total equity		**1,363.3**	2,014.5
Total liabilities and equity		**29,028.3**	37,582.9

Approved by the Board on 31 March 2016:

Dennis Holt, Chairman
Niall Booker, Chief Executive

The notes on pages 166 to 242 form part of these financial statements.

The Bank statement of cash flows

For the year ended 31 December 2015

All amounts are stated in £m unless otherwise indicated

	2015	2014
Cash flows used in operating activities		
Loss before taxation	**(610.6)**	(264.2)
Adjustments for:		
(Increase)/decrease in prepayments and accrued income	**(31.3)**	4.3
Increase/(decrease) in accruals and deferred income	**136.5**	(38.1)
Interest payable in respect of other borrowed funds	**28.6**	22.8
Effect of exchange rate movements	**0.2**	0.5
Fair value movement on investment properties	**–**	4.5
Impairment gains on loans and advances	**(48.6)**	(170.9)
Movements on investment impairments	**–**	(20.0)
Depreciation and amortisation	**39.4**	40.0
Impairment of intangible assets	**1.3**	7.6
Interest amortisation	**6.6**	6.0
Fair value movements and amortisation of financial assets and liabilities	**(106.6)**	(206.2)
Impairment of property, plant and equipment	**–**	14.7
Gain on disposal of property, plant, equipment and software	**(3.0)**	(0.2)
Loss on disposal of investment property	**–**	1.2
Net loss on sales of subsidiaries	**0.7**	–
Unwind of fair value adjustments arising on transfer of engagements	**117.2**	97.5
	(469.6)	(500.5)
Increase/(decrease) in deposits by banks	**110.5**	(2,142.1)
Decrease in customer accounts and capital bonds	**(7,068.4)**	(3,123.6)
Decrease in debt securities in issue	**(889.3)**	(764.0)
Decrease in loans and advances to banks	**510.9**	105.3
Decrease in loans and advances to customers	**5,729.0**	5,073.6
Net movement of other assets and other liabilities	**93.5**	(236.2)
Income tax (paid)/received	**(0.1)**	4.3
Net cash flows used in operating activities	**(1,983.5)**	(1,583.2)
Cash flows from investing activities		
Purchase of tangible and intangible fixed assets	**(79.5)**	(74.9)
Proceeds from sale of property, plant and equipment	**21.4**	8.3
Proceeds from sale of investment property	**–**	156.5
Purchase of investment securities	**(1,916.3)**	(2,279.0)
Proceeds from sale and maturity of investment securities	**1,269.9**	2,580.0
Profit from sales of subsidiaries	**30.2**	–
Net cash flows from investing activities	**(674.3)**	390.9

The Bank statement of cash flows continued

For the year ended 31 December 2015

All amounts are stated in £m unless otherwise indicated

	Note	2015	2014
Cash flows from financing activities			
Interest paid on other borrowed funds		**(28.6)**	(22.8)
Dividends paid to non-controlling interests		**–**	(0.2)
Issuance of other borrowed funds		**249.0**	–
Capital Commitment received from The Co-operative Group		**–**	313.0
Costs incurred relating to the May 2014 Capital Raising		**–**	(12.8)
Cash proceeds relating to the May 2014 Capital Raising		**–**	400.0
Net cash flows from financing activities		**220.4**	677.2
Decrease in cash and cash equivalents		**(2,437.4)**	(515.1)
Cash and cash equivalents at the beginning of the financial year		**5,577.1**	6,092.2
Cash and cash equivalents at the end of the financial year		**3,139.7**	5,577.1
Cash and balances with central banks	15	**2,632.9**	4,707.5
Held for sale	14	**–**	9.1
Loans and advances to banks	16	**506.8**	745.5
Short term investments	18	**–**	115.0
		3,139.7	5,577.1

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 Britannia Building Society merger.

The notes on pages 166 to 242 form part of these financial statements.

The Bank statement of changes in equity

For the year ended 31 December 2015

All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Bank								
	Share capital	**Share premium**	**Available for sale reserve**	**Cash flow hedging reserve**	**Capital redemption reserve**	**Retained earnings**	**Total**	**Non-controlling interest[1]**	**Total equity**
2015									
Balance at the beginning of the year	**22.6**	**1,736.9**	**24.6**	**59.0**	**410.0**	**(273.1)**	**1,980.0**	**34.5**	**2,014.5**
Total comprehensive (expense)/income for the year	**–**	**–**	**31.0**	**(24.4)**	**–**	**(623.3)**	**(616.7)**	**0.4**	**(616.3)**
Disposal of UTB	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(34.9)**	**(34.9)**
Transactions with owners recorded directly in equity:									
Issuance of new share capital	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Dividend	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Balance at the end of the year	**22.6**	**1,736.9**	**55.6**	**34.6**	**410.0**	**(896.4)**	**1,363.3**	**–**	**1,363.3**
2014									
Balance at the beginning of the year	12.5	1,359.8	(14.1)	13.1	410.0	(46.4)	1,734.9	33.6	1,768.5
Total comprehensive (expense)/income for the year	–	–	38.7	45.9	–	(226.6)	(142.0)	1.1	(140.9)
Transactions with owners recorded directly in equity:									
Issuance of new share capital	10.1	377.1	–	–	–	–	387.2	–	387.2
Dividend	–	–	–	–	–	(0.1)	(0.1)	(0.2)	(0.3)
Balance at the end of the year	22.6	1,736.9	24.6	59.0	410.0	(273.1)	1,980.0	34.5	2,014.5

1. In December 2015 the Bank disposed of its majority shareholding in Unity Trust Bank.

The notes on pages 166 to 242 form part of these financial statements.

1. Basis of preparation and significant accounting policies

1.1. Basis of preparation

Both the Company financial statements and the Bank 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 as adopted by the European Union (EU).

On including the Parent Company financial statements within the Bank's Annual Report and Accounts, 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.

The financial statements have 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 Bank 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 2015.

The financial statements comprise all audited sections of the accounts. Where indicated, the Risk Management section and capital management section form part of the audited accounts.

Standards and interpretations issued and effective

There have been no new or revised IFRS pronouncements during the year which have affected the preparation of this consolidated financial information.

Standards and interpretations issued but not yet effective

At the date of authorisation of these financial statements, the Bank has not applied the following new and revised IFRSs, that have been issued, but are not yet effective and, in some cases, not yet adopted by the EU.

- IFRS 9 (Financial Instruments)
  In July 2014, the IASB issued IFRS 9 (Financial Instruments), which is the comprehensive standard to replace IAS 39 'Financial Instruments: Recognition and Measurement' and is effective for periods beginning on or after 1 January 2018, and is currently expected to be endorsed by the EU in 2016. IFRS 9 includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

  Classification and measurement

  The classification and measurement of financial assets will depend on:

  - how the Bank manages such assets (the entity's business model); and
  - the contractual cash flow characteristics of the financial asset (whether the cash flows represent 'solely payments of principal and interest').

  The above factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income ('FVOCI') or fair value through profit or loss ('FVPL'). The application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of the Bank's financial assets measured at amortised cost or fair value compared with IAS 39.

  The classification and measurement of financial liabilities under IFRS 9 is not materially different to the current requirements under IAS 39, with the exception for certain liabilities measured at fair value, where gains or losses relating to changes in the entity's own credit risk are to be included in other comprehensive income as oppose to profit or loss under current rules. The Bank does not currently measure its own debt securities in issue at fair value under IAS 39 and therefore does not expect these changes to have a significant impact.

  The Bank's assessment of potential classification and measurement changes to financial assets and liabilities is ongoing as part of the Bank's programme to implement IFRS 9. Given the Bank's strategy for deleverage of Non-core assets and the consequences for the business model test on the effective date of IFRS 9, it is not yet possible to set out a complete view of the expected changes to the Bank's balance sheet composition. The Bank does however anticipate that:

  - Core loans and advances to banks and to customers that are classified as loans and receivables under IAS 39 will be measured at amortised cost under IFRS 9;
  - financial assets designated at FVPL will remain at FVPL;
  - debt securities classified as available for sale will be measured at amortised cost, FVOCI, or FVPL depending on their contractual cash flow characteristics or the business model within which they are held;
  - Treasury and other eligible bills classified as available for sale will be measured at amortised cost or FVOCI depending upon the business model in which they are held; and
  - there will be no significant changes to classification of financial liabilities under IFRS 9.

  Impairment

  IFRS 9 introduces a revised impairment model which will require entities to recognise expected credit losses based on unbiased forward-looking information, replacing the existing incurred loss model which only recognises impairment if there is objective evidence that a loss has already been incurred.

All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

The impairment requirements of IFRS 9 apply to financial assets measured at amortised cost and FVOCI, lease receivables and certain loan commitments, and financial guarantee contracts. At initial recognition, an allowance is required for expected credit losses ('ECL') resulting from default events that are expected within the next 12 months (12-month ECL). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all expected default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit impaired are in 'stage 3'.

The Bank is currently defining its allowance principles under IFRS 9, determining the criteria for classification of financial assets as 'stage 1', 'stage 2' or 'stage 3'. However, IFRS 9 is expected to result in:

- a more volatile impairment charge due to the requirement of IFRS 9 to include an estimate of future conditions and not just those which existed at the balance sheet date under IAS 39; and
- an increase in the total level of impairment. This is expected as all financial assets will be assessed for impairment with reference to at least a 12 month ECL and also, the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment under IAS 39.

Hedge accounting

IFRS 9 contains revised requirements on hedge accounting, which are more closely aligned with an entity's risk management strategies and objectives. IFRS 9 would replace the rules under IAS 39 which require a quantitative effectiveness test with an approach which requires that an economic relationship exists between the hedged item and hedging instrument.

The Bank is considering whether to exercise the accounting policy choice to continue IAS 39 hedge accounting or move onto an IFRS 9 basis for micro hedging, but will implement the revised hedge accounting disclosures required by the related amendments to IFRS 7 'Financial Instruments: Disclosures'.

Effective date

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The mandatory application date for the standard as a whole is 1 January 2018, subject to EU endorsement.

IFRS 9 implementation programme

The Bank is assessing the impact that the financial asset and liability classification and impairment requirements will have on the financial statements and intends to quantify the potential impact of IFRS 9 once it is practicable to provide reliable estimates. Until sufficient models have been developed and tested, the Bank will not have a reliable understanding of the potential impact on its financial statements and any consequential effects on regulatory capital requirements.

The Bank plans to base the ECL calculations within impairment models on the approach used to calculate Basel expected losses (with relevant adjustments made to the Basel risk components).

- Amendment to IFRS 11 (Joint arrangements: on acquisition of an interest in a joint operation (2014))
  This amendment adds new guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business. The amendments specify the appropriate accounting treatment for such acquisitions.

  The amendment is mandatory for years beginning on or after 1 January 2016 but is available for early adoption. The impact to the Bank of the amendment is likely to be immaterial.

- IFRS 15 (Revenue from Contracts with Customers (2014))
  This standard was issued in May 2014 and is a converged standard from the IASB and FASB on revenue recognition. IFRS 15 specifies how and when an IFRS reporter will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. This standard supercedes IAS 18 (Revenue) and a number of revenue interpretations.

  The standard will be effective for annual reporting years beginning on or after 1 January 2018 subject to EU endorsement. The impact to the Bank of the amendments is likely to be immaterial as income from IAS 39 financial instruments is outside the scope of IFRS 15. However, the Bank has not yet finalised its estimation of the financial effects.

- Amendments to IFRS 10 (Consolidated financial statements) and IAS 28 (Investments in associates and joint ventures (2014))
  These amendments address an inconsistency between the requirements in IFRS 10 and those in IAS 28 in dealing with the sale or contribution of assets between investor and its associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognised when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognised when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary.

  The effective date for the amendments is yet to be determined and has not yet been adopted by the EU. The impact to the Bank is likely to be immaterial.

1. Basis of preparation and significant accounting policies continued

- Amendment to IAS 16 (Property, plant and equipment) and IAS 38 (Intangible assets: on depreciation and amortisation (2014))
  In this amendment the IASB has clarified that the use of revenue based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset. The IASB has also clarified that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset.

  The standard is mandatory for years beginning on or after 1 January 2016 but is available for early adoption. The impact to the Bank of the amendments is likely to be immaterial.

- Amendments to IAS 7 (Statement of Cash Flows)
  The amendments require disclosure of information enabling users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments do not define financing activities, instead they clarify that financing activities are based on the existing definition used in IAS 7.

  The amendment is effective for reporting periods beginning on or after 1 January 2017 but is available for early adoption subject to EU endorsement. The impact to the Bank is likely to be immaterial.

- Amendments to IAS 27 (Separate financial statements: on the equity method (2014))
  These amendments allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.

  The standard is mandatory for years beginning on or after 1 January 2016 but is available for early adoption. The impact to the Bank of the amendments is likely to be immaterial.

- Amendments to IAS 1 (Presentation of Financial Statements)
  The narrow-focus amendments to IAS 1 clarify, rather than significantly change, existing IAS 1 requirements. In most cases the proposed amendments respond to overly prescriptive interpretations of the wording in IAS 1. The impact to the Bank of the amendments is likely to be immaterial.

- IAS 19 (Defined Benefit Plans (2013))
  This amendment clarifies the requirements that relate to how contributions from employees or third parties that are linked to service should be attributed to periods of service. In addition, it permits a practical expedient if the amount of the contributions is independent of the number of years of service, in that contributions can, but are not required, to be recognised as a reduction in the service cost in the period in which the related service is rendered. The standard is mandatory for years beginning on or after 1 February 2015 but is available for early adoption. The amendment is not expected to have a material impact on the financial statements of the Bank.

- IFRS 16 (Leases)
  The IASB has published a new standard, IFRS 16 'Leases'. The new standard brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. Lessor accounting however remains largely unchanged and the distinction between operating and finance leases is retained. IFRS 16 supersedes IAS 17 'Leases' and related interpretations and is effective for periods beginning on or after 1 January 2019, with earlier adoption permitted if IFRS 15 'Revenue from Contracts with Customers' has also been applied. The impact to the Bank of the new standard has not yet been quantified.

Other standards and interpretations have been issued but these are not considered to be relevant to the Bank's operations.

The Bank intends to comply with the standards from the date they become effective.

1.2. Going Concern

a) Introduction

In line with provision C1.3 of the 2014 UK Corporate Governance Code, the Directors consider it appropriate to adopt the Going Concern basis of preparing the financial statements but note that material uncertainties exist and thus have looked to identify and disclose those material uncertainties and any other necessary disclosures to give a true and fair view. The Directors have a reasonable expectation that the Bank will continue to have the necessary resources to continue in business for the foreseeable future, taking into account the matters referred to below.

When considering the Going Concern status of the Bank, the Directors have referenced appendix A of the Financial Reporting Council's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting published in September 2014, which explicitly covers the going concern basis of accounting and material uncertainties.

The assessment of the appropriateness of the Going Concern basis of accounting for the Bank's Annual Report and Accounts 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 process and discussions with the Bank regulators. This analysis included a particular focus on the 12 month period following the date of publication of the financial statements.

The Directors have assessed the Going Concern status using a framework focusing on the Bank's capital, liquidity and regulatory position, as outlined in detail within the Bank's 2016-2020 Strategic Plan (the Bank's Updated Plan), which has been approved by the Bank's Board and has been accepted by the Bank's regulators.

This statement should be read in conjunction with the Viability statement on page 43 and the Principal risks and uncertainties on page 32.

1. Basis of preparation and significant accounting policies continued

b) The Updated Plan

The 2015-2019 Revised Plan was reviewed and accepted by the PRA following the stress test results (Stress Tests) announced on 16 December 2014. This plan was designed to enable the Bank to withstand a stress of the severity of the stress test by the end of the Plan period and involves reshaping and restructuring the business with a distinct focus on its Core Retail and SME operations.

Throughout 2015 a number of systemic and idiosyncratic opportunities and challenges, together with the Bank's financial performance in 2015, have driven deviations to the assumptions included within the Revised Plan accepted by the PRA. These deviations have impacted the Bank's 2015 actual performance and driven revised expectations across the planning horizon.

These include a continued low interest rate environment, improved Core Bank origination, reduced market pricing for Non-core deleverage, systemic capital market volatility, increased market wide 2015 provisions for conduct risk and further clarity around future regulatory capital requirements, including MREL.

Consequently, the Bank has undertaken a strategic review in order to assess a number of options open to management that enable the Bank to mitigate some of the impacts of these changes.

The key strategic change in the Bank's Updated Plan compared to the Revised Plan relates to the Bank ceasing any further planned deleverage of the Non-core Optimum portfolio.

The underlying resiliency of the Optimum portfolio under a severe stress scenario has improved since the 2014 Bank of England stress testing exercise. Improvements in the economic environment have led to an improvement in the underlying credit quality of the Optimum assets through reductions in average loan to value ratios and a reduction in the proportion of the book within arrears. The portfolio is now considered to be more resilient to a severe economic stress than at the time of the 2014 stress test exercise. The portfolio has also reduced significantly as a result of the two 'whole structure' securitisations undertaken in 2015 thus further reducing the overall risk impact of any deterioration in the portfolio.

Furthermore, given current market volatility the Bank believes it may not achieve similar pricing to that of the Warwick Finance One and Two transactions at this point in time, so any further deleveraging in the near term would drive unacceptably high losses on disposal. The Bank's strategy is now to continue to hold these assets, which mitigates any further losses resulting from the sale of these assets and protects the Bank's income and CET1 capital in a continued low interest rate environment. The revised strategy for the Optimum assets will continue to be reviewed in light of changing economic conditions and forecasts and to ensure the desired balance between risk and reward is maintained.

c) Capital

Total CRD IV capital resources as at 31 December 2015 are £1.6bn (31 December 2014 £1.9bn) with Core Tier 1 capital after regulatory deductions of £1.2bn (31 December 2014 £1.6bn). The Bank's CET1 ratio stands at 15.5% (31 December 2014 13.0%) on a CRD IV end point basis. During 2015 the Bank successfully issued £250.0m of Tier 2 capital, which enhanced the Bank's total capital position.

As at 31 December 2015, the Bank met the Individual Capital Guidance (ICG) for total capital set by the PRA, however it is not forecast to remain compliant against the currently in force ICG requirements for most of the duration of the 2016-2020 planning period.

The Bank is mindful of the capital implications of the Bank of England's minimum requirement for own funds and eligible liabilities ('MREL') regime and the increased debt issuance this will drive, for the banking industry in general but also for the Bank.

The Bank's Updated Plan (2016-2020) incorporates MREL qualifying issuance commencing in 2018 which is the Board's current view of the earliest time when such issuance may be feasible. The PRA and the Bank of England have indicated their strong preference that the Bank incorporates an earlier profile of MREL issuance than currently contemplated by the Bank's Updated Plan. For further detail regarding MREL please refer to page 33 of the Principal Risk and Uncertainties.

The Bank must also seek to reduce those risks that sit outside of the Pillar 1 requirements under the ICG framework, for example, through seeking to reduce any Pillar 2a capital requirements with regards to operational risk.

The Bank continues to monitor the regulatory capital horizon for any new pieces of regulation that could impact the Bank's ability to deliver the Updated Plan. This includes, but is not limited to, any updates with regards to the implementation of the leverage ratio and MREL targets for the UK Banking sector.

The Bank is currently not compliant with CRR provisions related to the use of an Internal Ratings Based (IRB) approach to modelling its credit risk capital requirements. A review by the Regulator took place during 2015 and identified areas of non-compliance and inadequate procedures relating to use of an IRB approach requiring improvement and a remediation plan to rectify under supervisory guidance. These areas include the redesign of model risk policy and model inventory and the strengthening of the overall control environment. In March 2016 the Bank received a formal communication from the PRA regarding the levying of an additional Pillar 2a add on to cover the risks outlined above which has been factored into the Updated Plan. The Bank is in the process of creating a remediation plan in order to address the areas of non-compliance and has planned that this additional Pillar 2a add-on will be removed by the end of 2017.

A failure to address model risk non-compliance would potentially result in regulatory action such that the Bank's permission to use an IRB approach could be removed, resulting in among other things the use of a standardised approach to modelling credit risk. This could expose the Bank to a material increase in the calculation of its RWAs with a consequent requirement to hold additional capital, the creation of an additional ICG deficit and a reduction in the Bank's CET1 ratio.

Any crystallisation of proposals to implement floors for PD, LGD and CCF in retail mortgages could also impact the planned allocation of capital to such assets through the life of the plan.

The Bank remains reliant on the continued support of its regulators regarding its inability to meet regulatory capital requirements, including CRR, ICG and PRA buffer compliance.

1. Basis of preparation and significant accounting policies continued

d) Liquidity

The Bank's liquid asset ratio at 31 December 2015 was 15.4% (2014: 17.4%). The reduction in total assets was met with a proportionate reduction in primary liquidity holdings. The Bank complied with regulatory minima and the more prudent internal liquidity risk appetite throughout the period.

During the period to 31 December 2015, customer assets have continued to reduce primarily as a result of the Non-core asset disposals, reducing by a total of £5.8bn. The Bank has experienced a reduction of £6.3bn in customer liabilities following repricing activity on certain savings products and intentionally low retention of maturing term deposits; the deposit reductions are necessary to offset deleverage activity and deliver the stable liquid asset ratio quoted above and the reduction in pricing on them has helped improve the margin.

The Bank redeemed the Silk Road Finance Number One securitisation in March 2015 of £1.1bn. The Warwick transactions, which completed in May and September 2015, provided £1.3bn of net funding proceeds.

The Bank expects to stay above the current and future LCR regulatory minima across the planning period.

e) Regulatory Matters

The migration of IT Infrastructure to an IBM platform (announced in January 2015) is expected, in time, to deliver proven disaster recovery capability for all critical business processes. In Q1 2015 the Bank received written confirmation from the FCA that the lack of proven end to end disaster recovery capability constituted a breach of the FCA's Threshold Conditions.

The FCA continues to closely supervise the Bank on this issue and related IT improvements, described under risks and uncertainties below, as it works towards restoring compliance with the appropriate resources (non-financial resources) Threshold Condition. The FCA is not currently proposing further immediate supervisory intervention or the immediate exercise of any additional regulatory powers as a result of this previous assessment. The assessment took place prior to the improvements that have been made during 2015. The FCA reserves the right to take action in the future in relation to this breach. The PRA's general policy is not to communicate its assessment of its position in relation to the PRA's Threshold Condition. However, both the PRA and FCA are closely monitoring the position of the Bank and it remains in continued dialogue with both regulators.

f) Risks and uncertainties

The key risks and uncertainties associated with the successful execution of the Bank's Updated Plan include, but are not limited to:

1. The regulators' continued acceptance of the Bank's inability to meet regulatory requirements including CRR, ICG, PRA buffer compliance and other Threshold Conditions. To the extent this acceptance is not forthcoming, the Bank does not perform in line with its Updated Plan, or regulatory capital requirements are increased for any reason, then additional CET1 or other capital may be required over and above that included in the Updated Plan in order for the Bank to remain a Going Concern, and the PRA or FCA could exercise their powers under the Banking Act of 2009;
2. If in due course the Bank becomes subject to a binding requirement to issue MREL and it is unable to do so when required, the Bank's regulators can agree to accept the Bank's original issuance plan, a revised issuance plan, require some other action on the part of the Bank or in the absence of any of these the Bank of England may exercise its powers under the Banking Act 2009. In considering viability the Board has taken note of the contents of PRA consultation paper (CP 44/15) and the Board believes that resolution is less likely than the other outcomes while the Bank is executing its plan as accepted by the PRA and continuing to de-risk the Bank;
3. The Bank's IT systems have been under-invested in for a considerable period of time. The Bank needs to urgently and significantly improve and re-engineer its existing IT platform as the existing infrastructure is unsuitable and inherently fragile. There are also concerns about its resilience as the Bank's current IT disaster recovery plan has not been tested end to end. In January 2015 the Bank entered into an Enterprise Services (ES) contract with IBM in order to address this risk. However, until that work is completed, the Bank is at risk of an IT failure causing material disruption to the Bank's products and services. The required improvement and re-engineering of the Bank's IT platform and operational process is necessary and significant in scale, complexity and cost. In common with any programme of this scale it carries a significant level of execution risk. Any delays in, or failure by, the Bank to deliver the re-engineering of the Bank's IT platform may result in ongoing risk of technology failure, significant additional investment costs, inability to deliver operating cost reductions or revenue generating capability. This would subject the Bank to further regulatory scrutiny or sanction, and impact the Bank's ability to deliver its strategy. The Bank's regulators are fully aware of the steps the Bank is taking to address these operational risks;
4. The Bank has entered into an outsourcing contract with Capita for the provision of mortgage processing. This creates execution risk as the processes and data transfer to the third party supplier and the Bank begins to manage data and information flows from the third party relationship. The Bank has not entered into such an arrangement in recent times and this generates significant risk of delay to completion, increased costs and operational disruption in the short term. However, the arrangement should help reduce risk, support increased volume and improved retention, and increase resiliency in the medium to longer term;
5. The Bank's ability to separate its operations from its former parent, The Co-operative Banking Group Limited, and its ultimate former parent, The Co-operative Group, with both of which it shares premises, systems and services. The work is complex and time consuming and despite forecasting that separation costs will be higher than originally envisaged, there remains a risk that the costs of executing these separation plans may increase further. The potential misalignment of Group and Bank's objectives may also make separation slower and more costly than anticipated;

1. Basis of preparation and significant accounting policies continued

6. The Bank participates in The Co-operative Group's defined benefit pension scheme (Pace). As long as the Bank remains a participating employer in Pace, the Bank could be 'last man standing' in the event of the failure of one or more of the other participating employers meaning that some or all of Pace's liabilities would need to be borne by the Bank. In addition, a material difference to current estimates of the funding of the pension scheme, or the Bank being forced to pay for a greater proportion than currently envisaged, could increase the Bank's Pillar 2a Capital requirements or cause additional expense through increased contributions; and
7. More generally, the ability of the Bank to achieve the results set out in the Bank's Updated Plan, including further materialisation of particular challenges that are described in the Principal risks and uncertainties on pages 32 to 42 and 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 within the Corporate CoAM business; meeting its planned improvements in net interest margin; the ability of the Bank to generate sufficient Core Bank asset growth; a possible further deterioration in the quality of the Bank's asset portfolio; ability to deliver the complex transformation plan affecting the operations and systems without significant delay and within budget, failure to achieve either of which could have negative impacts on the Bank's financial performance; major macro-economic or political upheaval such as a Brexit scenario; unplanned costs from, for example, conduct risk matters, regulatory investigations, unforeseen regulatory change, IT investment and the ability to maintain the Bank's access at, an appropriate cost, to liquidity and funding.

g) Conclusion

The Directors have concluded that the risks outlined above represent a material uncertainty which may cast significant doubt upon the Bank's ability to continue as a Going Concern. The Bank may be unable to continue realising its assets and discharging its liabilities in the normal course of business. The Bank remains reliant on the continued support of its regulators regarding its inability to meet capital regulatory requirements (CRR), including ICG and PRA buffer compliance, during and beyond the period of the Going Concern assessment.

Nevertheless, after making enquiries of management and considering the Bank's Updated Plan, in particular those for the twelve month period following the date of the Bank's financial statements, 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 these financial statements. Therefore this set of financial statements does not include the adjustments that would result if the Bank was unable to continue as a Going Concern.

1.3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods, inclusive of assets recognised where the Bank is subject to the substantial risks and rewards of those assets.

1. Business combinations

On 1 August 2009, The Co-operative Bank plc merged with Britannia Building Society, with Britannia transferring their engagements to the Bank. This business combination has been accounted for by 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 all entities (including structured entities) controlled by the Company. Control exists whenever the Company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity, in accordance with the requirements of IFRS 10 (Consolidated financial statements). 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.

When the Company ceases to have control any retained interest in the entity is re-measured to its fair value at the date control is lost, with the change in carrying amount recognised in the profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for retained interest as a financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

The financial information has been prepared using uniform accounting policies and is based on the same accounting period as the Company.

Intra-group balances and transactions, and any unrealised gains and losses arising from intra-group transactions, are eliminated in preparing the consolidated financial information.

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 Company; and
- Covered Bond Limited Liability Partnership created in order to act as a guarantor for the issue of covered bonds.

1. Basis of preparation and significant accounting policies continued

An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Bank under IFRS 10 considerations, the Company concludes that it controls the SPE.

The following circumstances may indicate a relationship in which, in substance, the Company controls and consequently consolidates an SPE:

- the activities of the SPE are being conducted on behalf of the Company according to its specific business needs so that the Bank obtains benefits from the SPE's operation;
- the Company has the decision making powers to obtain the majority of the benefits of the activities of the SPE;
- the Company 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 Company 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 Company has control over an SPE is carried out at inception. A reassessment of whether the Company has control over an SPE is performed at the end of each period.

b) Interests in joint ventures

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement, have rights to the net assets of the arrangement.

Those parties are called joint venturers. 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.

c) Interests in unconsolidated structured entities

Unconsolidated structured entities are unconsolidated entities that have been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity. The Bank does not consolidate structured entities where the Bank determines, with due regard to the variable returns from the structured entity and the Bank's ability to affect those returns, that it does not control the structured entity under IFRS 10 (Consolidated financial statements) considerations. The Bank acts as a sponsor for certain unconsolidated securitisation vehicle holding companies which the Bank neither owns nor controls. The Bank has determined itself a sponsor of unconsolidated securitisation vehicle companies if the Bank does not have a material ongoing interest in the entity, but it may act to protect its reputation in relation to the structured entity.

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 origination and incremental transaction costs and fees including arrangement and broker fees, valuation and solicitor costs, discounts and premiums where appropriate.

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.

When an instrument is impaired, the Bank reduces the carrying amount, based on the revised cash flows, discounted at the original EIR of the instrument, and continues unwinding the discount as interest income.

Early redemption charges are recognised on a cash basis as received, as it is not possible to reliably estimate the receipt of such fees.

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 EIR 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.

All other fee and commission income, such as loan closure fees or arrears fees, not included in the EIR calculation, is recognised on an accruals basis as the service is provided.

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.

1. Basis of preparation and significant accounting policies continued

4. Financial instruments (excluding derivatives)

a) Recognition

Financial assets are recognised in the Bank's balance sheet when the Bank becomes party to the contractual provisions of the instrument. The Bank initially recognises loans and advances when they are advanced to customers. Deposits, debt securities issued and other borrowed funds are recognised 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.

b) Derecognition

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial assets expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognises its retained interest in the asset and an associated liability for amounts it may have to pay. A substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) is accounted for as an extinguishment of the original financial liability and a recognition of a new financial liability.

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 profit or loss.

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 EIR method. The amortised cost is the amount advanced less principal repayments, plus the cumulative amortisation using the EIR method of any difference between the amount advanced less provisions for impairment 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 (4.c) iv. below).

The Bank has a number of facility agreements with multiple counterparties, which form a single contractual relationship. The Bank considers these arrangements to be single financial instruments and accounts for these accordingly within loans and advances to customers, or customer deposits respectively.

iii. Available for sale

Available for sale financial assets are debt securities and equity shares quoted in an active market and not accounted for at fair value through profit or loss. These are initially recognised on their trade date, 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 cash flow 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, these are reclassified 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 cash flow analysis, with reference to relevant market rates, and other commonly used valuation techniques.

iv. Financial assets at fair value through profit or loss

Financial assets designated at fair value are assets which have been designated to eliminate or significantly reduce a measurement inconsistency or where management specifically manages an asset or liability on that basis, e.g. capital bonds.

1. Basis of preparation and significant accounting policies continued

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 cash flow 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 other operating 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. Derivative financial liabilities are subsequently re-measured to their fair value at each balance sheet date. The resulting gain or loss is recognised in the income statement immediately unless the derivative is designated and effective as a hedging instrument in a cash flow hedge. See 'Derivative financial instruments and hedge accounting' policy for more detail.

Capital bonds within customer accounts have been designated at fair value through profit or loss upon initial recognition in the balance sheet. Changes in fair value are recognised through the income statement.

Capital bonds are economically hedged 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, eliminating potential measurement inconsistency that would otherwise arise from valuing the capital bonds at amortised cost and the derivatives at fair value.

When a financial liability is derecognised any cumulative gain or loss that had been recognised in other comprehensive income, is recognised in the income statement.

ii. Other borrowed funds

Borrowings are recognised initially at fair value, being 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 estimated life of the liability using the EIR method.

The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments.

5. Impairment provisions

a) Assessment

i. Objective evidence

At the balance sheet date, the Bank assesses whether there is objective evidence that a financial asset or group of financial assets, not held at FVPL, is impaired. Impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition and before the statement of financial position date (a 'loss event') which has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

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

Loans under forbearance are subject to a specific identified impairment assessment.

Unsecured Retail business

Irrespective of forbearance, impairment is charged in accordance with the identified past due and unidentified loss event approaches described on page 114.

Corporate business

All accounts subject to forbearance which are in default and on the watchlist are individually assessed for impairment.

For further information on the Bank's approach to forbearance, its management and execution, see the Risk Management section.

1. Basis of preparation and significant accounting policies continued

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.

All Corporate loans on watchlist, or in default, are individually assessed for impairment.

Loans and advances that do not meet the criteria for individual impairment, or which do, but are not found to be impaired, are collectively assessed for impairment (incurred but not yet reported) 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 a shortfall based on the difference between the current loan balance and the expected 'forced sale' price of collateral, discounted at the effective interest rate of the loan to reflect the anticipated time to sale, and taking into account anticipated fees and costs prior to sale. The shortfall is multiplied by the probability the loan will default and further multiplied by the probability that the loan will be taken into possession to determine the impairment required.

When assessing collective impairment for unsecured retail loans, the Bank estimates losses on loans via a two stage approach, which determines PD and LGD to generate provision rates which are applied to the current balance sheet, including loans transferred to debt collection agencies. Once impaired, accounts are subjected to higher levels of impairment according to both their relevant stage of delinquency, i.e. 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.

Impairment stock determined by provision models is augmented where it is judged that the best estimate of losses are likely to differ from those suggested by historical trends. Impairment determined both via provision models and management overlays are reviewed by the Impairment Adequacy Forum.

b) Corporate

Collective provision is held for all Corporate exposures, apart from customers in default for which specific provision has been raised and customers in default with nil impairment for which there is evidence that they have been individually assessed at SAR. Collective provision is determined by multiplying the drawn balance of the loan by the following default estimates:

i) the probability that, during the emergence period, balances will move to default; or

ii) the probability that, during the emergence period, balances will move to impaired; and

iii) the probability that, during the outcome period, balances will move from impaired to default

The resulting balance is multiplied by the proportion of newly defaulted balances that ultimately move to an unrecoverable LGD.

The loss emergence period is defined as the time between a loss event occurring and it being evidenced. For Corporate loans the emergence period is 6 months and is reviewed annually. For all commercial real estate loans where the indexed loan-to-value LTV is greater than 100% and to those loans which are due to contractually expire in the next 36 months and the indexed LTV is greater than 65% the probability of emerging to impaired Pe(i) parameter is set to 100%. All other PD components are based on recently observed loan migration experience. Loans which are on watchlist are impaired and therefore Pe(i) is set to 100%.

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 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.

1. Basis of preparation and significant accounting policies continued

Provisions are released at the point at which 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 the fair value of an impaired available for sale equity security is recognised directly in equity.

6. 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.

7. 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 cash flow models. Further information is provided in note 19. 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 cash flow hedge accounting.

Where hedge accounting is applied, the Bank formally documents the economic 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 also formally documents its 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' in 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 offset in changes in fair value in 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 profit or loss. 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 profit or loss, 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 cash flow 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.

1. Basis of preparation and significant accounting policies continued

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 percentage 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 for the hedged risk 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 item on an appropriate basis.

The Bank measures the fair value of each hedging instrument and this 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 for the hedged risk 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 profit or loss), the embedded derivative is separated from the host and held on-balance sheet at fair value. Movements in fair value are recognised in the income statement, whilst the host contract is accounted for according to the relevant accounting policy for that particular asset or liability.

8. Property, plant and equipment

The Bank recognises assets where it is exposed substantially to all the risks and rewards of those assets.

Acquired computer software licences are capitalised on the basis of cost incurred to acquire and bring the software to use.

Items of property, plant and equipment are stated at cost less any accumulated depreciation and impairment losses. Depreciation is recognised on a straight line basis at the following rates, which are estimated to reduce the assets to their realisable values at the end of their useful lives.

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 greater than the recoverable amount, the shortfall 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, less costs to sell, with the carrying amount and are recognised net within operating expenses in the income statement.

9. Intangible assets

The Bank recognises intangible assets where it is exposed substantially to all the risks and rewards of those assets.

a) Computer software

Computer software is stated at cost less cumulative amortisation and impairment, and comprises acquired computer software together with the costs of internal 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. Costs are capitalised only if the asset can be reliably measured, will generate future economic benefits, the completion of the asset is feasible, there is an intention to complete the asset, an intention and ability to use the asset, and costs attributable to the asset are able to be reliably measured. 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. Once the asset is available for use 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.

1. Basis of preparation and significant accounting policies continued

b) Other intangible assets

Other intangible assets are stated at cost less cumulative amortisation and impairment. Amortisation is charged on a straight line basis 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 10 years is applied.

c) Impairment

Intangible assets are assessed for indications of impairment at least annually. If impairment indicators are discovered, 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, the shortfall is recognised as a charge to 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.

10. 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 cash flow 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.

11. Leases

a) Overview

The Bank enters into leases for land and buildings, finance leases for software 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's 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. The Bank provides for dilapidation where an obligation exists to make good dilapidation or other damage, or return the asset to the configuration that existed at the inception of the lease.

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

The amount to be recognised as a finance lease is calculated on inception of the lease. Finance lease assets are capitalised at commencement of the lease (being the date at which the Bank is able to exercise its right to use the asset) at the lower of fair value of the leased asset and the present value of the minimum future lease payments, and subsequently in accordance with the relevant policy for the underlying asset. An equal liability is recorded in other liabilities. The interest element of the finance charge 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.

12. 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. The Bank accounts for all investment properties using the fair value method. Fair value is based on current prices in an active market for similar properties in the same location and condition. No depreciation is provided on investment 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. Prior to such a transfer the property is measured at fair value with any gain or loss recognised in the income statement. 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.

1. Basis of preparation and significant accounting policies continued

13. 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 cash flow statement.

14. Income tax

a) Overview

Tax 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. In addition, estimated amounts receivable from TCG for tax losses surrendered and changes in that estimate are recorded as an adjustment to the tax expense.

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 and is supported by the Updated Plan.

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.

15. Pension costs

a) Co-operative Pension Scheme

The Bank participates in the Co-operative Pension Scheme (Pace). Pace is a hybrid scheme, consisting of a closed defined benefit section and a defined contribution section. There is currently insufficient information available to consistently and reliably identify the Bank's share of its liabilities in respect of this multi-employer scheme. For this reason the pension costs in respect of Pace are accounted for on a defined contribution basis in accordance with IAS 19 Employee Benefits (revised 2011). Pension costs are recognised as an expense in the Bank's income statement. See note 34 for further details.

b) Britannia Pension Scheme

The Britannia scheme is a defined benefit scheme. On the 23 December 2015, a Flexible Apportionment Arrangement (FAA) was executed, at which time the Co-operative Bank plc was named as a participating employer and replaced CFSMS as the principal employer, following which, CFSMS, WMS and PHL departed from the scheme with their share of the scheme's liabilities being transferred to the Bank. As the Bank had already been recognising the total assets and liabilities of the scheme on its balance sheet, due to a guarantee it provided, the FAA has not had a significant new impact on the Bank's exposure to the risks of the scheme. See note 34 for further details.

Accordingly, the Bank recognises the fair value of the scheme assets less the present value of the scheme's estimated obligations, less an asset restriction that reflects the Bank's inability to access the surplus in the scheme. In addition, the Bank recognises as a liability the present value of irrecoverable minimum funding requirements. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates on high quality corporate bonds.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise. Past service costs are recognised immediately in income.

When the scheme is in an accounting surplus, this is not recognised as an asset in accordance with IFRIC 14. Actuarial gains are only recognised to the point where any previously recognised liability is reversed.

16. Foreign currency

The functional and presentational currency for the Bank is pounds 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 prevailing 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 cash flow hedge, which are recognised directly in the statement of comprehensive income. 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.

1. Basis of preparation and significant accounting policies continued

17. Investments in Co-operative Bank undertakings

Investments in subsidiaries are initially measured at fair value which equates to cost and subsequently valued at cost less impairment.

18. 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 an appropriate pre-tax rate, if the expected future cash flows can be reliably estimated.

In the case of restructuring provisions, a constructive obligation arises when a plan is sufficiently detailed and is formalised. Restructuring provisions include only direct expenditure arising from the restructuring plan which is both necessary for restructuring and not associated with the Bank's ongoing activities.

Provisions are recognised for discounts on performing loans identified for disposal at the balance sheet date which will be sold post year end at a loss.

19. Share premium

Share premium is the amount by which the fair value of the consideration received exceeds the nominal value of shares issued. Expenses and commissions paid on the issue of shares are written off against the share premium of the same issue.

20. Assets held for sale

Non-current assets and disposal groups (including both the assets and liabilities of the disposal groups) are classified as held for sale when their carrying amounts will be recovered principally through sale, they are available for sale in their present condition and their sale is highly probable. Non-current assets held for sale and disposal groups are measured at the lower of their carrying amount and fair value less cost to sell, except for those assets and liabilities that are not within the scope of the measurement requirements of IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations) such as deferred taxes, financial instruments, investment properties, insurance contracts and assets and liabilities arising from employee benefits. These are measured in accordance with the accounting policies described above. Immediately before the initial classification as held for sale, the carrying amounts of the asset (or assets and liabilities in the disposal group) are measured in accordance with applicable IFRSs. On subsequent remeasurement of a disposal group, the carrying amounts of the assets and liabilities noted above that are not within the scope of the measurement requirements of IFRS 5 are remeasured in accordance with applicable IFRSs before the fair value less costs to sell of the disposal group is determined.

21. Share-based payments

For cash settled share-based payments, a liability is recognised for the goods or services acquired, measured initially at the fair value of the liability at the grant date. The fair value excludes the effect of non-market based vesting conditions. At each balance sheet date until the liability is settled, and at the date of settlement, the fair value of the liability is re-measured, with any changes in fair value recognised in the profit or loss for the year. Details regarding the determination of the fair value of cash settled share-based transactions are set out in note 40.

Cash settled share-based payments are expensed on a straight line basis over the vesting period, based on the Bank's estimate of awards that will eventually vest, and adjusted each year for the change in fair value. The vesting period is the period over which all specified vesting conditions are to be satisfied. At each balance sheet date, the Bank revises its estimate of the number of awards expected to vest as a result of the effect of non-market based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in the profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the liability.

2. Critical judgements and estimates

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

Estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

The judgements and assumptions that are considered to be the most important to the portrayal of the Bank's financial condition are those relating to loan impairment provisions, conduct risk and legal provisions, deferred tax, pensions, separation provision, effective interest rates (EIR) and fair value adjustments, group relief receivable and derecognition of financial assets.

a. Loan impairment provisions

i. Overview

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

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

2. Critical judgements and estimates continued

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

Further explanation of the treatment of forborne balances is included in the Bank's risk management disclosures.

The section below explains the methodology for loan impairment for both the Core (unsecured and secured residential) and Non-core (Corporate and Optimum) segments. Only the critical elements of judgement are discussed in detail.

ii. Collective provisions

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

a) Core

i) Unsecured and secured residential

The Bank's collective provision for unsecured and secured retail personal advances is £101.5m (2014: £107.3m). Loans are identified as impaired by taking account of the stage of the debt's delinquency, the product type and the regularity of payments made whilst in arrears. The provision is calculated using assumed PD and LGD for unidentified impairment.

The provision rates reflect the likelihood that the debt will be written off or charged off at some point in the future. The PD and LGD parameters are based on historical experience and are subject to regular review.

A key estimate within the unsecured models is the probability that impaired accounts move to a default status during the outcome period. The model uses historical actual data over a defined period of time to arrive at an average probability of accounts moving to default. If the maximum PD has been used for each category of arrears and for each product, this would increase the collective provision by £5.5m for all of the unsecured portfolios.

A key estimate used in the secured impairment model provisioning is the collateral value. A 10% decrease in the indexed collateral used in the model would increase the provision by £1.2m.

There were no significant changes made to the collective provision methodology in 2015.

b) Non-core

i) Corporate

The Bank's collective provision against corporate loans in the Non-core division has decreased to £7.5m (2014: £16.7m).

The collective provision is calculated using factors such as observed default rates and LGD. As assessment is made of the likelihood of the loan becoming recognised as impaired in the loss emergence period and for loans that are impaired the likelihood of them moving to default over the outcome period. The calculation of the collective provision relies heavily on assumed PDs.

There were no significant changes to the collective provision methodology in 2015 except for i) utilising property collateral for non-CRE customers when assessing their loss rates, and ii) the introduction of explicit discounting in assessing the proceeds of property sales.

The strategic deleveraging of the Bank's Non-core assets in 2015 has been the primary reason for the reduction in the collective provision.

The impact of increasing the default rates by 10% is an increase of the collective by £1.1m. A 10% decrease in collateral values would increase the provision by £1.6m.

ii) Optimum collective

In addition to the above, collective provisions of £3.3m (2014: £12.4m) are held in the Optimum segment of the Non-core business.

A key estimate is the collateral value. A 10% decrease to the indexed collateral used in the model would increase the provision by £7.0m.

There were no significant changes made to the collective provision methodology in 2015.

Further explanation of collection loan impairment method is included in the Bank's risk management disclosures.

iii. Individual provisions

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

All amounts are stated in £m unless otherwise indicated

2. Critical judgements and estimates continued

a) Core

i) Unsecured and secured residential

Individual provisions for unsecured and secured residential lending total £3.8m (2014: £4.5m). There were no significant changes made to the provision methodology in 2015. Sensitivities to the key estimates within the secured residential individual impairment model are disclosed in the Risk Management section.

b) Non-core

i) Corporate

The Bank's individual impairment provision on Corporate loans totals £118.4m (2014: £386.8m). The provision has decreased reflecting improving macroeconomic factors and the Bank's strategic deleverage of Non-core assets.

The determination of individual impairment provisions requires the exercise of considerable management judgement involving matters such as economic conditions and the resulting trading performance of the customer and the value of security held, for which there may not be a readily accessible market. In particular, significant judgement is required by management in assessing the borrower's cash flows and debt servicing capability together with the realisable value of collateral. The actual amount of the future cash flows and their timing may differ from the assumptions made for the purposes of determining the impairment provision and consequently these provisions can be subject to change over time.

For further information on credit risk and impairment, see the Bank's risk management disclosures.

ii) Optimum individual

The Bank's individual impairment provision on Optimum mortgages is £9.9m. (2014: £9.5m). Mortgage accounts are identified as impaired and provided for on an individual basis by taking account of the stage of the debt's delinquency.

b. Conduct risk and legal provisions

i. Overview

The conduct and legal risks provision involves significant judgement and therefore constitutes one of the Bank's critical accounting estimates.

Significant components of the conduct risk and legal provision are potential customer redress in relation to Payment Protection Insurance (PPI), and breaches of the technical requirements of the Consumer Credit Act (CCA). The Bank has also made provision for conduct issues requiring redress which are individually less significant.

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

ii. Payment Protection Insurance (PPI)

A provision of £87.0m (2014: £73.6m) has been recorded in respect of potential customer redress relating to past sales of PPI. The provision is in respect of the total expected cost of carrying out this work and paying compensation, bringing the total provisions raised to date of £423.8m (2014: £352.0m).

The most significant factors behind the £71.8m increase are the rate of decline of the inbound complaint volumes was slower than previously expected and forecast future inbound complaint volumes are expected to remain higher than originally forecast due to the proposed time bar by which customers can bring a claim and the associated FCA communications campaign. The increased forecast volume of complaints has led to an increase in operational delivery costs.

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

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

Description of estimate	Current position	Future expected	Sensitivity on current position
Number of inbound valid[1] complaints	92,000	23,000	1,000 = £2.6m
Average uphold rate per valid[1] complaint	65%	69%	1% = £0.5m
Average redress per upheld complaint	£3,339	£2,774	£100 = £0.7m

1. Valid complaints excludes those complaints for which no PPI policy exists.

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

2. Critical judgements and estimates continued

iii. Breaches of the technical requirements of the Consumer Credit Act (legal provision) – Unsecured Loans

An amount of £124.8m (2014: £162.1m) has been provided regarding interest refunds following identification of breaches of the technical requirements of the CCA. The Bank's redress and remediation programme is ongoing but is expected to be completed in 2016. Once the Bank remediates open loan accounts they become compliant with the CCA and the Bank can start to recognise loan interest again.

The increase in the gross provision reflects further interest chargeable on affected loans in accordance with relevant loan agreements which requires redressing, an updated estimate of the costs which will be incurred in delivering redress, and an increase in the provision because of a change to assumptions reflecting the latest actual redress amounts. The provision will continue to increase in line with interest charged until the issue is resolved.

Assumptions for provisioning purposes are that the payment profile of loans was as per those agreed at drawdown. The provision covers all interest accrued during non-compliance to the end of December 2015.

Included within the provision are operating costs of £20.0m based upon the latest view of delivery timeframes.

iv. Other conduct/compliance related provisions

Other conduct/compliance related provisions include the following:

- £5.9m (2014: £17.8m) for potential customer redress relating to the processing of first payments on certain mortgages;
- £27.3m (2014: £24.0m) relating to potential customer redress in relation to mortgage early redemption charges;
- £4.7m (2014: £14.9m) for alleged failings in the introduction of third party sales of card and identification protection products (as part of an industry wide review announced by the FCA on 27 January 2015);
- £6.5m (2014: £20.0m) relating to potential customer redress due to mortgage customer detriment;
- £9.4m (2014: £34.8m) for potential customer redress in relation to arrears fees and charges;
- £27.9m (2014: £17.4m) relating to packaged accounts;
- £15.0m (2014: £15.0m) relating to provision for potential conduct issues incurred but not identified;
- £1.2m (2014: £7.0m) relating to potential customer redress and other costs in relation to mortgage documentation;
- £21.9m (2014: £22.5m) relating to cost of mortgage redress;
- £3.6m (2014: £14.8m) relating to interest rate swaps; and
- £20.3m (2014: £12.2m) of other conduct provisions.

Key assumptions 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.

c. Deferred tax

The Bank has recognised a deferred tax asset of £7.6m (2014: £21.9m) which includes £nil (2014: £0.9m) within a disposal group classified as held for sale.

The Bank has recognised a deferred tax liability of £47.8m (2014: £84.0m).

The deferred tax asset relates to temporary differences where the recoverability is not dependent on the future performance of the Bank and temporary differences in subsidiaries that are forecast to make taxable profits. The Bank has not recognised a deferred tax asset in respect of any trading losses or other temporary differences as doubt exists over the availability of sufficient future taxable profits.

During the year, effective from 1 April 2015, the standard rate of corporation tax in the UK changed from 21% to 20%. Reductions in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and 18% (effective from 1 April 2020) were substantively enacted on 18 November 2015. A banking surcharge tax of 8% will also apply to the Bank (effective from 1 January 2016) and this change was substantively enacted on 18 November 2015. Deferred tax has been calculated by reference to the most appropriate rate based on forecasts.

d. Pensions

i. Defined contribution accounting for the Pace scheme

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

A provision of £2.5m (2014: £2.9m) has been recognised in relation to the annual deficit funding which the Bank has agreed to pay. A further agreement on deficit funding may be reached at that point if the overall liability position has not been resolved at that time. See note 34 for further details.

2. Critical judgements and estimates continued

ii. Defined benefit accounting for the Britannia scheme

The Britannia scheme is a defined benefit scheme. On the 23 December 2015, a Flexible Apportionment Arrangement (FAA) was executed, at which time the Co-operative Bank plc was named as a participating employer and replaced CFSMS as the principal employer, following which, CFSMS, WMS and PHL departed from the scheme with their share of the scheme's liabilities being transferred to the Bank. As Bank had already been recognising the total assets and liabilities of the scheme on its balance sheet, due to a guarantee it provided, the FAA has not had a significant impact on the Bank's exposure to the risks of the scheme. See note 34 for further details.

The next full (triennial) actuarial funding valuation of the Britannia Pension Scheme, with an effective date of 5 April 2014, is currently ongoing. Consequently it is considered there was no minimum funding requirement at the year end.

Further information on the financial implications of accounting for the Britannia scheme on a defined benefit basis is disclosed in note 34.

iii. Sensitivity of defined benefit obligations

The measurement of the Bank's defined benefit liability is particularly sensitive to changes in certain key assumptions, which are described below. The methods used to carry out the sensitivity analyses presented below for the material assumptions are the same as those the Bank has used previously. The calculations alter the relevant assumption by the amount specified, whilst assuming that all other variables remained the same. This approach is not necessarily realistic, since some assumptions are related; for example, if the scenario is to show the effect if inflation is higher than expected, it might be reasonable to expect that nominal yields on corporate bonds will increase also. However, it enables the reader to isolate one effect from another.

e. Separation provision

During November 2013, the Bank publically announced its intention to separate from The Co-operative Group. The Bank has recognised a provision of £64.3m (2014: £112.3m) in relation to separation costs which are eligible to be provided for under IAS 37 (Provisions, Contingent Liabilities and Contingent Assets). For further details please refer to note 32.

The separation provision represents the costs directly relating to the Bank's obligation to separate from The Co-operative Group. The calculation of the separation provision requires significant judgement by management in determining appropriate assumptions. Key assumptions include the day rate which will be paid to contract staff as part of the separation of Enterprise Services Programme and the overall time it will take to achieve separation. A reasonably possible change in overall estimates of costs for key separation provision judgements could increase the provision by £8.0m.

f. Effective Interest Rate and Fair Value adjustments

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

In calculating the EIR adjustment to apply to mortgage balances, the most significant assumption in terms of impact and volatility is the assumed standard variable rate which will be in effect at the end of a fixed rate product term. This is determined with reference to expected Bank of England base rate rises, with a proportion of future increases assumed to pass through to the Bank's standard variable rate. As a measure of the sensitivity of this input, a 0.5% increase in the assumed standard variable rate in place after the expiry of the fixed rate period for all products would result in an £8.6m (26%) increase in the EIR adjustment required to the loans and advances to customers balance as at 31 December 2015.

On the merger of the Bank and Britannia Building Society in August 2009, an exercise was undertaken to fair value the respective assets and liabilities of Britannia Building Society. These fair value adjustments are unwound on an EIR basis over the effective lives of the assets and liabilities. Management is required to apply significant judgement in determining the EIR assumptions which underpin the unwind profile of the fair value adjustments. The most significant assumption in terms of impact and volatility in determining the unwind profile for fair value adjustments is the remaining average lives of the related instruments.

The most significant fair value adjustment is that made to the Leek debt securities, which were valued below par upon merger. This adjustment has been unwinding towards the call date of the underlying Leek debt securities. As a measure of the sensitivity of the remaining lives on these instruments, if the Leek notes were to be redeemed one month earlier than the assumed call date, the Leek notes fair value adjustment would decrease by £17.1m (7.2%) as at 31 December 2015, resulting in additional expense of £17.1m in the year to 31 December 2015.

g. Group relief receivable

As part of the negotiations relating to the separation of the Bank from The Co-operative Group, the Bank and The Co-operative Group agreed terms relating to the surrender of group relief between the entities in the Bank's tax group and entities in The Co-operative Group tax group. A deed sets out the basis of the agreement by The Co-operative Group to take proactive steps to allow it to maximise its claim for tax losses from the Bank for the accounting periods to 31 December 2012 and 2013. The deed also addresses the terms of the payment by The Co-operative Group to the Bank for those tax losses. The 2015 financial statements, which include a group relief receivable of £60.1m (2014: £126.8m), have been prepared on a basis consistent with the deed.

2. Critical judgements and estimates continued

The Bank receives payment from The Co-operative Group when The Co-operative Group realises the benefit of the losses surrendered and at the corporation tax rate at which the benefit is realised. The value of the asset is sensitive to a number of assumptions including the forecast repayments provided by The Co-operative Group for the periods to 2018; The Co-operative Group's capital expenditure qualifying for capital allowances in future periods; The Co-operative Group's taxable profits in future periods; the Bank's extrapolation of the forecast repayments for the periods after 2018; the rate of corporation tax; the rates at which capital allowances on qualifying capital expenditure are available; and The Co-operative Group's capacity to claim the tax losses. If The Co-operative Group's capacity to realise benefit in 2018 from the previously surrendered losses decreases by 5%, the value of the group relief receivable decreases by £5.1m.

h. Derecognition of financial assets

During the year, the Bank closed two whole structure securitisations of its Non-core optimum residential mortgage portfolio through the issuance of notes and residual certificates by Warwick Finance 1 and Warwick Finance 2. Those assets were assessed for derecognition on a stand alone and consolidated basis in accordance with IAS 39 and IFRS 10.

Stand alone basis

Pass through test

Under the pass through test, the obligation to pay the cashflows from the mortgages to Warwick Finance 1 and Warwick Finance 2 was met since payments from the mortgage borrower are made into the collection accounts required to be transferred to Warwick Finance 1 and Warwick Finance 2, respectively, on the next business day.

Risk and rewards test

The Bank has assessed whether substantially all the risks and rewards of ownership of the mortgages to Warwick Finance 1 and Warwick Finance 2 have been transferred. Whilst the Bank retains an interest in Class A notes of both structured entities, the holders of residual certificates are independent third parties, fees and terms and conditions are on an arms length basis, and the Bank is not consulted over decision to make further advances with regard to mortgages which have been securitised as part of these transactions. The Bank has concluded that the transfer of substantially all risks and rewards test is therefore met.

Requirement to consolidate the results of Warwick Finance 1 and Warwick Finance 2

Variable rights of return

The Bank has assessed whether it has exposure or rights to variable returns from involvement with Warwick Finance 1 and Warwick Finance 2, and if it has the ability to affect those returns.

Up until 1 August 2015, the Bank owned WMSL, which provided services to Warwick Finance 1, however the Bank only acted as agent for junior and residual noteholders and not as a principal acting in its own interest. Hence the Bank had no power over Warwick Finance 1 and was only exposed to a de-minimus variable return from Warwick Finance 1.

Since the Bank sold WMSL on 1 August 2015 the Bank now has no further de-minimus powers over Warwick Finance 1. The Bank therefore concluded that Warwick Finance 1 should not be consolidated into its results.

The Bank closed its second whole structure securitisation of its Non-core optimum residential mortgage portfolio through the issuance of notes and residual certificates by Warwick Finance 2 after the date which the Bank sold WMSL. The Bank therefore concluded that Warwick Finance 2 should not be consolidated into its results.

The conclusion that Warwick 1 and 2 should not be consolidated into the Bank's results was made with full regard to the nature of the return associated with the Bank retained notes of both structures.

All amounts are stated in £m unless otherwise indicated

3. Segmental information

The Bank is managed as two divisions, Core and Non-core. Core represents activity consistent with the strategy and risk appetite of the Bank. This includes Retail, Business and Commercial Banking (BaCB), Treasury and Other segments. Non-core business lines include activities not aligned with current strategy of the Bank which are targeted for run down or exit.

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.

Further detail of the components of the Core and Non-core divisions is provided in the detailed financial review.

	Core					Non-core			
	Retail	BaCB	Treasury	Other[1]	Total Core	Corporate CoAM	Optimum	Total Non-core	Total
2015									
Net interest income	**421.7**	**41.9**	**(5.8)**	**2.8**	**460.6**	**1.6**	**9.3**	**10.9**	**471.5**
Losses on asset sales	**–**	**–**	**(0.1)**	**(0.7)**	**(0.8)**	**(67.5)**	**(53.1)**	**(120.6)**	**(121.4)**
Non-interest income	**43.2**	**11.6**	**(6.4)**	**4.0**	**52.4**	**14.0**	**3.5**	**17.5**	**69.9**
Operating income	**464.9**	**53.5**	**(12.3)**	**6.1**	**512.2**	**(51.9)**	**(40.3)**	**(92.2)**	**420.0**
Direct costs	**(138.1)**	**(9.3)**	**(7.4)**	**(10.4)**	**(165.2)**	**(9.9)**	**(4.9)**	**(14.8)**	**(180.0)**
Impairment (losses)/gains on loans and advances	**(3.7)**	**1.3**	**–**	**2.1**	**(0.3)**	**37.9**	**11.0**	**48.9**	**48.6**
Contribution result	**323.1**	**45.5**	**(19.7)**	**(2.2)**	**346.7**	**(23.9)**	**(34.2)**	**(58.1)**	**288.6**
Operations and central costs									**(311.9)**
Operating project costs									**(49.7)**
Operating result									**(73.0)**
Remediation projects									**(124.5)**
Strategic projects									**(99.7)**
Share of post tax profits from joint ventures									**0.7**
Conduct/legal risk									**(193.7)**
Fair value amortisation									**(120.4)**
Loss before taxation									**(610.6)**
Income tax									**(12.2)**
Loss for the financial year									**(622.8)**

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

1. Included within 'Core - Other' is Unity Trust Bank. Unity Trust Bank operates in the corporate banking and social economy sectors on behalf of trade unions and is consolidated into the Bank's results on the basis of control. In December 2015 the Bank disposed of the majority of its shareholding in Unity Trust Bank. This is referred to in more detail in note 6.

All amounts are stated in £m unless otherwise indicated

3. Segmental information continued

	Core					Non-core				
	Retail	BaCB	Treasury	Other[1]	Total Core	Corporate CoAM	Optimum	Illius	Total Non-core	Total
2014 (re-presented)										
Net interest income	396.3	46.1	(11.0)	13.4	444.8	9.3	43.2	(3.9)	48.6	493.4
Losses on asset sales	–	–	(2.1)	–	(2.1)	(11.1)	–	(1.2)	(12.3)	(14.4)
Non-interest income	105.2	14.9	(29.7)	–	90.4	17.2	4.7	2.8	24.7	115.1
Operating income	501.5	61.0	(42.8)	13.4	533.1	15.4	47.9	(2.3)	61.0	594.1
Direct costs	(154.8)	(14.6)	(10.3)	(8.9)	(188.6)	(17.1)	(2.9)	(4.2)	(24.2)	(212.8)
Impairment gains on loans and advances	1.8	1.6	–	0.1	3.5	152.6	15.6	–	168.2	171.7
Contribution result	348.5	48.0	(53.1)	4.6	348.0	150.9	60.6	(6.5)	205.0	553.0
Operations and central costs										(355.6)
Operating project costs										(71.0)
Operating result										126.4
Remediation projects										(145.6)
Strategic projects										(60.5)
Share of post-tax profits from joint ventures										0.6
Conduct/legal risk										(101.2)
Fair value amortisation										(83.9)
Loss before taxation										(264.2)
Income tax										39.0
Loss for the financial year										(225.2)

All amounts are stated in £m unless otherwise indicated

3. Segmental information continued

	2015	2014 (re-presented)
Net interest income		
Total interest margin for reportable segments	**471.5**	493.4
Gains on asset sales	**1.0**	1.6
Interest fair value unwind	**(115.0)**	(89.0)
Provision for customer redress	**(58.3)**	(48.0)
Net interest income	**299.2**	358.0
Non-interest income		
Total non-interest income for reportable segments	**69.9**	115.1
Losses on asset sales	**(128.4)**	(16.0)
Interest fair value unwind	**–**	9.8
Non-interest income	**(58.5)**	108.9
Comprising:		
Net fee and commission income	**71.8**	122.4
Other operating expense	**(130.3)**	(13.5)
	(58.5)	108.9
Operating expenses		
Total operating expenses for reportable segments	**(180.0)**	(212.8)
Operations and central costs	**(311.9)**	(355.6)
Project costs	**(273.9)**	(277.1)
Interest fair value unwind	**(5.4)**	(4.7)
Provision for customer redress	**(0.5)**	(0.9)
Gains on asset sales	**6.0**	–
Impairment reclassification	**–**	(1.5)
Operating expenses	**(765.7)**	(852.6)
Interest fair value unwind		
Total interest unwind for reportable segments	**(120.4)**	(83.9)
Interest margin unwind	**115.0**	89.0
Non-interest income unwind	**–**	(9.8)
Operating expenses unwind	**5.4**	4.7
Interest fair value unwind	**–**	–
Impairment gains on loans and advances		
Total impairment gains on loans and advances for reportable segments	**48.6**	171.7
Impairment reclassification	**–**	1.5
Impairment gains on loans and advances	**48.6**	173.2

The 2014 comparatives have been re-presented as described in the detailed financial review.

Notes to the Bank financial statements continued
For the year ended 31 December 2015
All amounts are stated in £m unless otherwise indicated

3. Segmental information continued

	Core					Non-core			
2015	**Retail**	**BaCB**	**Treasury**	**Other**	**Total Core**	**Corporate CoAM**	**Optimum**	**Total Non-core**	**Total**
Segment assets	**14,219.3**	**520.9**	**8,078.8**	**–**	**22,819.0**	**1,998.0**	**3,155.9**	**5,153.9**	**27,972.9**
Unallocated assets									**1,055.4**
Bank total assets									**29,028.3**

	Core					Non-core			
2015	**Retail**	**BaCB**	**Treasury**	**Other**	**Total Core**	**Corporate CoAM**	**Optimum**	**Total Non-core**	**Total**
Segment liabilities	**19,725.2**	**2,682.0**	**3,267.4**	**–**	**25,674.6**	**211.3**	**–**	**211.3**	**25,885.9**
Unallocated liabilities									**1,779.1**
Bank total liabilities									**27,665.0**

	Core					Non-core			
2014	Retail	BaCB	Treasury	Other	Total Core	Corporate CoAM	Optimum	Total Non-core	Total
Segment assets	14,611.4	620.0	9,729.4	515.4	25,476.2	3,930.1	6,822.9	10,753.0	36,229.2
Unallocated assets									1,353.7
Bank total assets									37,582.9

	Core					Non-core			
2014	Retail	BaCB	Treasury	Other	Total Core	Corporate CoAM	Optimum	Total Non-core	Total
Segment liabilities	25,562.3	2,837.0	4,523.3	468.4	33,391.0	557.4	–	557.4	33,948.4
Unallocated liabilities									1,620.0
Bank total liabilities									35,568.4

Unallocated assets are assets which cannot be attributed to a reportable segment.

4. Auditor's remuneration

	2015 £'000	2014 £'000
Loss before taxation is stated after:		
Audit of these financial statements	**2,000**	1,400
Audit of prior year financial statements	**841**	–
Amounts receivable by the Company's auditor and its associates in respect of:		
Audit of financial statements of subsidiaries of the Company	**300**	325
Audit related assurance services	**–**	–
Other tax advisory services	**–**	–
Other assurance services	**200**	530
Corporate finance services	**–**	–
All other services	**93**	455

£160k (2014: £300k) of other assurance services relates to review work performed on the half year accounts.

5. Directors' emoluments

	2015 £'000	2014 £'000
Executive Directors	**4,783**	3,594
Non-Executive Directors	**910**	745
	5,693	4,339

No retirement benefits are accruing to Directors under defined benefit schemes.

The aggregate of emoluments and amounts receivable under incentive schemes of the highest paid Director was £3,851k (2014: £3,088k).

Further details of Directors' emoluments are included in the Directors Remuneration report, which is unaudited.

All amounts are stated in £m unless otherwise indicated

6. Disposal of subsidiary

Prior to December 2015 the Bank owned 26.7% of Unity Trust Bank (UTB) and previously consolidated this entity into the overall results on the basis of its ability to control and direct the relevant activities of UTB. In December 2015, the Bank entered into a sale agreement to dispose of the majority of its shareholding in UTB for consideration of £5.85m, reducing the Banks shareholding from 26.7% to 6.7%. The disposal was completed on 14 December 2015. As a consequence of the share restructure, disposal, and subsequent changes to shareholders' rights, the Bank no longer controls UTB.

The net assets of UTB at the date of disposal were £47.6m. UTB results have been included in the consolidated income statement up to the date of disposal. A loss of £5.0m on disposal was incurred, representing the proceeds of disposal less the carrying value of UTB's net assets attributable to the Bank at the disposal date. The loss is recognised within other operating expense.

7. Net interest income

	2015	2014 Re-presented
Interest receivable and similar income		
On financial assets not at fair value through profit or loss:		
On loans and advances to customers	**776.6**	1,052.6
On loans and advances to banks	**19.9**	24.1
On investment securities	**71.9**	75.8
Total of financial assets not at fair value through profit or loss	**868.4**	1,152.5
On financial assets at fair value through profit or loss:		
Net interest expense on financial instruments hedging assets	**(60.7)**	(106.7)
Net interest income on financial instruments not in a hedging relationship	**13.9**	19.0
Total interest receivable	**821.6**	1,064.8

	2015	2014
Interest expense and similar charges		
On financial liabilities not at fair value through profit or loss:		
On customer accounts	**(248.2)**	(405.2)
On bank and other deposits	**(257.7)**	(247.8)
On subordinated liabilities	**(28.6)**	(22.8)
Total of financial liabilities not at fair value through profit or loss	**(534.5)**	(675.8)
On financial liabilities at fair value through profit or loss:		
Net interest income/(expense) on financial instruments hedging liabilities	**8.9**	(21.4)
Net interest income/(expense) on financial instruments not in a hedging relationship	**3.2**	(9.6)
Total interest expense	**(522.4)**	(706.8)

Interest expense on bank and other deposits includes interest expense on deposits by banks and on debt securities in issue. It also includes fair value unwind on debt securities in issue of £143.5m (2014: £109.2m), further details of which are provided in note 39.

All amounts are stated in £m unless otherwise indicated

8. Net fee and commission income/(expense)

	2015	2014
Fee and commission income		
On items not at fair value through profit or loss	**131.8**	197.2
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	**131.9**	197.3

	2015	2014
Fee and commission expense		
On items not at fair value through profit or loss	**(59.7)**	(74.8)
On items at fair value through profit or loss	**(0.4)**	(0.1)
Total fee and commission expense	**(60.1)**	(74.9)

9. Other operating expense

	Note	2015	2014 Re-presented
Profit on sale of investment securities – loans and receivables		**0.9**	0.5
Loss on sale of investment properties		**–**	(1.2)
Rent receivable from investment properties	22	**–**	7.5
Change in fair value of investment properties	22	**0.1**	(4.5)
Loss on sale of loans and advances to customers		**(126.0)**	–
Expense from derivatives and hedge accounting		**(24.6)**	(102.0)
Income from assets and liabilities held at fair value through profit and loss		**29.9**	79.5
Other		**(10.6)**	6.7
Total Other Operating expense		**(130.3)**	(13.5)

During the year, the Bank securitised part of its Non-core Optimum residential mortgages portfolio through the issuance of notes and residual certificates by Warwick Finance Residential Mortgages Number One PLC (Warwick Finance One) and Warwick Finance Residential Mortgages Number Two PLC (Warwick Finance Two). This, together with other disposals of Corporate loans in the year, has contributed to the £126.0m loss on sale of loans and advances to customers.

All amounts are stated in £m unless otherwise indicated

10. Operating expenses

	Note	2015	2014
Operating Expenses			
Staff costs	11	**287.5**	304.1
Administrative expenses		**258.3**	296.7
Depreciation of property, plant and equipment	23	**9.9**	13.3
Amortisation of intangible fixed assets	21	**29.5**	26.7
Impairment of property, plant and equipment	23	**–**	6.3
Impairment of intangible assets	21	**0.3**	3.1
Profit on sale of property, plant and equipment		**(3.0)**	(0.2)
Operating lease rentals		**23.0**	25.6
Financial Services Compensation Scheme Levies	32	**19.0**	24.4
Property provisions for liabilities and charges provided in the year	32	**3.4**	2.1
Other provisions for liabilities and charges provided in the year	32	**14.2**	24.7
Direct expenses from investment properties that generated rental income in the period		**–**	3.6
Direct expenses from investment properties that did not generate rental income in the period		**–**	0.2

The following are included in operating expenses, which have been incurred outside the ordinary course of business:

	Note	2015	2014
Incurred outside the ordinary course of business			
Investment, integration and rationalisation costs		**79.6**	40.7
Bank separation costs		**44.0**	72.9
Impairment of property, plant and equipment	23	**–**	8.4
Total of items incurred outside the ordinary course of business		**123.6**	122.0

Included within Bank separation costs is £8.9m provided in the year, see note 32.

The 2014 Bank separation costs included in the table above are the net impact of a charge of £94.5m and a utilisation of £21.6m.

11. Staff costs

	Note	2015	2014
Wages and salaries		**157.6**	180.6
Social security costs		**14.5**	16.0
Pension costs:			
Defined benefit plans	34	**5.0**	4.9
Defined contribution plans	34	**17.8**	26.1
Other staff costs		**92.6**	76.5
Total staff costs		**287.5**	304.1

Average number of employees

The average number of persons working for the Bank during the year is as follows:

	No. of employees 2015	No. of employees 2014
Full time	**4,463**	4,772
Part time	**1,251**	1,630
	5,714	6,402

Employees of the Bank were employed by CFS Management Services Limited (CFSMS) until 20 December 2013 and staff costs recharged to the Bank. At the beginning of 2014, the majority of the Bank's employees had their employment contracts transferred from CFSMS to The Co-operative Bank plc. The transfer was required to support the legal separation of the Bank from The Co-operative Group. This transfer took place under the Transfer of Undertakings (Protection of Employment) Regulations 2006.

All amounts are stated in £m unless otherwise indicated

12. Income tax

	Note	2015	2014
Current tax			
Current year		**47.6**	(22.3)
Prior year		**(0.1)**	7.8
Total current tax		**47.5**	(14.5)
Deferred tax			
Current year	33	**(27.6)**	(24.5)
Prior year	33	**(3.2)**	–
Impact of corporation tax rate change	33	**(4.5)**	–
Total deferred tax		**(35.3)**	(24.5)
Total tax charge/(credit)		**12.2**	(39.0)

In addition to the above, included within other comprehensive income is a current tax credit of £3.9m (2014: tax charge of £12.5m) and a deferred tax charge of £12.5m (2014: £8.7m).

Further information on deferred tax is presented in note 33.

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:

	Note	2015	2014
Loss before taxation		**(610.6)**	(264.2)
Tax calculated at a rate of 20.25% (2014: 21.49%)		**(123.6)**	(56.8)
Effects of:			
Unrecognised deferred tax	33	**74.7**	22.7
Adjustment to group relief debtor		**50.6**	–
Expenses not deductible for tax purposes		**22.7**	(4.4)
Discount of group relief debtor		**(5.2)**	(9.7)
Impact of corporation tax rate change		**(4.5)**	–
Adjustments to tax charge in respect of prior periods		**(3.3)**	7.7
Other differences		**0.8**	(1.8)
Depreciation of capital expenditure not qualifying for capital allowances		**–**	1.5
Write off of deferred tax		**–**	1.8
		12.2	(39.0)

Amounts receivable from The Co-operative Group for tax losses surrendered and changes in that amount are recorded as an adjustment to the tax expense. The group relief debtor adjustment has arisen as a result of a revised repayment profile provided by the Co-operative Group Limited. For further information on the group relief receivable, refer to note 2. Expenses not deductible for tax purposes includes provisions for compensation payments arising after 8 July 2015 for which tax relief has been restricted following a change in legislation.

13. Earnings per share

Basic earnings per share is calculated by dividing the net loss attributable to equity shareholders of the Bank by the weighted average number of ordinary shares in issue during the year.

	Note	2015	2014
Loss attributable to equity shareholders of the Bank		**(623.3)**	(226.6)
Number of Ordinary shares in issue (millions)			
At the beginning of the year		**451.5**	250.0
Issue of new ordinary shares	38	**–**	200.5
Issue of bonus shares	38	**–**	1.0
At the end of the year		**451.5**	451.5
Weighted average number of ordinary shares in issue (millions)		**451.5**	368.6
Basic losses per share (expressed in pence per share)		**(138.05)p**	(61.48)p

201.5m new shares were issued as part of the capital raising completed in May 2014, see note 38 for further details.

14. Non-current assets classified as held for sale

a) Non-current assets classified as held for sale

	Note	2015	2014
Property, plant and equipment	23	**3.4**	50.1
Intangible assets	21	**–**	0.3
Loans and advances to customers	17a	**–**	323.4
Cash and cash equivalents		**–**	9.1
Other receivables		**–**	4.4
		3.4	387.3

b) Liabilities directly associated with non-current assets classified as held for sale

	2015	2014
Other liabilities, accruals and deferred income	**–**	6.6
Current tax liabilities	**–**	1.0
Provision for liabilities and charges	**–**	0.3
	–	7.9

Non-current assets presented as held for sale relate solely to a number of branch assets which are currently being marketed for sale, with the expectation that these sales will be completed by the end of 2016. Impairment losses of £0.3m were recognised on classification of these assets as held for sale.

All assets classified as held for sale in 2014 were sold in 2015.

15. Cash and balances at central banks

	2015	2014
Cash in hand	**187.3**	218.0
Balances with the Bank of England other than mandatory reserve deposits	**2,445.6**	4,489.5
Included in cash and cash equivalents	**2,632.9**	4,707.5
Mandatory reserve deposits with the Bank of England	**45.6**	57.8
	2,678.5	4,765.3

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.

All amounts are stated in £m unless otherwise indicated

16. Loans and advances to banks

	2015	2014
Items in course of collection from other banks	**18.3**	63.3
Placements with other banks	**488.5**	682.2
Included in cash and cash equivalents	**506.8**	745.5
Other loans and advances to banks	**364.2**	862.9
	871.0	1,608.4

17. a) Loans and advances to customers

	Note	2015	2014
Gross loans and advances		**19,935.6**	26,240.7
Less: allowance for losses		**(245.2)**	(539.9)
Classified as held for sale	14	**–**	(323.4)
		19,690.4	25,377.4

Loans and advances to customers include £174.0m (2014: £182.7m) of financial assets at fair value through income or expense designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency, and £4.2m of financial assets held for trading. Of these, £103.9m (2014: £78.4m) are secured by real estate collateral.

Loans and advances to customers include £3.2bn (2014: £7.9bn) 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 the Bank's deposits by banks are £10.1m (2014: £10.1m) of loans from external third parties and within the Bank's debt securities in issue are £2.3bn (2014: £2.9bn) 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. Further information on the concentration of exposure is included within the risk management disclosures.

Allowance for losses on loans and advances

	Core		Non-core		
	Individual	Collective	Individual	Collective	Total
2015					
At the beginning of the year	**4.5**	**110.0**	**396.3**	**29.1**	**539.9**
Balances with debt collection agencies[1]	**–**	**–**	**–**	**–**	**–**
Disposal of UTB	**(2.1)**	**(0.5)**	**–**	**–**	**(2.6)**
(Release)/charge against profits[2]	**(1.3)**	**4.2**	**(22.3)**	**(18.3)**	**(37.7)**
Amounts written back/(written off)	**2.7**	**(9.1)**	**(244.2)**	**–**	**(250.6)**
Unwind of discount allowance	**–**	**(2.3)**	**(1.5)**	**–**	**(3.8)**
Interest charged on impaired loans	**–**	**–**	**–**	**–**	**–**
At the end of the year	**3.8**	**102.3**	**128.3**	**10.8**	**245.2**

1. The movement in the allowance for losses on loans and advances in relation to balances with debt collection agencies is immaterial and is incorporated within the (release)/charge against profits for the year.
2. The net impairment credit in the Bank's income statement is £48.6m (2014: £173.2m credit). This includes amounts recovered by the Bank of £7.5m (2014: £2.3m) against amounts previously written off.

The net impairment also includes a provision release of £44.3m (2014: £1.5m charge) made against fair value adjustments for hedged risk during the year (see note 17b).

This is summarised in the table below:

	Note	2015
Net impairment release shown in income statement		**(48.6)**
Amounts recovered against amounts previously written off		**7.5**
Transfer to loss on sale of assets - loans and receivables		**(40.9)**
Provision against fair value adjustment for hedged risk	17b	**44.3**
Release against profits shown above		**(37.7)**

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All amounts are stated in £m unless otherwise indicated

17. a) Loans and advances to customers continued
Core provisions are analysed in further detail below:

	Core						
	Retail		BaCB		Other		Total
	Individual	Collective	Individual	Collective	Individual	Collective	Core
2015							
At the beginning of the year	**1.0**	**107.3**	**1.4**	**2.2**	**2.1**	**0.5**	**114.5**
Balances with debt collection agencies	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Disposal of UTB	**–**	**–**	**–**	**–**	**(2.1)**	**(0.5)**	**(2.6)**
(Release)/charge against profits	**(1.4)**	**5.6**	**0.1**	**(1.4)**	**–**	**–**	**2.9**
Amounts written back/(written off)[3]	**3.2**	**(9.1)**	**(0.5)**	**–**	**–**	**–**	**(6.4)**
Unwind of discount allowance	**–**	**(2.3)**	**–**	**–**	**–**	**–**	**(2.3)**
Interest charged on impaired loans	**–**	**–**	**–**	**–**	**–**	**–**	**–**
At the end of the year	**2.8**	**101.5**	**1.0**	**0.8**	**–**	**–**	**106.1**

Non-core provisions are analysed in further detail below:

	Non-core				
	Corporate		Optimum		Total
	Individual	Collective	Individual	Collective	Non-core
2015					
At the beginning of the year	**386.8**	**16.7**	**9.5**	**12.4**	**425.4**
Balances with debt collection agencies	**–**	**–**	**–**	**–**	**–**
Charge/(release) against profits	**12.6**	**(9.2)**	**(34.9)**	**(9.1)**	**(40.6)**
Amounts (written off)/written back[3]	**(279.5)**	**–**	**35.3**	**–**	**(244.2)**
Unwind of discount allowance	**(1.5)**	**–**	**–**	**–**	**(1.5)**
Interest charged on impaired loans	**–**	**–**	**–**	**–**	**–**
At the end of the year	**118.4**	**7.5**	**9.9**	**3.3**	**139.1**

3. 'Retail – Individual' and 'Optimum – Individual' both contain fair value reversals of £3.7m and £40.2m respectively. These balances are within the 'Amounts written off' rows within the above tables.

2014 loans and advances to customers comparisons are shown below:

	Core		Non-core		
	Individual	Collective	Individual	Collective	Total
2014					
At the beginning of the year	10.7	167.8	724.5	49.4	952.4
Balances with debt collection agencies[4]	–	39.6	–	–	39.6
(Release)/charge against profits	(1.5)	(3.3)	(147.3)	(20.3)	(172.4)
Amounts written off	(4.6)	(89.9)	(174.4)	–	(268.9)
Unwind of discount allowance	(0.1)	(4.2)	(6.6)	–	(10.9)
Interest charged on impaired loans	–	–	0.1	–	0.1
At the end of the year	4.5	110.0	396.3	29.1	539.9

	2014
Net impairment release shown in income statement	(173.2)
Amounts recovered against amounts previously written off	2.3
Provision against fair value adjustment for hedged risk	(1.5)
Release against profits shown above	(172.4)

4. A review of the Bank's relationships with debt collection agencies in 2014 concluded that the bank substantially retained all of the risk and rewards associated with such relationships. The related gross receivables of £41.4m and associated allowance of £39.6m was therefore recognised as at 31 December 2014.

All amounts are stated in £m unless otherwise indicated

17. a) Loans and advances to customers continued

Core provisions are analysed in further detail below:

	Core						
	Retail		BaCB		Other[1]		Total
	Individual	Collective	Individual	Collective	Individual	Collective	Core
2014							
At the beginning of the year	2.8	161.9	0.5	5.3	7.4	0.6	178.5
Balances with debt collection agencies	–	39.6	–	–	–	–	39.6
(Release)/charge against profits	(1.3)	(0.1)	1.3	(3.1)	(1.5)	(0.1)	(4.8)
Amounts written off	(0.5)	(89.9)	(0.4)	–	(3.7)	–	(94.5)
Unwind of discount allowance	–	(4.2)	–	–	(0.1)	–	(4.3)
At the end of the year	1.0	107.3	1.4	2.2	2.1	0.5	114.5

1. 'Core – Other' relates to Unity Trust Bank.

Non-core provisions are analysed in further detail below:

	Non-core				
	Corporate		Optimum		Total
	Individual	Collective	Individual	Collective	Non-core
2014					
At the beginning of the year	698.4	40.0	26.1	9.4	773.9
(Release)/charge against profits	(129.0)	(23.3)	(18.3)	3.0	(167.6)
Amounts written off	(176.1)	–	1.7	–	(174.4)
Unwind of discount allowance	(6.6)	–	–	–	(6.6)
Interest charged on impaired loans	0.1	–	–	–	0.1
At the end of the year	386.8	16.7	9.5	12.4	425.4

The overall write back of impairment is largely due to improved credit conditions and the disposal of Non-core assets at favourable prices, as part of the Bank's strategy to exit these books.

Loans and advances to customers include finance lease receivables:

	2015	2014
Gross investment in finance leases may be analysed as follows:		
No later than one year	**7.3**	14.3
Later than one year and no later than five years	**18.9**	47.8
Later than five years	**17.3**	51.0
	43.5	113.1
Unearned future finance income on finance leases	**(10.7)**	(30.4)
Net investment in finance leases	**32.8**	82.7
The net investment in finance leases may be analysed as follows:		
No later than one year	**5.4**	9.0
Later than one year and no later than five years	**14.4**	33.1
Later than five years	**13.0**	40.6
	32.8	82.7

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.

All amounts are stated in £m unless otherwise indicated

17. b) 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.

	2015	2014
Gross fair value adjustments for hedged risk	**98.0**	196.8
Less: impairment provision	**(4.0)**	(48.3)
	94.0	148.5

Movements on impairment provision on fair value adjustments for hedged risk are shown below:

	2015	2014
At the beginning of the year	**48.3**	46.8
(Release)/charge against profits	**(44.3)**	1.5
At the end of the year	**4.0**	48.3

18. Investment securities

a) Loans and receivables

	2015	2014
Loans and receivables:		
Listed	**15.0**	18.1
Unlisted	**–**	–
Total gross investment securities – loans and receivables	**15.0**	18.1
Less: allowance for losses	**–**	–
Total net investment securities – loans and receivables	**15.0**	18.1

Movement in investment securities – loans and receivables:

	2015	2014
At the beginning of the year	**18.1**	23.6
Disposals and maturities	**(3.2)**	(8.5)
Exchange adjustments	**–**	(0.5)
Amortisation	**0.1**	–
Release and utilisation of impairment provision	**–**	6.4
Movement in interest accrual	**–**	(2.9)
At the end of the year	**15.0**	18.1

All amounts are stated in £m unless otherwise indicated

18. Investment securities continued

b) Available for sale

	2015	2014
Available for sale:		
Listed	**4,296.8**	3,022.4
Unlisted	**–**	145.1
Total gross investment securities (available for sale)	**4,296.8**	3,167.5
Less: allowance for losses	**–**	–
Total net investment securities (available for sale)	**4,296.8**	3,167.5
Included in cash and cash equivalents	**–**	115.0

Included in investment securities are repurchase receivables of £517.0m. These receivables are gilts subject to repurchase transactions where the transferee has the ability to re-pledge or sell the assets.

Movement in investment securities – available for sale:

	2015	2014
At the beginning of the year	**3,167.5**	2,732.4
Acquisitions	**1,916.3**	1,940.1
Disposals and maturities	**(404.9)**	(1,644.5)
Disposal of UTB[1]	**(338.7)**	–
Fair value movements through equity	**(19.1)**	44.7
Fair value movements through income or expense	**(17.7)**	81.4
Amortisation	**(6.7)**	(8.9)
Release and utilisation of impairment provision	**–**	20.0
Movement in interest accrual	**0.1**	2.3
At the end of the year	**4,296.8**	3,167.5

1. Majority of Bank's shareholding in UTB was disposed of in the year. See note 6.

Impairment analysis of investment securities – available for sale

	2015	2014
At the beginning of the year	**–**	20.0
Release for the year	**–**	(1.1)
Utilised during the year	**–**	(18.9)
At the end of the year	**–**	–

c) Fair value through profit or loss

	2015	2014
Fair value through profit or loss:		
Listed	**582.4**	1,236.9
Unlisted	**–**	–
Total gross investment securities (FVTPL)	**582.4**	1,236.9
Less: allowance for losses	**–**	–
Total net investment securities (FVTPL)	**582.4**	1,236.9

All amounts are stated in £m unless otherwise indicated

18. Investment securities continued

Movement in investment securities (FVTPL):

	2015	2014
At the beginning of the year	**1,236.9**	1,743.4
Acquisitions	**–**	338.8
Disposals and maturities	**(639.9)**	(893.1)
Fair value movements through profit or loss	**(10.7)**	53.4
Movement in interest accrual	**(3.9)**	(5.6)
At the end of the year	**582.4**	1,236.9

d) Analysis of investment securities by issuer

	2015	2014
Investment securities issued by public bodies:		
Government securities	**2,518.1**	3,210.3
Other public sector securities	**87.2**	339.7
Total investment securities issued by public bodies	**2,605.3**	3,550.0
Investment securities issued by other issuers:		
Bank and building society certificates of deposits	**–**	145.1
Other debt securities:		
Other floating rate notes	**674.2**	709.3
Mortgage backed securities	**1,614.7**	18.1
Total investment securities issued by other issuers	**2,288.9**	872.5
Total investment securities	**4,894.2**	4,422.5

Other floating-rate notes (FRNs) relate to sterling denominated FRNs with maturities ranging from one month to six years from the balance sheet date.

All amounts are stated in £m unless otherwise indicated

19. Derivative financial instruments

The Bank has entered, as principal, into various derivatives either as economic hedges which are treated as held for trading (not in a qualifying hedge relationship), or in a qualifying hedge accounting relationship for the management of interest rate risk and foreign exchange rate risk. Positive and negative fair values have not been netted off as the Bank does not have a legal right of offset.

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 year the Bank has entered into fair value hedges to mitigate price movements due to interest rate sensitivities.

	2015 Fair value		2014 Fair value	
	Assets	**Liabilities**	Assets	Liabilities
Derivatives held for non-trading purposes				
Derivatives designated as cash flow hedges:				
Interest rate swaps	**35.1**	**(9.2)**	46.1	(16.7)
Derivatives designated as fair value hedges:				
Interest rate swaps	**29.3**	**(189.6)**	0.6	(341.2)
Cross currency interest rate swaps	**157.8**	**–**	173.4	(17.8)
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	**124.8**	**(143.6)**	198.2	(174.2)
Cross currency interest rate swaps	**2.2**	**(0.3)**	–	–
Forward currency transactions	**2.1**	**(4.0)**	0.6	(0.6)
OTC interest rate options	**0.2**	**(0.2)**	0.9	(0.1)
Equity swaps	**18.6**	**–**	50.9	(1.1)
Total derivative assets/(liabilities) held for non-trading purposes	**370.1**	**(346.9)**	470.7	(551.7)
Total recognised derivative assets/(liabilities)	**370.1**	**(346.9)**	470.7	(551.7)

The derivatives designated as cash flow hedges are interest rate swaps and futures used to hedge interest rate risk in the Bank's retail operations. Cash flows are hedged by quarterly time periods for durations up to 10 years. During the year there were no forecast transactions for which hedge accounting had previously been used but are no longer expected to occur.

In line with industry standards, credit valuation adjustments (CVAs) and debit valuation adjustments (DVAs) are applied to non-collateralised swaps representing the fair value measurement of counterparty risk. The net credit adjustment across the portfolio at the end of 2015 was £3.2m (2014: £3.9m). CVAs and DVAs are not applied to derivatives that are fully cash collateralised.

All amounts are stated in £m unless otherwise indicated

20. Equity shares

	2015	2014
Investment securities:		
Listed	**0.1**	0.1
Unlisted	**55.5**	2.7
	55.6	2.8
Included above are the following trade investments:		
Unity Trust Bank	**1.9**	–
Visa Europe – 1 ordinary share of €10 (2014: 1)	**51.2**	–
VocaLink Holdings Limited – 4,416,165 ordinary shares of £1 each (2014: 4,416,165)	**2.4**	2.7

Equity shares are classified as available for sale. The fair value of Visa Europe has been remeasured based on an offer to purchase the Bank's share by Visa Inc. This is referred to in more detail in the detailed financial review.

21. Intangible assets

	2015			2014 (re-presented)		
	Internally generated intangible assets	**Other intangible assets**	**Total**	Internally generated intangible assets[1]	Other intangible assets	Total
Cost						
At the beginning of the year	**472.1**	**46.0**	**518.1**	455.0	46.0	501.0
Additions	**73.0**	**–**	**73.0**	36.4	–	36.4
Disposals	**(0.3)**	**–**	**(0.3)**	(8.8)	–	(8.8)
Disposal of UTB	**(1.3)**	**–**	**(1.3)**	–	–	–
Impairment	**(0.3)**	**–**	**(0.3)**	(7.6)	–	(7.6)
Write off of fully amortised assets	**(296.1)**	**–**	**(296.1)**	–	–	–
Transfer to property, plant and equipment	**(3.7)**	**–**	**(3.7)**	–	–	–
Transfer to non-current assets held for sale	**–**	**–**	**–**	(2.9)	–	(2.9)
At the end of the year	**243.4**	**46.0**	**289.4**	472.1	46.0	518.1
Accumulated amortisation and impairment						
At the beginning of the year	**387.9**	**26.5**	**414.4**	368.3	22.0	390.3
Charge for the year	**25.0**	**4.5**	**29.5**	22.2	4.5	26.7
Disposals	**(0.2)**	**–**	**(0.2)**	–	–	–
Disposal of UTB	**(1.0)**	**–**	**(1.0)**	–	–	–
Write off of fully amortised assets	**(296.1)**	**–**	**(296.1)**	–	–	–
Transfer to non-current assets held for sale	**–**	**–**	**–**	(2.6)	–	(2.6)
At the end of the year	**115.6**	**31.0**	**146.6**	387.9	26.5	414.4
Net book value						
At the end of the year	**127.8**	**15.0**	**142.8**	84.2	19.5	103.7
At the beginning of the year	**84.2**	**19.5**	**103.7**	86.7	24.0	110.7

1. 2015 internally generated intangible assets include £2.4m of fully amortised assets which were previously written off, but were deemed to still be in use as at 31 December 2015. As a result, these assets have also been re-presented in the 2014 comparator.

Internally generated intangible assets consist of software development costs.

Other intangible assets consist of a core deposit intangible of £15.0m (2014: £19.5m).

Internally generated assets include £67.5m (2014: £26.7m) of assets in the course of construction.

All amounts are stated in £m unless otherwise indicated

22. Investment properties

	Note	2015	2014
Fair value			
At the beginning of the year		**2.1**	164.1
Additions – other expenditure		**–**	0.2
Disposals		**(0.1)**	(157.7)
Changes in fair value	9	**0.1**	(4.5)
At the end of the year		**2.1**	2.1

At the year end, investment properties relate solely to the Bank's stake in residential shared ownership properties. Shared ownership properties are carried at fair value, being the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction, measured under level 3 of the fair value hierarchy (see note 39). Fair value is calculated by using recent valuations of individual assets within the portfolio, indexed linked to the balance sheet date using the relevant regional house price index and the resulting profit/loss is recorded in the Bank's income statement.

Illius Properties Limited was sold on 28 November 2014. The loss on sale was £1.2m.

All investment properties are held to generate rental income until such time that the Bank considers it appropriate to realise its investment.

Included in the Bank's other operating expense for the year is £nil (2014: £7.5m) of rental income relating to investment properties (note 9).

23. Property, plant and equipment

2015	Note	Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost						
At the beginning of the year		**46.2**	**25.0**	**142.0**	**1.0**	**214.2**
Additions		**0.1**	**–**	**3.9**	**2.5**	**6.5**
Disposals		**(11.3)**	**(1.3)**	**(47.9)**	**–**	**(60.5)**
Disposal of UTB		**–**	**–**	**(2.3)**	**–**	**(2.3)**
Transfer from intangibles		**–**	**–**	**4.9**	**(1.2)**	**3.7**
Classified as held for sale	14	**(4.2)**	**–**	**–**	**–**	**(4.2)**
At the end of the year		**30.8**	**23.7**	**100.6**	**2.3**	**157.4**
Accumulated depreciation						
At the beginning of the year		**15.1**	**24.3**	**107.3**	**–**	**146.7**
Charge for the year		**1.1**	**0.6**	**8.2**	**–**	**9.9**
Disposals		**(7.0)**	**(1.3)**	**(34.1)**	**–**	**(42.4)**
Disposal of UTB		**–**	**–**	**(2.1)**	**–**	**(2.1)**
Classified as held for sale	14	**(0.8)**	**–**	**–**	**–**	**(0.8)**
At the end of the year		**8.4**	**23.6**	**79.3**	**–**	**111.3**
Net book value						
At the end of the year		**22.4**	**0.1**	**21.3**	**2.3**	**46.1**
At the beginning of the year		**31.1**	**0.7**	**34.7**	**1.0**	**67.5**

All amounts are stated in £m unless otherwise indicated

23. Property, plant and equipment continued

2014	Note	Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost						
At the beginning of the year		83.0	25.1	142.5	13.7	264.3
Additions		12.7	–	18.2	7.6	38.5
Disposals		(2.1)	(0.1)	(10.7)	–	(12.9)
Transfer between categories		–	–	9.2	(9.2)	–
Classified as held for sale	14	(47.4)	–	(17.2)	–	(64.6)
Impairment		–	–	–	(11.1)	(11.1)
At the end of the year		46.2	25.0	142.0	1.0	214.2
Accumulated depreciation						
At the beginning of the year		18.6	22.5	108.0	–	149.1
Charge for the year		0.8	1.9	10.6	–	13.3
Disposals		(0.3)	(0.1)	(4.4)	–	(4.8)
Classified as held for sale	14	(6.9)	–	(7.6)	–	(14.5)
Impairment		2.9	–	0.7	–	3.6
At the end of the year		15.1	24.3	107.3	–	146.7
Net book value						
At the end of the year		31.1	0.7	34.7	1.0	67.5
At the beginning of the year		64.4	2.6	34.5	13.7	115.2

As part of the separation of the Bank from the Group, in November 2014, the Bank purchased the legal title of all Bank specific assets held by CFSMS (shared assets remained with CFSMS). The carrying value of these assets on the balance sheet at 31 December 2014 is £42.9m.

	2015	2014
The net book value of land and buildings comprises:		
Freehold	**21.1**	30.5
Leasehold	**1.3**	0.6
	22.4	31.1

24. Other assets

	2015	2014
Amounts recoverable within one year:		
Trade debtors	**26.5**	24.3
Other assets	**–**	0.5
Amounts owed by the Co-operative Group	**37.5**	64.7
Amounts recoverable after more than one year:		
Amounts owed by the Co-operative Group	**60.1**	98.1
	124.1	187.6

Amounts owed by The Co-operative Group includes group tax relief recoverable of £60.1m (2014: £126.8m). Further details of the related party relationship of the Bank with The Co-operative Group and its undertakings are contained in note 37.

All amounts are stated in £m unless otherwise indicated

25. Prepayments and accrued income

	2015	2014
Amounts recoverable within one year	**35.4**	6.2
Amounts recoverable after more than one year	**8.1**	6.0
	43.5	12.2

Following separation from CFSMS, items previously classified as other assets are now classified as prepayments and accrued income.

26. Deposits by banks

	2015	2014
Items in course of collection	**31.8**	37.9
Deposits from other banks	**694.1**	577.5
	725.9	615.4

Included within deposits from other banks are liabilities of £671.2m (2014: £nil) secured on investment securities with a carrying value of £710.4m (2014: £nil) which have been sold under sale and repurchase agreements (note 39).

27. Customer accounts – capital bonds

	2015	2014
Retail	**77.4**	263.8

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. They have been designated on initial recognition at fair value through profit or loss 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.

The maximum amount the Bank would contractually be required to pay at maturity for all the capital bonds is £77.4m (2014: £264.3m).

The Bank 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 £20.9m (2014: £37.8m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the year is £nil (2014: £1.5m).

28. Debt securities in issue

	2015	2014
Fixed and floating rate notes	**2,554.3**	3,443.6

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. Where appropriate, the Bank applies fair value hedge accounting to reduce the accounting volatility from these positions.

Debt securities in issue include fixed and floating rate notes, the majority of which are secured on portfolios of variable and fixed rate mortgages. Some of these notes (securitisations) are redeemable in part from time to time, with such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets. There is no obligation for the Bank to make good any shortfall out of general funds. Other notes (covered bonds secured and certificates of deposit) require the Bank to repay contractual amounts due on specified maturity dates.

All amounts are stated in £m unless otherwise indicated

29. Other borrowed funds

	2015	2014
Fixed rate subordinated notes 2025	**250.0**	–
Fixed rate subordinated notes 2023	**206.0**	206.0
Issue costs, discounts and accrued interest	**1.0**	(9.6)
Fair value hedge accounting adjustment	**2.9**	–
	459.9	196.4

The 2025 subordinated notes were issued on 1 July 2015 and mature on 1 July 2020. These notes carry an annual interest rate of 8.5% to maturity and Interest is payable yearly in arrears. The 2023 subordinated notes were issued on 20 December 2013 and mature on 20 December 2023. These notes carry an annual interest rate of 11% to maturity and Interest is payable quarterly in arrears.

The notes have been admitted to trading on the London Stock Exchange; they are Tier 2 capital and an unsecured obligation of the Bank.

30. Other liabilities

	2015	2014
Amounts falling due within one year:		
ATM creditor	**1.2**	3.6
Amounts owed to subsidiaries of The Co-operative Banking Group Limited	**–**	126.0
Other creditors	**59.6**	23.9
Amounts falling due after one year:		
Other creditors	**8.0**	4.3
	68.8	157.8

Following separation from CFSMS in 2015, £126.0m of amounts owed to CFSMS are now classified on a net basis within other assets.

Further details of the Bank's related party relationship with The Co-operative Banking Group are contained in note 37.

Other creditors of the Bank include finance lease obligations as follows:

	Present value of lease payments		Future minimum lease payments	
	2015	2014	**2015**	2014
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**	1.3	**1.6**	1.6
	1.3	1.4	**1.7**	1.7

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

	2015	2014
Amounts falling due within one year	**129.2**	15.9
Amounts falling due after one year	**23.3**	0.1
	152.5	16.0

Following separation from CFSMS in 2015, items previously classified as other liabilities are now classified as accruals and deferred income.

All amounts are stated in £m unless otherwise indicated

32. Provisions for liabilities and charges

	Note	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
2015								
At the beginning of the year		**24.4**	**12.7**	**73.6**	**362.5**	**112.3**	**32.0**	**617.5**
Transferred from CFSMS		**23.8**	**–**	**–**	**–**	**–**	**6.6**	**30.4**
Provided/(released) in the year:								
Interest income		**–**	**–**	**–**	**58.3**	**–**	**–**	**58.3**
Operating expense	10	**3.4**	**19.0**	**–**	**–**	**8.9**	**14.2**	**45.5**
Provision for customer redress		**–**	**–**	**71.8**	**63.6**	**–**	**(0.5)**	**134.9**
Utilised during the year		**(7.9)**	**(20.7)**	**(58.4)**	**(215.7)**	**(56.9)**	**(27.5)**	**(387.1)**
Disposal of UTB[1]		**–**	**(0.2)**	**–**	**–**	**–**	**(0.1)**	**(0.3)**
At the end of the year		**43.7**	**10.8**	**87.0**	**268.7**	**64.3**	**24.7**	**499.2**
Provisions were analysed as follows:								
Amounts falling due within one year		**26.9**	**10.8**	**40.7**	**246.1**	**64.3**	**23.0**	**411.8**
Amounts falling due after one year		**16.8**	**–**	**46.3**	**22.6**	**–**	**1.7**	**87.4**
Total provisions		**43.7**	**10.8**	**87.0**	**268.7**	**64.3**	**24.7**	**499.2**

	Note	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
2014								
At the beginning of the year		23.1	13.3	133.8	304.6	39.4	35.5	549.7
Provided/(released) in the year:								
Interest income		–	–	–	48.0	–	–	48.0
Operating expense	10	2.1	24.4	–	4.4	94.5	(1.3)	124.1
Provision for customer redress		–	–	5.0	43.8	–	3.5	52.3
Utilised during the year		(0.5)	(25.0)	(65.2)	(38.3)	(21.6)	(21.5)	(172.1)
Transfer to liabilities associated with non-current assets held for sale		(0.3)	–	–	–	–	–	(0.3)
Increase in discount on loans identified for disposal		–	–	–	–	–	15.8	15.8
At the end of the year		24.4	12.7	73.6	362.5	112.3	32.0	617.5
Provisions were analysed as follows:								
Amounts falling due within one year		12.6	12.7	60.0	349.9	89.5	31.6	556.3
Amounts falling due after one year		11.8	–	13.6	12.6	22.8	0.4	61.2
Total provisions		24.4	12.7	73.6	362.5	112.3	32.0	617.5

The Directors consider conduct and legal provisions a critical accounting judgement. Further details are provided in note 2.

1. Majority of Bank's shareholding in UTB was disposed of in the year. See note 6.

32. Provisions for liabilities and charges continued

Property

The Bank has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases. In addition, dilapidation provisions are recorded to the extent that the Bank has incurred dilapidations and/or the dilapidation clause within the contract has been invoked. During the year £0.3m (2014: £2.7m) has been provided for this.

Financial Services Compensation Scheme (FSCS) levies

In common with other regulated UK deposit takers, the Bank pays levies to the FSCS to enable the FSCS to meet claims against it. During 2008 and 2009 claims were triggered against the FSCS in relation to a number of financial institutions. The compensation paid out to consumers is currently funded through loans from HM Treasury. The Bank 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 term of these loans was interest only for the first three years, with the FSCS recovering the interest cost, together with its own ongoing management expenses, through annual management levies on its members. The initial three year term expired in September 2011, and under the renegotiated terms the interest rate was reset from 12 month LIBOR +30bps to 12 month LIBOR +100bps.

By virtue of it holding deposits protected under the FSCS scheme the Bank has an obligation to pay levies in respect of the interest cost for 2015/16. From 2013, the FSCS had also started to repay the principal of the Treasury loans and a further levy has been raised in 2013/14, 2014/15 and 2015/16 for the expected capital shortfall for these loans, so that they are fully repaid by March 2016. The total levy to be raised is £1,019.0m over three years, with the first instalment of £363.0m collected in 2013 and the second instalment of £399.0m collected in 2014. The Bank has provided £10.8m as at 31 December 2015 (2014: £12.7m) for its share of the levies raised by the FSCS. The Bank's interest levy provision calculation includes estimates of the total FSCS levy in each levy year and estimates of the Bank's market participation in each levy year. Of the amount paid £10.7m and £9.5m is in respect of its 2014/15 interest levy and share of the capital levy respectively in 2015.

Payment Protection Insurance (PPI)

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

The FSA issued a policy statement in August 2010, which amended the 'Disputes Resolution: Complaints' section of the FSA Handbook, setting out new rules for handling complaints, including complaints of PPI mis-selling. The Bank must comply with the policy statement which requires complainants to receive adequate redress and the Bank to deliver fair outcomes and treat customers fairly including non-complainants. An additional provision of £71.8m (2014: £5.0m) has been recognised in the year, in respect of the total expected cost to the Bank of carrying out this work and paying compensation, making total provisions raised of £423.8m (2014: £352.0m). This is discussed in more detail in note 2.

Conduct/legal provisions

During the year the Bank provided an additional £58.3m (2014: £48.0m) in respect of customer redress due to breaches of the technical requirements of the Consumer Credit Act.

The £63.6m (2014: £43.8m) charged through provision for customer redress consists of £40.4m in relation to CCA delivery costs, £16.8m in relation to packaged accounts and a £6.4m increase of other conduct related provisions.

Other

The Bank is engaged in commercial contractual discussions with certain providers of outsourced services. Provisions have been recognised within Other Provisions above where the Bank is able reliably to estimate any financial liabilities associated with such discussions.

All amounts are stated in £m unless otherwise indicated

33. Deferred tax

The movements on the deferred tax accounts are as follows:

	2015			2014		
	Deferred tax asset	**Deferred tax liability**	**Total**	Deferred tax asset	Deferred tax liability	Total
Deferred tax at the beginning of the year	**21.0**	**(84.0)**	**(63.0)**	25.1	(103.0)	(77.9)
(Charged)/credited to the income statement:						
Current year	**(8.2)**	**35.8**	**27.6**	5.5	19.0	24.5
Prior year	**3.2**	**–**	**3.2**	–	–	–
Impact of corporation tax rate change	**4.1**	**0.4**	**4.5**	–	–	–
	(0.9)	**36.2**	**35.3**	5.5	19.0	24.5
Charged to other comprehensive income:						
Cash flow hedges	**–**	**–**	**–**	(8.7)	–	(8.7)
Available for sale	**(12.5)**	**–**	**(12.5)**	–	–	–
	(12.5)	**–**	**(12.5)**	(8.7)	–	(8.7)
Reclassified to assets held for sale	**–**	**–**	**–**	(0.9)	–	(0.9)
Deferred tax at the end of the year	**7.6**	**(47.8)**	**(40.2)**	21.0	(84.0)	(63.0)

The deferred tax asset above includes an offset for those deferred tax liabilities that are permissible to be offset.

	2015		2014	
	Deferred tax asset	**Deferred tax liability**	Deferred tax asset	Deferred tax liability
Deferred tax comprises:				
Capital allowances on fixed assets and assets leased to customers	**20.4**	**–**	12.1	–
Fair value adjustments – Bank subsidiaries	**–**	**(44.9)**	–	(76.4)
Other temporary differences	**7.5**	**(2.9)**	21.0	(7.6)
Cash flow hedges	**(11.2)**	**–**	(11.5)	–
Unrealised appreciation on investments	**(13.1)**	**–**	(0.6)	–
Capital losses	**4.0**	**–**	–	–
	7.6	**(47.8)**	21.0	(84.0)

Net deferred tax assets expected to be recoverable after one year are £4.6m (2014: £21.0m).

Other temporary differences for the Bank totalling £4.6m (2014: £13.4m) relate to temporary differences where the recoverability is not dependent on the future performance of the Bank, and temporary differences in subsidiaries that are forecast to make future taxable profits.

The deferred tax liability of £44.9m (2014: £76.4m) relating to fair value adjustments is net of a deferred tax asset of £4.1m (2014: £3.3m).

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

The deferred tax credit in the income statement comprises:

	2015	2014
Capital allowances on fixed assets and assets leased to customers	**(8.3)**	(5.1)
Fair value adjustments	**(31.5)**	(16.5)
Other temporary differences	**8.8**	1.1
Cash flow hedges	**(0.3)**	1.2
FSCS levy provision	**–**	(5.2)
Capital losses	**(4.0)**	–
	(35.3)	(24.5)

Deferred tax assets totalling £356.2m (2014: £297.5m) have not been recognised where doubt exists over the availability of sufficient future taxable profits. Deferred tax has not been recognised in respect of trading losses of £1,669.8m (with deferred tax of £300.6m) and other temporary differences of £219.0m (with deferred tax of £55.6m). Deferred tax assets of £74.7m (2014: £22.7m) in respect of the current year have not been recognised.

33. Deferred tax continued

During the year, effective from 1 April 2015, the standard rate of corporation tax in the UK changed from 21% to 20%. Reductions in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and 18% (effective from 1 April 2020) were substantively enacted on 18 November 2015. A banking surcharge tax of 8% will also apply to the Bank (effective from 1 January 2016) and this change was substantively enacted on 18 November 2015. Deferred tax has been calculated by reference to the most appropriate rate based on forecasts. On 16 March 2016, the Chancellor of the Exchequer announced a further reduction of the corporation tax rate to 17% effective from 1 April 2020; this change has not yet been substantively enacted.

During the year, effective from 1 April 2015, new tax legislation was introduced to restrict the proportion of banks' annual taxable profits that can be offset by tax losses arising prior to this date to 50%. On 16 March 2016, the Chancellor of the Exchequer announced that the proportion will be restricted further to 25% effective from 1 April 2016.

34. Pensions

Pension charge

The pension charge in the income statement at 31 December 2015 was £22.8m (2014: £31.0m) which includes £5.0m (2014: £5.0m) as the Bank's contribution to the Pace deficit recovery charge.

a) The Co-operative Pension Scheme (Pace)

The Bank participates in Pace, a hybrid scheme, consisting of a closed defined benefit section (Pace Complete) and a defined contribution section (Pace DC). The Pace scheme is considered to be a multi-employer scheme under IAS 19 Employee benefits (revised 2011) with The Co-operative Group being the Principal Employer.

In October 2015, Pace Complete closed to new members. Benefits built up in the scheme have been preserved and remain in the scheme with annual increases being applied in line with the scheme rules. From 29 October 2015, members in Pace Complete automatically began building up benefits in Pace DC (unless they opted out).

i. Scheme Background

At 31 December 2012 the scheme was recognised as a Group plan, since risks were shared between entities under the common control of The Co-operative Group. It was accounted for on a defined contribution basis since there was no contractual agreement or stated Co-operative Group policy for charging the net defined benefit cost for the scheme as a whole to individual participating entities. Therefore, the Bank did not recognise its share of the net defined benefit cost. The net defined benefit cost of the pension scheme was recognised fully by the sponsoring employer, which was the Co-operative Group Limited.

On 4 November 2013, The Co-operative Group and the Bank entered into an undertaking pursuant to which The 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 LME or any subsequent reduction in The Co-operative Group's shareholding in the Bank (including to nil).

Following separation of the Bank from the wider Co-operative Group as a result of the LME, the Bank remained a participating employer in the Pace scheme. In early 2016, a tripartite steering group with representatives from the Bank, The Co-operative Group and the Pace Trustee was established to progress the separation of the Bank from Pace.

ii. Risks arising from the scheme

As a multi-employer pension scheme, Pace exposes the participating businesses to actuarial risks associated with the current and former employees of the other participating employers. The proportion of Pace liabilities accrued by members whilst employees of the Bank is believed to represent a minority of total Pace liabilities. The Bank could, however, be liable for funding a greater proportion of Pace liabilities.

There are, for example, liabilities in Pace relating to benefits accrued by members whilst employed by CFSMS and working in the Bank's business. On 23 January 2014, following the legal separation of the Bank from the wider Co-operative Group, employment contracts for the majority of those employees who spent most of their time working on behalf of the Bank were transferred from CFSMS to the Bank. This increased the number of Bank employees participating in the Pace scheme in 2014.

There may also be 'orphan liabilities' in Pace that do not relate to any current employer participating in Pace. The extent to which the Bank could be liable for funding a greater proportion of Pace liabilities will depend, inter alia, on what position is reached as to the Pace liabilities properly attributable to the Bank following discussions with The Co-operative Group and the Pace Trustee. Whilst these discussions are underway as at March 2016, they are not yet sufficiently progressed so as to have reached a conclusion on the matter of liability share.

There is, therefore, currently insufficient information available to consistently and reliably identify the Bank's share of Pace liabilities and employer costs. For the above reasons the pension costs in respect of Pace are accounted for on a defined contribution basis in accordance with IAS 19 (revised 2011). Pension costs are recognised as an expense in the Bank income statement on a defined contribution basis as explained below, based on a fixed percentage as agreed with the Pace Trustee.

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.

There is no agreed allocation of a deficit or surplus on (i) wind up of the plan; or (ii) the entity's withdrawal from the plan.

All amounts are stated in £m unless otherwise indicated

34. Pensions continued

The key aspects of Pace are illustrated below.

iii. Scheme information

Risks arising in Pace are identified at 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.

iv. Contribution payments

On an accounting basis the Pace scheme is in a surplus of £1,266.3m at 31 December 2015 (2014: surplus of £1,128.5m). Under the current arrangements the Bank does not have an unconditional right of refund of scheme assets on winding up or any right to reduction of contributions as a result of this surplus.

Prior to the scheme's closure to future benefit accrual, based on advice from a qualified actuary, the contributions in respect of future service in the defined benefit section were 18%.

v. Funding the liabilities

The Pace triennial valuation as at 5 April 2013 was completed on 21 July 2014. The funding shortfall for the entire scheme had increased from £248.0m per the previous triennial valuation as at 5 April 2010 to £600.0m as at 5 April 2013. The latest funding shortfall position calculated by the scheme actuary on an approximate basis as at 5 April 2015 was £304.0m. The level of funding for the Pace scheme is agreed between The Co-operative Group and the Pace Trustee. The Co-operative Group agreed a recovery plan with the Trustee of the scheme to contribute £25.0m per annum over 5 years from 1 July 2014 to 30 June 2019 (inclusive) to repay the £104.0m deficit calculated on an approximate basis as at 31 May 2014. The actual funding level is below the expected level at 5 April 2015, with the deficit being £205.0m higher than that estimated by the recovery plan.

On 19 August 2014, the Bank agreed to meet 20% of the total Pace deficit contributions at that date for a period of one year only. The Bank recognised £5.0m on 19 August 2014 as a result of this agreement which represented 12 months of deficit contribution being the time frame which was expected to elapse to the point that the Pace separation process is completed, which is ongoing as at March 2016. As a result, in 2015 the Bank committed an additional £5.0m p.a. to Pace, with the expectation the Pace separation would complete within the next 12 months. The liability in respect of the deficit contribution agreement dated 19 August 2014 as at 31 December 2015 was £2.5m (2014: £2.9m). The current recovery plan ending in 2019 between The Co-operative Group and the Pace scheme Trustees may however be insufficient to fund the latest valuation of the deficit. The Bank's agreement on 19 August 2014 to meet 20% of the total Pace deficit contributions was predicated upon this percentage contribution not setting a precedent for future discussions on the separation of accrued Pace assets and liabilities between The Co-operative Group and the Bank. The Co-operative Group has undertaken to agree with the Bank its final proportion of employer contributions in Pace and, if not agreed, the matter will be referred to an independent third party. Accordingly, there is a wide range of outcomes regarding the duration and contribution requirements of a new schedule of contributions and recovery plan which make the overall contributions uncertain.

The next formal triennial valuation of Pace as at 5 April 2016 will not be completed until 2017, however a funding shortfall position calculated by the scheme actuary on an approximate basis arose in 2015. There is therefore a risk that in future periods the Bank will recognise significant liabilities in respect of the scheme in its accounts.

The Bank also pays contributions in respect of the employed members of the defined contribution sections of the scheme of between 2% and 16% of pensionable salaries. The key financial aspects of Pace are illustrated below for information. These amounts are not recognised within these financial statements.

vi. Key assumptions of the Pace pension scheme

The key aspects of the Pace scheme are as follows:

	2015	2014
The principal assumptions used to determine the liabilities of the Pace scheme are:		
Discount rate	**3.80%**	3.70%
Rate of increase in salaries	**3.55%**	3.30%
Future pension increases where capped at 5.0% per annum	**3.20%**	3.30%
Future pension increases where capped at 2.5% per annum	**2.20%**	2.50%
Assumptions used to determine net pension cost for the Pace scheme are:		
Discount rate	**3.70%**	4.45%
Rate of increase in salaries	**3.30%**	3.60%

All amounts are stated in £m unless otherwise indicated

34. Pensions continued

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the Pace scheme at the 2015 year end is:

	Male	Female
Life expectancy:		
Member currently aged 65 (current life expectancy)	**22.9**	**25.2**
Member currently aged 45 (life expectancy at age 65)	**25.2**	**27.4**

The balance sheet amounts attributable to the entire scheme are as follows:

	2015	2014
Fair value of plan assets	**9,185.0**	9,153.7
Present value of funded obligations	**(7,918.4)**	(8,024.8)
	1,266.6	1,128.9
Present value of unfunded obligations	**(0.3)**	(0.4)
	1,266.3	1,128.5

The asset allocations at the year end were as follows:

	2015	2014
Equities	**1,906.8**	1,808.1
Liability driven investments	**5,524.5**	5,228.7
Alternative growth	**850.0**	964.8
Property	**305.0**	318.6
Other	**598.7**	833.5

The table below shows the value of the assets in each category which have a quoted market price:

	2015	2014
Equities	**1,906.8**	1,808.1
Liability driven investments	**5,524.5**	4,912.7
Other	**150.8**	378.9

b) Britannia Pension Scheme (Britannia Scheme)

The Britannia Scheme is a defined benefit scheme.

i. Scheme Background

In 2009, following the transfer of engagements of Britannia Building Society, CFSMS, a Co-operative Group subsidiary, became principal employer of the scheme, and the three other participating employers of the Britannia Scheme were Bank wholly owned subsidiary entities. Until December 2015, the Bank itself was not a participating employer in the scheme, but provided a guarantee to the Britannia Trustee in relation to funding the pension obligations.

The scheme closed to new members on 6 October 2010, with active members at the date of closure being invited to join the respective defined benefit or contribution Co-operative Pension Scheme for future pension accrual. The Trustee agreed to wind up the defined contribution section from February 2013, with any remaining members given the option of transferring their funds to an alternative approved pension arrangement, or securing benefits with an insurance contract. No future service contributions are payable to the scheme due to the closure of the scheme to future accrual. This was only fully severed in October 2015. The weighted average duration of the defined benefit obligation of the Britannia Scheme is 23 years.

At 31 December 2012 the scheme was recognised as a Group plan since all participating entities were within common control of The Co-operative Group. The Bank and its subsidiary entities participating in the scheme (Platform, WMS and Britannia International) accounted for the scheme on a defined contribution basis, recognising the contribution paid as an expense in the income statement. Following separation of the Bank from the wider Co-operative Group as a result of the LME in 2013, the scheme was considered to be a multi-employer scheme under IAS 19 (revised 2011). At 31 December 2013 the Bank did not have sufficient information to reliably and consistently measure its share of the obligation and therefore the Bank accounted for the scheme on a defined contribution basis. During 2014, employment contracts for those employees who spent the majority of their time working on behalf of the Bank were transferred from CFSMS to the Bank. As a result of this transfer, whilst CFSMS remained the sponsoring employer of the scheme, the Bank recognised the total assets and liabilities of the scheme on the balance sheet as at 31 December 2014.

34. Pensions continued

On the 23 December 2015, a Flexible Apportionment Arrangement (FAA) was executed, at which time the Co-operative Bank plc was named as a participating employer and replaced CFSMS as the principal employer, following which, CFSMS, WMS and PHL departed from the scheme with their share of the scheme's liabilities being transferred to the Bank. As the Bank recognised the total assets and liabilities of the scheme on its balance sheet, due to a guarantee it provided, the FAA has not had a significant impact on the Bank's exposure to the risks of the scheme.

Whilst the Britannia Scheme is in an accounting surplus, this has not been recognised on the balance sheet in accordance with IFRIC 14. The Bank has however recognised a £3.1m liability (2014: recognised £3.3m liability) representing unfunded pension liabilities of the Britannia Supplementary Pension and Life Assurance plan. There is no charge supplementary arrangement for certain Executive Directors. Benefits under this unfunded arrangement are valued on the same assumptions as the Britannia Scheme and are disclosed as unfunded obligations.

ii. Nature of benefits

The Britannia Scheme 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.

iii. Funding the liabilities

Britannia Pension Trustees Limited is the corporate body that acts as 'Trustee' of the Britannia Scheme. UK legislation requires the Trustee to carry out valuations at least every three years and to target full funding against a basis that prudently reflects the scheme's risk exposure. The Scheme Actuary completed an actuarial valuation of the Scheme as at 5 April 2011, in accordance with the scheme specific funding requirements of the Pensions Act 2004. The results of the valuation showed that the Britannia Scheme had a shortfall of £3.7m. CFSMS (the previous sponsoring employer) agreed to pay a lump sum of £3.7m to eliminate this shortfall. The latest funding shortfall position calculated by the scheme actuary as at 5 April 2013 was £61.3m.

The statutory deadline for the completion of the triennial valuation of the scheme's assets and liabilities as at 5 April 2014 has passed, although there is an expectation that the valuation will be concluded in early 2016. At this point, the Bank will be required to agree with the Trustees a schedule of contributions in respect of any deficit in the Britannia Scheme.

iv. Governance

The Chair of the Trustee Board is appointed by and from the Trustee Directors and the Board comprises an Independent Trustee, nominees of The Co-operative Bank and elected scheme members. The Trustee, in consultation with the Bank, is responsible for the risk management arrangements for the Britannia Scheme, agreeing suitable contribution rates, investment strategy and for taking professional advice as appropriate.

v. Risks associated with the Scheme

Risks arising in the Britannia Scheme are identified and assessed under the Bank's Risk Management Framework. The Bank is exposed to potential future increases in required contributions and capital held for pension risk.

Actions taken by the Pensions Regulator, changes to European legislation, or changes in the financial strength of the Bank could result in stronger funding standards, which could materially affect the Bank's cash flow and balance sheet. There is also a risk that changes in the assumptions for life expectancy, interest rates or in price inflation could result in a deficit in the scheme. Other assumptions used to value the defined benefit obligation are also uncertain, although their effect is less material.

The Bank previously granted a guarantee in respect of participating employers' liabilities in relation to the Britannia Scheme up to 105% funding on the section 179 Pensions Act 2004 valuation basis. This guarantee was extinguished as part of the FAA discussed above.

vi. Investment strategy

Some risk arises from the Britannia Scheme defined benefit section because the value of the asset portfolio and returns from it may be less than expected. There is also a risk of a mismatch between the Scheme's assets and liabilities and differences in sensitivity to changes in financial and demographic factors. The Trustee's objective is to invest the Scheme's assets in the best interest of the members and beneficiaries. Within this framework the Trustee has agreed a number of objectives to help guide them in their strategic management of the assets and control of the various risks to which the Britannia Scheme is exposed.

vii. Indirect participation

In 2015 the Bank paid approximately £1.0m (2014: £1.0m) to CFSMS in relation to Britannia Scheme pension costs. The pension cost shown in these accounts is the actual contribution paid by the Bank and three of its subsidiaries.

All amounts are stated in £m unless otherwise indicated

34. Pensions continued

The key aspects of the defined benefit section of the Britannia scheme are as follows:

	2015	2014
The principal assumptions used to determine the liabilities of the Britannia defined benefit scheme are:		
Discount rate	**3.90%**	3.70%
Revaluation in deferment (CPI)	**2.20%**	2.20%
Future pension increases where capped at 5.0% per annum	**3.15%**	3.15%
Future pension increases where capped at 5.0% per annum, minimum 3.0%	**3.60%**	3.60%
Assumptions used to determine net pension cost for the Britannia defined benefit scheme are:		
Discount rate	**3.70%**	4.45%
Price inflation rate (RPI)	**3.20%**	n/a
Rate of increase in salaries	**n/a**	3.60%

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 2015 year end is:

	Male	Female
Life expectancy:		
Member currently aged 65 (current life expectancy)	**22.9**	25.1
Member currently aged 45 (life expectancy at age 65)	**25.2**	27.5

	2015	2014
Fair value of plan assets	**720.3**	728.5
Present value of funded obligations	**(639.9)**	(683.7)
	80.4	44.8
Pension surplus not recognised under IAS 19 (revised 2011)	**(80.4)**	(44.8)
Present value of unfunded obligations	**(3.1)**	(3.3)
	(3.1)	(3.3)

The amounts recognised in the income statement of the Bank are as follows:

	2015	2014
Interest expense on defined benefit obligation	**(24.9)**	(26.5)
Interest income on plan assets	**26.6**	27.7
Interest expense on effect of onerous liability	**(1.7)**	(1.2)
Total net interest cost	**–**	–
Administrative expenses	**(1.5)**	(1.5)
Defined benefit costs included in income statement	**(1.5)**	(1.5)

Changes in the present value of the defined benefit obligation are as follows:

	2015	2014
Defined benefit obligation at the start of the year	**683.7**	604.2
Past service cost	**(6.0)**	–
Interest expense	**24.9**	26.5
Benefit payments from plan assets	**(21.8)**	(15.8)
Remeasurements:		
Effect of changes in demographic assumptions	**(6.7)**	12.0
Effect of changes in financial assumptions	**(30.9)**	56.8
Effect of experience assumptions	**(3.3)**	–
Defined benefit obligation at the end of the year	**639.9**	683.7

All amounts are stated in £m unless otherwise indicated

34. Pensions continued

	2015	2014
Fair value of plan assets at the start of the year	**728.5**	630.7
Interest income	**26.6**	27.7
Employer contributions	**0.9**	–
Benefit payments from plan assets	**(21.8)**	(15.8)
Administrative expenses paid from plan assets	**(1.5)**	(1.5)
Return on plan assets (excluding interest income)	**(12.4)**	87.4
Fair value of plan assets at the end of the year	**720.3**	728.5

Changes in the effect of the asset ceiling are as follows:

	2015			2014		
	Asset	**Defined benefit obligation**	**Asset ceiling**	Asset	Defined benefit obligation	Asset ceiling
At the start of the year	**728.5**	**(683.7)**	**(44.8)**	630.7	(604.2)	(26.5)
Past service cost	**–**	**6.0**	**(6.0)**	–	–	–
Interest income/(expense)	**26.6**	**(24.9)**	**(1.7)**	27.7	(26.5)	(1.2)
Employer direct benefit payments	**0.9**	**–**	**(0.9)**	–	–	–
Administrative expenses paid from plan assets	**(21.8)**	**–**	**21.8**	(1.5)	–	1.5
Benefits paid	**(1.5)**	**21.8**	**(20.3)**	(15.8)	15.8	–
Actuarial (losses)/gains	**(13.1)**	**40.9**	**(27.8)**	87.4	(68.8)	(18.6)
Fair value of plan assets at the end of the year	**719.6**	**(639.9)**	**(79.7)**	728.5	(683.7)	(44.8)

The asset allocations at the year end were as follows:

	2015	2014
Equities	**126.0**	118.5
Liability driven investments	**452.2**	463.0
Alternative growth	**35.3**	49.1
Property	**81.7**	87.3
Other	**24.4**	10.6

The table below shows the fair value of the assets in each category which have a quoted market price:

	2015	2014
Equities	**126.0**	118.5
Liability driven investments	**415.9**	425.7
Other	**22.7**	9.3

All amounts are stated in £m unless otherwise indicated

34. Pensions continued

Bank (unfunded) pension scheme

The Bank also operates a small unfunded pension scheme.

	2015	2014	2013	2012	2011
Price inflation rate (RPI)	**3.2%**	3.3%	3.6%	3.3%	3.3%
Rate of increase in salaries	**n/a**	3.3%	5.1%	4.8%	4.8%
Discount rate	**3.9%**	3.7%	4.7%	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:

	2015	2014
Present value of unfunded obligations	**(4.4)**	(4.7)
Deficit in scheme	**(4.4)**	(4.7)
Related unrecognised deferred tax asset	**1.1**	0.9
Net pension liability	**(3.3)**	(3.8)
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:

	2015	2014
Opening defined benefit liabilities	**4.7**	4.0
Current service cost	**–**	–
Interest on liabilities	**0.2**	0.2
Actuarial losses	**(0.3)**	0.7
Benefits paid	**(0.2)**	(0.2)
Closing defined benefit liabilities	**4.4**	4.7

Amounts recognised in the statement of comprehensive income:

	2015	2014
Actuarial losses on scheme liabilities during the period	**(0.3)**	0.7
Total scheme losses during the period	**(0.3)**	0.7

The amounts for the current year are as follows:

	2015	2014
Defined benefit obligation	**(4.4)**	(4.7)
Deficit in scheme	**(4.4)**	(4.7)
Experience adjustment on scheme liabilities	**–**	–
Experience adjustment on scheme assets	**–**	–

All amounts are stated in £m unless otherwise indicated

35. Contingent liabilities

The tables below provide 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 CRD IV rules.

The contingent liabilities, as detailed below, arise in the normal course of banking business and it is not practical to quantify their future financial effect.

	Unaudited		Unaudited	
	Contract Amount 2015	**Risk weighted amount 2015**	Contract amount 2014 (re-presented)	Risk weighted amount 2014 (re-presented)
Contingent liabilities:				
Guarantees and irrevocable letters of credit	**21.0**	**15.0**	43.2	18.0
Other commitments:				
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[1]	**2,571.7**	**313.5**	2,862.9	448.5
	2,592.7	**328.5**	2,906.1	466.5

1. Undrawn loan commitments include revocable commitments which are unused credit card limits of £1,557.6m (2014: £1,787.3m).

During 2015, the Bank reviewed its interpretation of items comprising Forward Asset Purchases and now considers that they do not classify as other commitments. The effect of re-presentation is to reduce Other commitments by £154.9m at December 2014.

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 requirement.

See note 39 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 will be required to make over the remaining lives of the leases.

	Land and buildings 2015	**Equipment 2015**	Land and Buildings 2014	Equipment 2014
Falling due:				
Within one year	**14.0**	**–**	18.3	0.1
Between one and five years	**30.2**	**–**	46.3	0.3
In five years or more	**84.3**	**–**	51.5	–
	128.5	**–**	116.1	0.4

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 £13.9m (2014: £5.0m).

Indemnification agreement

The Bank has an indemnification agreement with CFSMS, accounted for as a guarantee under IFRS 4, in which the Bank has agreed to indemnify CFSMS against all and any liability, loss, damage, costs and expense arising from the agreement (under which CFSMS provides certain assets and services to the Bank). This agreement will remain in place until it is terminated after separation activities with the wider Co-operative Group are fully completed, but this will require the consent of CFSMS.

35. Contingent liabilities continued

Conduct issues

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 possibility that certain aspects of the Bank's current or historic business, including, amongst other things, mortgages and relationship banking, may be determined by the FCA and other regulatory bodies or the courts as, in their opinion, not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment.

In particular, there is currently a significant regulatory focus on the sale practices and reward structures that financial institutions have used when selling financial products. There may also be other regulatory investigations and action against the Bank in the future in relation to conduct and other issues that the Bank is not presently aware of, including investigations and actions against it resulting from alleged mis-selling of financial products or the ongoing servicing of those financial products. The outcome of any ongoing disputes and legal, regulatory or other investigations or proceedings is currently uncertain.

Consumer Credit Act issues

The Consumer Credit Act regulates consumer lending and governs the way in which entities, including banks, providing consumer credit to retail customers carry out business. From 1 April 2014 the Financial Services and Markets Act 2000 also applies alongside certain retained provisions of the Consumer Credit Act. The Consumer Credit Act includes very detailed, prescriptive and highly technical requirements for lenders affecting customer documentation and which, in turn, impact how operational processes and IT systems are configured. While the Bank has undertaken a detailed analysis to identify certain instances where its documentation or processes have not been fully compliant with the technical requirements and has provided accordingly, it is not possible to rule out the possibility of other instances which have not yet been identified. Breaches may have the effect of triggering periods of non-compliance during which an affected customer is not liable to pay interest.

Debit interest refunds would therefore need to be made in certain cases where a period of non-compliance has been previously triggered, in the same way the Bank will be making such refunds as a consequence of the issues already identified. A provision of £124.8m is in place for these matters at the end of 2015, being the best estimate of the liability based on detailed legal analysis of whether breaches of the technical requirements have in fact occurred to date. In the event that such legal analysis and judgements are determined to be incorrect, the Bank could be exposed to further liabilities.

Proposed sale of the Bank's share in Visa Europe Limited (VE)

On 2 November 2015, Visa Inc. announced the proposed acquisition of VE of which the Bank is a member and shareholder. Completion of the deal is subject to regulatory approvals and is not expected to occur before 1 April 2016. In connection with the transaction, the Bank and certain other members of VE have entered into a Loss Sharing Agreement (LSA) pursuant to which the Bank has agreed, on a several and not joint basis, to indemnify Visa Inc. for certain losses which may be incurred as a result of existing and potential litigation relating to the setting and implementation of domestic MIF rates in the UK. This indemnification is up to a maximum amount of the upfront cash consideration to be received by the Bank, being approximately €50m. For any such losses, the new arrangement under the LSA will replace the potential uncapped indemnity under the existing VE Operating regulations, which will otherwise continue for claims outside the UK. The Preference Stock, the LSA and the continuation of the existing indemnity for claims outside the UK work together to provide Visa Inc. with protection against liabilities from MIF litigation in the VE territory. The Preferred Stock serves as a 'first loss' piece, such that the LSA indemnity is only triggered if, amongst other things, either (a) €1bn of losses have first been allocated to the value of the Preferred Stock in respect of liabilities in connection with UK domestic MIF claims, or (b) the value of the Preferred Stock is reduced to zero in respect of liabilities in connection with MIF claims across the VE territory.

The potential exists, therefore, for the entire value of the Bank's upfront consideration (cash and Preference Stock) to be eroded by liabilities incurred by Visa Inc. in connection with MIF litigation in the VE territory. However, at this stage, the Bank has concluded that there is no reliable estimate available of value of the potential exposure from existing and future litigation, assuming the deal closes. The fair value of VE shareholding has been remeasured based on the offer by Visa Inc. See note 20.

Regulatory and other investigations

The Bank is the subject of multiple regulatory and other investigations and enquiries into events at the Bank and circumstances surrounding them. These include:

- The Treasury announced by press release on 22 November 2013 that it intends to conduct an independent investigation into events at the Bank and the circumstances surrounding them from 2008, including the Verde transaction and Britannia merger. The investigation will review the conduct of Regulators and the Government but is not anticipated to commence until it is clear that it will not prejudice the outcome of the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) enforcement investigations.
- The Financial Reporting Council has launched an investigation under its Accountancy Scheme into the preparation, approval and audit of the Bank's accounts up to and including its 2012 annual accounts, which focuses on the role of the auditors and individual accountants.

The Bank is co-operating with the investigating authorities. It is not possible to estimate the financial impact upon the Bank should any adverse findings be made.

Legal proceedings

The Bank is engaged in various other legal proceedings involving claims by and against it which arise in the ordinary course of business, including debt collection, mortgage enforcement, consumer claims and contractual disputes. The Bank does not expect the ultimate resolution of any of these proceedings to which the Bank is party to have a material adverse effect on its results of operations, cash flows or the financial position of the Bank and has not disclosed the contingent liabilities associated with these claims. Provisions have been recognised for those cases where the Bank is able reliably to estimate the probable loss where the probable loss is not de minimis. See note 32.

35. Contingent liabilities continued

Mortgage securitisation representations and warranties

In connection with the Bank's mortgage securitisations and covered bond transactions described in note 39 (Bank financial statements) and note 26 (Company financial statements), the Bank makes various representations and warranties relating to the mortgage loans, including in relation to ownership, compliance with legislation and origination procedures. If the representations and warranties are breached subject to any applicable materiality determination, the Bank may be required to repurchase the affected mortgage loans or in some circumstances pay compensation to the securitisation vehicle.

There is a risk that a number of the underlying matters giving rise to the conduct and legal provisions set out in note 32 could have given rise to breaches of such representations and warranties. Accordingly there is a risk that the Bank may be required to pay compensation or repurchase affected mortgage loans in amounts that may reduce the Bank's liquidity.

The Bank is unable to estimate the extent to which, the matters described above will impact it or how future developments may have a material adverse impact on the Bank's net assets, operating results or cash flows in any particular period.

Pensions

There is uncertainty over the amount that the Bank will have to pay while it continues to participate in Pace. The Bank's obligations to contribute to Pace would increase significantly if another large employer in Pace becomes insolvent while the Bank continues to participate. If the Bank seeks to address these risks by terminating its participation, the default position is that material liabilities in respect of the deficit in Pace will arise. The Co-operative Group and the Bank have entered good faith discussions to manage this by seeking agreement so that the liabilities properly attributable to the Bank (and an equivalent proportion of assets) would be transferred to a separate scheme, or a segregated section of Pace, on the Bank's exit but, no arrangements have yet been agreed. There is therefore uncertainty over the amount that the Bank will have to pay in the event that it exits Pace. Separation of Pace will also require the co-operation of the Pace Trustees which may not be forthcoming.

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.

Other pensions risks and uncertainties include the risk to the Bank's capital and funds from the Bank's exposure to scheme liabilities (to the extent liabilities are not met by scheme assets), risks inherent in the valuation of scheme liabilities and assets, risks regarding the split of liabilities between the Bank and other participating employers while the Bank continues to participate in Pace and on exit from Pace.

It is not practicable to provide an estimate of the financial impact of this matter or what effect, if any, that these matters may have upon the Bank's operating revenues, cash flows or financial position in any period.

Tax treatment of separation

Until separation of the Bank from The Co-operative Group is complete, the Bank will continue to be responsible for indemnifying CFSMS under the CFSMS-Bank Services Agreement.

During 2013, the Directors reviewed and reconsidered the accounting treatment of the intangible asset in development and all other assets held on the balance sheet of CFSMS which were used solely by the Bank. The Directors concluded that the Bank was substantially exposed to the risks and rewards of these assets and after considering the funding of the asset and CFSMS's lack of assets to absorb losses, the appropriate accounting treatment would be to hold these assets on the balance sheet of the Bank. The Bank applied a consistent approach to the tax and accounting treatment of the Bank exclusive assets. However, if, and to the extent that, there is a change to this treatment, there may be an additional tax charge. In November 2014 the Bank became the legal owner of the assets held by CFSMS for the provision of services exclusively to the Bank.

There will continue to be VAT charges incurred in respect of any assets that are supplied to the Bank under the CFSMS-Bank Services Agreement that are not owned by the Bank, until separation is fully effected.

Warwick Finance One and Two mortgage securitisation representations and warranties

In connection with the Bank's Warwick mortgage securitisation, the Bank makes various representations and warranties relating to the mortgage loans, which include ownership, compliance with legislation and origination procedures. If the representations and warranties are breached subject to any applicable materiality determination, the Bank may be required to repurchase the affected mortgage loans or in some circumstances pay compensation to the securitisation vehicle.

There is a risk that a number of the underlying matters giving rise to the conduct and legal provisions set out in note 32 could have given rise to breaches of such representations and warranties. Accordingly there is a risk that the Bank may be required to pay compensation or repurchase affected mortgage loans in amounts that may reduce the Bank's liquidity. The Bank is unable to estimate the extent to which the matters described above will impact it or how future developments may have a material adverse impact on the Bank's net assets, operating results or cash flows in any particular period.

All amounts are stated in £m unless otherwise indicated

36. Investments in joint ventures

The Bank's investment in joint ventures is £4.9m (2014: £5.3m).

The Bank owns 49% of the ordinary shares in Britannia Personal Lending Limited (BPL) and Britannia New Homes (Scotland) Limited (BNH(S)), both registered in England and operating in the UK. BPL trades in the business of unsecured personal lending and BNH(S) trades in the construction of domestic buildings. Both are considered a joint venture as decisions about relevant activities require the unanimous consent of joint venturers.

The Bank's interest in BPL and BNH(S) is as follows:

	2015	2014
Current assets	**7.1**	7.5
Non-current assets	**1.0**	1.3
	8.1	8.8
Current liabilities	**3.2**	3.5
Non-current liabilities	**–**	–
Equity	**4.9**	5.3
	8.1	8.8
Income	**0.8**	0.9
Expenses	**(0.1)**	(0.3)
Profit before tax	**0.7**	0.6
Taxation	**–**	–
Profit after tax	**0.7**	0.6

Joint ventures are accounted for using the equity method.

37. Related party transactions

Parent, subsidiary and ultimate controlling party

The ownership structure of the Bank changed on 20 December 2013 as a result of the LME, after which, The Co-operative Banking Group, a subsidiary of The Co-operative Group, owned approximately 30% of the Bank. The remaining, approximately 70%, was owned by a number of investors, two of which individually owned more than 10% at the end of 2015. As a result of a further share issue of £400m to existing shareholders in May 2014, The Co-operative Banking Group's share dropped to approximately 20%.

At 31 December 2015, the Bank is an associate of, and therefore a related party of, The Co-operative Group as The Co-operative Group owns 20.16% of the Bank's ordinary shares, has the right to Bank Board representation and there are material transactions between the two companies.

The Bank has a significant relationship with The Co-operative Group. As part of the Recapitalisation Plan and the Bank ceasing to be a wholly owned subsidiary of The Co-operative Group, the Bank entered into the following agreements and several other arrangements.

Transactions with The Co-operative Group

Balances owed by The Co-operative Group to the Bank are shown below. In total these balances would exceed the Bank's risk appetite in the normal course of business. These obligations are currently performing in line with expectations and based on investigations and the information provided, therefore the Board considers that impairment is not required. Further details or relationship agreements with The Co-operative Group are shown in the Corporate Governance report.

Pensions Undertaking

On 4 November 2013, The Co-operative Group and the Bank entered into an undertaking whereby The Co-operative Group agreed with the Bank not to require the Bank to cease to participate in Pace in connection with the LME. The parties also agreed at the request of one of the parties to enter into good faith discussions to reach agreement on the separation of Pace and agree the Bank's proportion of employer contributions in Pace (and if not agreed, the matter will be referred to an independent third party).

Good faith discussions have not yet concluded and no Pace separation terms have been agreed. The Bank has expressed an intention to conclude negotiations over its exposure, the scale of contributions and its role in the longer-term scheme. The aim is to conclude these discussions during 2016. Further information is provided in note 34.

IT and other services

The Bank and The Co-operative Group entered into an IT Costs Separation Agreement on 22 January 2015. In consequence of the Bank's IT outsourcing agreement with IBM for enterprise computing services, the Bank is not progressing the proposed revised IT Service Agreement (ITSA) which was described in the 2013 Annual report and accounts. In addition, a number of service contracts under the Professional Services Master Agreement have now been terminated and services repatriated to the Bank, with the intention that the majority will be terminated in 2016.

37. Related party transactions continued

IT separation costs agreement

Under the IT costs separation agreement, both CGL and CFSMS undertake to support activities for the separation of the Bank's IT infrastructure from the wider Co-operative Group's IT infrastructure, to enable the smooth transition to IBM. As part of this, the Bank entered into an amendment agreement on 21 December 2015 to the Third Party Access agreement that is in place between the Bank, IBM and The Co-operative Group governing how The Co-operative Group delivers services on behalf of the Bank in the Bank's target IT infrastructure. Further, CGL and CFSMS undertake that any notice to terminate the existing IT services agreement (in the case of CGL) and the CFSMS-Bank Framework Agreement (in the case of CFSMS) would not take effect prior to 31 December 2017 to give the Bank sufficient time to separate the Bank's IT infrastructure. The IT separation costs agreement also allocated the contributions to be made towards The Co-operative Group's own costs of keeping the wider Co-operative Group's existing IT infrastructure stable and operable during and following the Bank's separation of its IT infrastructure; to this end CBGL (as the parent of CFSMS) undertook to contribute a maximum of £95m towards such Co-operative Group costs, with the Bank to make a contribution of up to £25m, based on a formula in the event that the total cost of this Co-operative Group project falls between £76m and £120m.

Deed of surrender and release – Bank ATMs in Group Food stores

On 1 January 2008 the Bank was granted a licence by CGL to install and operate ATMs at a number of Co-operative Food stores in the UK. On 14 April 2014 CGL served notice on the Bank to terminate this licence with effect from 1 January 2016. As part of a new arrangement between CGL and another third party, on 20 November 2014 CGL and the Bank entered into a deed for the Bank to surrender immediately any rights of occupation it may have in relation to these premises. In consideration for this early surrender, CGL paid to the Bank £2.9m, and a further £5.2m was paid in 2015. The Bank entered into a simultaneous agreement with Cardtronics UK Limited for the sale of these ATMs in CGL premises.

CFSMS transactions

CFSMS is a subsidiary of The Co-operative Banking Group and continues to undertake the provision of supplies and services on behalf of the Bank. Further details of the CFSMS-Bank Framework agreement are disclosed below.

CFSMS-Bank Framework

On 16 February 2006, the Bank and CFSMS entered into the CFSMS-Bank Services Agreement pursuant to which CFSMS provides assets such as office equipment, materials and office space, other facilities and services, and consultants who act as secondees to the Bank. 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.

The Bank and CFSMS commenced unwinding this arrangement during 2014 with the transfer of the employment of most staff to the Bank (see 'Transfer of Staff from CFSMS to Bank' below), the transfer of assets to the Bank (see 'Tangible and Intangible Assets' below) and the Bank entering into numerous contracts with third party suppliers to replace those previously provided through CFSMS or the wider The Co-operative Group. These activities continued into 2015, in particular in respect of the Bank's transition of enterprise services to IBM.

Tax loss share

As part of the negotiations relating to the separation of the Bank from The Co-operative Group, the Bank and The Co-operative Group also agreed terms relating to the surrender of group relief between the entities in the Bank's tax group and entities in The Co-operative Group tax group. A deed sets out the basis of the agreement by The Co-operative Group to take proactive steps to allow it to maximise its claim for tax losses from the Bank for the accounting periods to 31 December 2012 and 2013. The deed also addresses the terms of the payment by The Co-operative Group to the Bank for those tax losses. The 2015 Financial Statements, which include a group relief debtor of £60.1m (2014: £126.8m), have been prepared on a basis consistent with the deed. The Bank receives payment from The Co-operative Group when The Co-operative Group realises the benefit of the losses surrendered and at the corporation tax rate at which the benefit is realised.

Transfer of staff from CFSMS to Bank

As explained in relation to the CFSMS-Bank Framework above, from 16 February 2006 CFSMS provided consultants acting as secondees to the Bank. The employment of substantially all Bank dedicated staff provided under that arrangement was transferred to the Bank under the Transfer of Undertakings (Protection of Employment) Regulations, on 23 January 2014. The employment of a further tranche of IT security personnel took place in November 2014.

IT Security

The Bank's specialist IT security team will continue to provide an IT security service in relation to the IT infrastructure which the Bank and Co-operative Insurance Services General Insurance Limited (CISGIL) share until that infrastructure is separated. This service comprises a small number of people. The Bank has historically provided ad hoc IT security services to The Co-operative Group. Whilst no services are currently being provided, the Bank and The Co-operative Group entered into an agreement to provide a framework for future services on 28 November 2014.

IT Security Services Letter Agreement

Following the TUPE transfer of IT security personnel from CFSMS to the Bank in November 2014, the Bank entered into a letter agreement with CFSMS that regulated the terms on which certain IT security personnel would have transferred from CFSMS to the Bank, and the terms on which the Bank would provide an IT security service that the transferred IT security personnel used to provide, in relation to the IT infrastructure which the Bank and CFSMS share. This service is provided by a small number of people who are provided to CFSMS by way of secondment.

All amounts are stated in £m unless otherwise indicated

37. Related party transactions continued

Britannia Pension Scheme

On 23 December 2015 the Bank entered into a deed of Amendment, Cessation, Substitution of Principal Employer, Apportionment, Augmentation and Release (the Deed) relating to the Britannia Pension Scheme with CFSMS and other parties. Under the Deed, the Bank agreed to become Principal Employer and Sponsor of the Britannia Pension Scheme in place of CFSMS with effect from 25 December 2015. In addition, the Bank was released from previous guarantees given in favour of the Scheme Trustees and also for the benefit of the Scheme.

Tangible and intangible assets

A number of assets were originally purchased by CFSMS using funds advanced by the Bank and then provided to the Bank by CFSMS under the 2006 CFSMS-Bank Services Agreement referred to above. In 2013, the Directors of the Bank concluded these assets met the accounting criteria to be shown as assets of the Bank, and therefore reported them on the balance sheet. Legal title of these assets transferred to the Bank in 2014.

As part of the separation activity, in November 2014 the Bank purchased the legal title of all Bank specific assets held by CFSMS (shared assets remained with CFSMS) through an SPV called CBG Asset Management Limited. The carrying value of these assets on the balance sheet at that time was £126.0m.

Balances with The Co-operative Group

The tables below provide an analysis of balances with The Co-operative Group and its undertakings at 31 December 2015 and 31 December 2014 and their location within the Bank's balance sheet.

	2015			
	Loans & advances to customers	**Other assets**	**Customer accounts**	**Other liabilities**
The Co-operative Group Limited	**1.0**	**61.6**	**(100.1)**	**–**
The Co-operative Banking Group Ltd	**–**	**–**	**(0.3)**	**–**
Subsidiaries of The Co-operative Banking Group Ltd	**–**	**19.2**	**(4.6)**	**(6.1)**
	1.0	**80.8**	**(105.0)**	**(6.1)**

	2014			
	Loans & advances to customers	Other assets	Customer accounts	Other liabilities
The Co-operative Group Limited	51.0	127.1	(163.7)	–
The Co-operative Banking Group Ltd	–	–	(55.5)	–
Subsidiaries of The Co-operative Banking Group Ltd	–	35.7	(27.3)	(126.0)
	51.0	162.8	(246.5)	(126.0)

	2015		2014	
	Interest and fees received	**Interest and fees paid**	Interest and fees received	Interest and fees paid
The Co-operative Group Limited	**2.6**	**0.4**	6.3	2.1
The Co-operative Banking Group Ltd	**–**	**–**	–	–
Subsidiaries of The Co-operative Banking Group Ltd	**0.3**	**–**	0.3	–
	2.9	**0.4**	6.6	2.1

A number of transactions are entered into with related parties in the normal course of business on normal commercial terms. These include loans and deposits. Outstanding balances at the year end and related income and expense for the year is presented in the tables above.

Shareholder rights agreement

At the time of the capital raising in May 2014, the Bank entered into a Shareholder Rights Agreement with The Co-operative Group and a number of other investors. As at 31 December 2015, each of The Co-operative Banking Group Limited, SP Coop Investments Limited and Golden Tree Asset Management (via various Golden Tree funds) owns more than 10% of the Bank's ordinary shares and is therefore a related party of the Bank.

The Shareholder Rights Agreement grants certain rights to the shareholders including the right of Silverpoint Capital and Perry Capital to nominate a Director for appointment to the Board for so long as it continues to own 5% or more of the Bank. In addition, the Shareholder Rights Agreement grants the right for one Director to be appointed to a sub-committee of the Board to assess the feasibility of the Bank listing its ordinary shares on the London Stock Exchange (IPO Committee).

All amounts are stated in £m unless otherwise indicated

37. Related party transactions continued

Transactions with other related parties

Key management personnel, as defined by IAS 24 (Related Party Disclosures), are considered to be the Board of the Bank, and Board members of the Bank's immediate and ultimate holding organisations. The volume of related party transactions with key management is provided below:

Directors, key management personnel and close family members

	2015	2014
Loans outstanding at the beginning of the year	–	0.3
Net movement	–	(0.3)
Loans outstanding at the end of the year	–	–
Deposits and investments at the beginning of the year	0.2	0.2
Net movement	0.3	–
Deposits and investments at the end of the year	0.5	0.2

Directors' loans

	2015			2014		
	Mortgages	Personal loans	Credit cards	Mortgages	Personal loans	Credit cards
Number of Directors with loan type	–	–	1	–	–	–
Total value of Directors' loans	–	–	–	–	–	–

Key management compensation

	2015	2014
Salaries and short term benefits	4.6	6.3
Termination benefits	–	–
	4.6	6.3

38. Share capital

	2015		2014	
	No. of shares (millions)	**Share capital**	No. of shares (millions)	Share capital
Allotted, called up and fully paid (ordinary shares of 5p each)				
At the beginning of the year	**451.5**	**22.6**	250.0	12.5
Issue of new ordinary shares	**–**	**–**	200.5	10.0
Issue of new bonus shares	**–**	**–**	1.0	0.1
At the end of the year	**451.5**	**22.6**	451.5	22.6
Share premium account				
At the beginning of the year		**1,736.9**		1,359.8
Issue of new ordinary shares		**–**		377.2
Issue of new bonus shares		**–**		(0.1)
At the end of the year		**1,736.9**		1,736.9

The £400.0m capital raising completed in May 2014 resulted in an issuance of new ordinary share capital of £10.0m and a gross increase in share premium of £390.0m. Bonus shares of £0.1m were also issued. As part of the capital raising the Bank incurred transaction costs of £12.8m. These were offset against the gross share premium amount, giving a net increase in capital of £387.2m, of which £377.1m was recorded as share premium.

The number of ordinary shares in issue at 31 December 2015 was 451,456,510 (2014: 451,456,510). The ordinary shareholders have one vote for every share held.

All amounts are stated in £m unless otherwise indicated

39. 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. The tables below analyse the balance sheet carrying values of financial assets and liabilities by classification.

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
As at 31 December 2015							
Assets							
Cash and balances at central banks	–	–	2,678.5	–	–	–	2,678.5
Loans and advances to banks	–	–	871.0	–	–	–	871.0
Loans and advances to customers	4.2	174.0	19,512.2	–	–	–	19,690.4
Fair value adjustments for hedged risk	–	–	94.0	–	–	–	94.0
Investment securities	–	582.4	15.0	4,296.8	–	–	4,894.2
Derivative financial instruments	147.9	–	–	–	–	222.2	370.1
Equity shares	–	–	–	55.6	–	–	55.6
Other assets	–	–	124.1	–	–	–	124.1
Total financial assets	152.1	756.4	23,294.8	4,352.4	–	222.2	28,777.9
Non-financial assets							250.4
Total assets							29,028.3
Liabilities							
Deposits by banks	–	–	–	–	725.9	–	725.9
Customer accounts	–	–	–	–	22,732.0	–	22,732.0
Customer accounts – capital bonds	–	77.4	–	–	–	–	77.4
Debt securities in issue	–	–	–	–	2,554.3	–	2,554.3
Derivative financial instruments	148.1	–	–	–	–	198.8	346.9
Other borrowed funds	–	–	–	–	459.9	–	459.9
Other liabilities	–	–	–	–	68.8	–	68.8
Total financial liabilities	148.1	77.4	–	–	26,540.9	198.8	26,965.2
Non-financial liabilities							699.8
Total liabilities							27,665.0
Capital and reserves							1,363.3
Total liabilities and equity							29,028.3

Whilst the Bank does not hold any derivative financial instruments that are considered 'derivatives held for trading purposes' as shown in note 19, IAS 39 requires derivative financial instruments that are not in a hedging relationship to be classified as 'held for trading'.

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

During 2015, there was a £1.4bn securitisation transaction with Warwick Finance Residential Mortgages Number One PLC and a £1.7bn securitisation transaction with Warwick Finance Residential Mortgages Number Two PLC. For further details please refer to the detailed financial review.

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	Derivatives in a hedging relationship	Total
As at 31 December 2014							
Assets							
Cash and balances at central banks	–	–	4,765.3	–	–	–	4,765.3
Loans and advances to banks	–	–	1,608.4	–	–	–	1,608.4
Loans and advances to customers	3.9	182.7	25,190.8	–	–	–	25,377.4
Fair value adjustments for hedged risk	–	–	148.5	–	–	–	148.5
Investment securities	–	1,236.9	18.1	3,167.5	–	–	4,422.5
Derivative financial instruments	250.6	–	–	–	–	220.1	470.7
Equity shares	–	–	–	2.8	–	–	2.8
Other assets	–	–	187.6	–	–	–	187.6
Total financial assets	254.5	1,419.6	31,918.7	3,170.3	–	220.1	36,983.2
Non-financial assets							599.7
Total assets							37,582.9
Liabilities							
Deposits by banks	–	–	–	–	615.4	–	615.4
Customer accounts	–	–	–	–	29,614.0	–	29,614.0
Customer accounts – capital bonds	–	263.8	–	–	–	–	263.8
Debt securities in issue	–	–	–	–	3,443.6	–	3,443.6
Derivative financial instruments	176.0	–	–	–	–	375.7	551.7
Other borrowed funds	–	–	–	–	196.4	–	196.4
Other liabilities	–	–	–	–	157.8	–	157.8
Total financial liabilities	176.0	263.8	–	–	34,027.2	375.7	34,842.7
Non-financial liabilities							725.7
Total liabilities							35,568.4
Capital and reserves							2,014.5
Total liabilities and equity							37,582.9

39. Fair values of financial assets and liabilities continued

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 principal 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.

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 income. Held for trading instruments are held for economic hedging purposes only as the Bank does not have an active trading book.

Deposits by banks and debt securities in issue

The Bank issues medium term notes within an established medium term note programme and also issues certificates of deposit and commercial paper as part of its normal treasury activities.

In addition to this the Bank has issued notes secured by mortgage assets through a number of different securitisation programs.

Other borrowed funds

The Bank utilises a broad spread of long term wholesale funding in the form of fixed rate subordinated debt in addition to funding from ordinary share capital and retained earnings.

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 ALCO, to which authority is delegated by the Board.

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

b) Valuation of financial assets and liabilities at fair value

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

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

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
As at 31 December 2015				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	–	4.2	–	4.2
Designated at fair value:				
Loans and advances to customers	–	168.5	5.5	174.0
Investment securities	582.4	–	–	582.4
Available for sale financial assets:				
Investment securities	2,697.0	–	1,599.8	4,296.8
Equity shares	0.1	4.3	51.2	55.6
Derivative financial instruments	–	370.1	–	370.1
Non-financial assets				
Investment properties	–	–	2.1	2.1
Total assets carried at fair value	3,279.5	547.1	1,658.6	5,485.2
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	–	77.4	–	77.4
Derivative financial instruments	–	346.9	–	346.9
Total liabilities carried at fair value	–	424.3	–	424.3

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
As at 31 December 2014				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	–	3.9	–	3.9
Designated at fair value:				
Loans and advances to customers	–	176.0	6.7	182.7
Investment securities	1,236.9	–	–	1,236.9
Available for sale financial assets:				
Investment securities	3,022.5	145.0	–	3,167.5
Equity shares	0.1	2.7	–	2.8
Derivative financial instruments	–	470.7	–	470.7
Non-financial assets				
Investment properties	–	–	2.1	2.1
Total assets carried at fair value	4,259.5	798.3	8.8	5,066.6
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	–	263.8	–	263.8
Derivative financial instruments	–	551.7	–	551.7
Total liabilities carried at fair value	–	815.5	–	815.5

39. Fair values of financial assets and liabilities continued

The carrying values of financial instruments measured at fair value are determined in compliance with the accounting policies in note 1 and according to the 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 primarily relate to Corporate loans of £159.1m (2014: £164.7m) which are fair valued through profit or loss 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

Over-the-counter (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.

Equity shares

Equity shares relate to investments held in VocaLink Holdings Limited and Unity Trust Bank plc, both of which are unquoted shares. For VocaLink, the valuation of these shares is based on the Bank's percentage shareholding and the net asset value of the consolidated group according to its most recently published financial statements. Following the Bank's sale of 20.0% shareholding in Unity Trust Bank in December 2015 (see note 6), the sale price has been used to estimate the fair value of the 6.7% retained.

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 £5.5m (2014: £6.7m) which are fair valued through profit or loss using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has decreased the valuation by £0.2m in 2015 (2014: £0.5m decrease). A reasonably possible change in the assumptions would not result in any material change in the valuation.

Investment securities – available for sale

Investment securities – available for sale include MBS of £1,599.8m (2014: nil), which are fair valued through other comprehensive income. The Bank uses an independent third party valuation agent which provides prices obtained from large financial institutions. These prices are indicative values only and do not represent an offer to purchase the securities.

The Bank owns a significant portion of the MBS issuance and the trading volume of the remaining portions in the market is not readily available.

These MBS represent the Bank's interest in unconsolidated structured entities.

A 1% increase or decrease in the price of the notes will result in the value increasing or decreasing by approximately £16m respectively.

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

Equity shares

Equity shares include the Bank's share in Visa Europe Limited, which are classified as available for sale, with any movements in fair value being recognised through other comprehensive income. The fair value of the Visa Europe share has been calculated based on an offer to purchase the Bank's share, which has been accepted, and is expected to complete during 2016. The fair value of the consideration offered has been considered when calculating the fair value of the Visa Europe share.

If the illiquidity premium to the discount rate was assumed to be double (2% instead of 1%), it would result in a reduction in the overall fair value of the equity shares of £2.6m (5%) at 31 December 2015. Therefore, this valuation model is not deemed to be materially sensitive to this input, with a 100% increase resulting in a 5% change in valuation.

Investment properties

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

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

	Fair value at the beginning of the year	Purchases and transfers in	Sales, transfers out and repayments	Other Comprehensive Income	Income Statement	Fair value at the end of the year
As at 31 December 2015						
Loans and advances to customers	**6.7**	**–**	**(1.0)**	**–**	**(0.2)**	**5.5**
Derivative assets	**–**	**–**	**–**	**–**	**–**	**–**
Derivative liabilities	**–**	**–**	**–**	**–**	**–**	**–**
Investment securities	**–**	**1,685.5**	**(86.8)**	**1.1**	**–**	**1,599.8**
Equity shares	**–**	**–**	**–**	**51.2**	**–**	**51.2**
Investment properties	**2.1**	**–**	**(0.1)**	**–**	**0.1**	**2.1**
	8.8	**1,685.5**	**(87.9)**	**52.3**	**(0.1)**	**1,658.6**
As at 31 December 2014						
Loans and advances to customers	8.7	–	(1.5)	–	(0.5)	6.7
Derivative assets	30.5	–	(30.5)	–	–	–
Derivative liabilities	(61.2)	–	61.2	–	–	–
Investment securities	–	–	–	–	–	–
Equity shares	–	–	–	–	–	–
Investment properties	6.2	–	(4.3)	–	0.2	2.1
	(15.8)	–	24.9	–	(0.3)	8.8

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

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

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

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

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

unless there is no significant difference between carrying and fair values.

	Core				Non-core					
Carrying Value	**Retail**	**BaCB**	**Treasury**	**Total Core**	**Corporate CoAM**	**Optimum**	**Total Non-core**	**Unity Trust Bank**	**Unallocated & Statutory Adjustments**	**Total**
As at 31 December 2015										
Financial assets										
Loans and advances to banks	–	–	871.0	871.0	–	–	–	–	–	871.0
Loans and advances to customers	14,257.1	576.5	–	14,833.6	1,817.3	2,861.3	4,678.6	–	–	19,512.2
Fair value adjustments to hedged risk	98.0	–	–	98.0	(4.0)	–	(4.0)	–	–	94.0
Investment securities	–	–	15.0	15.0	–	–	–	–	–	15.0
Other assets	–	–	–	–	–	–	–	–	124.1	124.1
Financial liabilities										
Deposits by banks	–	–	725.9	725.9	–	–	–	–	–	725.9
Customer accounts	19,838.7	2,682.0	–	22,520.7	211.3	–	211.3	–	–	22,732.0
Debt securities in issue	–	–	2,554.3	2,554.3	–	–	–	–	–	2,554.3
Other borrowed funds	–	–	459.9	459.9	–	–	–	–	–	459.9
Other liabilities	–	–	–	–	–	–	–	–	68.8	68.8

	Core				Non-core					
Fair Value	**Retail**	**BaCB**	**Treasury**	**Total Core**	**Corporate CoAM**	**Optimum**	**Total Non-core**	**Unity Trust Bank**	**Unallocated & Statutory Adjustments**	**Total**
As at 31 December 2015										
Financial assets										
Loans and advances to banks	–	–	871.0	871.0	–	–	–	–	–	871.0
Loans and advances to customers	14,429.3	559.5	–	14,988.8	1,659.4	2,556.6	4,216.0	–	–	19,204.8
Fair value adjustments to hedged risk	98.0	–	–	98.0	(4.0)	–	(4.0)	–	–	94.0
Investment securities	–	–	13.3	13.3	–	–	–	–	–	13.3
Other assets	–	–	–	–	–	–	–	–	124.1	124.1
Financial liabilities										
Deposits by banks	–	–	725.9	725.9	–	–	–	–	–	725.9
Customer accounts	19,842.2	2,683.5	–	22,525.7	211.3	–	211.3	–	–	22,737.0
Debt securities in issue	–	–	2,882.7	2,882.7	–	–	–	–	–	2,882.7
Other borrowed funds	–	–	498.7	498.7	–	–	–	–	–	498.7
Other liabilities	–	–	–	–	–	–	–	–	68.8	68.8

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

Carrying Value	Core				Non-core					
	Retail	BaCB	Treasury	Total Core	Corporate CoAM	Optimum	Total Non-core	Unity Trust Bank	Unallocated & Statutory Adjustments	Total
As at 31 December 2014										
Financial assets										
Loans and advances to banks	–	–	1,292.3	1,292.3	–	–	–	316.1	–	1,608.4
Loans and advances to customers	14,611.3	618.3	–	15,229.6	3,432.5	6,356.2	9,788.7	172.5	–	25,190.8
Fair value adjustments to hedged risk	196.8	–	–	196.8	(48.3)	–	(48.3)	–	–	148.5
Investment securities	–	–	18.1	18.1	–	–	–	–	–	18.1
Other assets	–	–	–	–	–	–	–	–	187.6	187.6
Financial liabilities										
Deposits by banks	–	–	615.4	615.4	–	–	–	–	–	615.4
Customer accounts	25,466.7	2,842.2	–	28,308.9	557.4	–	557.4	747.7	–	29,614.0
Debt securities in issue	–	–	3,443.6	3,443.6	–	–	–	–	–	3,443.6
Other borrowed funds	–	–	196.4	196.4	–	–	–	–	–	196.4
Other liabilities	–	–	–	–	–	–	–	–	157.8	157.8

Fair Value	Core				Non-core					
	Retail	BaCB	Treasury	Total Core	Corporate CoAM	Optimum	Total Non-core	Unity Trust Bank	Unallocated & Statutory Adjustments	Total
As at 31 December 2014										
Financial assets										
Loans and advances to banks	–	–	1,292.3	1,292.3	–	–	–	316.1	–	1,608.4
Loans and advances to customers	14,600.3	601.5	–	15,201.8	3,167.5	5,113.1	8,280.6	175.2	–	23,657.6
Fair value adjustments to hedged risk	196.8	–	–	196.8	(48.3)	–	(48.3)	–	–	148.5
Investment securities	–	–	14.3	14.3	–	–	–	–	–	14.3
Other assets	–	–	–	–	–	–	–	–	187.6	187.6
Financial liabilities										
Deposits by banks	–	–	615.4	615.4	–	–	–	–	–	615.4
Customer accounts	25,478.0	2,842.6	–	28,320.6	557.4	–	557.4	747.6	–	29,625.6
Debt securities in issue	–	–	3,478.9	3,478.9	–	–	–	–	–	3,478.9
Other borrowed funds	–	–	223.2	223.2	–	–	–	–	–	223.2
Other liabilities	–	–	–	–	–	–	–	–	157.8	157.8

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 amortised cost value of all loans and advances to banks are deemed to be a close approximation of their fair value 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 in total is 98% of the carrying value as at 31 December 2015. The overall fair value is less than par primarily due to two main factors for Non-core loans in particular:

1. Customer interest rates are below the market rate for the period until expected maturity or the repricing date, if earlier; and
2. Credit risk adjustments due to incurred and expected future credit losses.

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. The market rate applied in the calculation is the average market rate for new originations of mortgages with similar characteristics to the book of mortgages being valued. This rate is assumed to encompass the time value of money, plus a risk premium to account for the inherent uncertainty in the timing and amount of future cash flows arising from a book of mortgage assets.

Forecast principal repayments are based on redemption at the earlier of maturity or re-pricing 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 that there would be no other factors which market participants would take into account when assessing the fair value of the Retail mortgage assets. It is assumed there is no fair value adjustment required in respect of interest rate movement on standard variable rate mortgage assets, as the interest rate being charged is assumed to be equal to the market rate for those mortgage assets.

ii. Optimum

Fair values have been calculated using the future lifetime income approach. Under this approach, fair value is measured by determining discounted expected cash flows, derived using expected redemption profiles of the portfolio and discounting these cash flows at current market rates for products with similar characteristics and risk profiles. The current market rate used is assumed to encompass the time value of money, plus a risk premium to account for the inherent uncertainty in the timing and amount of future cash flows arising from a book of mortgage assets.

iii. Corporate

As part of the implementation of the Bank's strategy for Non-core assets, certain assets have either already been sold after the 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 cash flow income approach has been used. Under this approach, value is measured by determining expected cash flows, derived using redemption profiles, from the portfolio and then considering credit costs, funding costs and tax to derive equity cash flows which are discounted at an appropriate blended cost of capital. The blended cost of capital is taken as an average of quoted cost of capital of the five largest listed banks in the UK, as this is assumed to represent the rate at which market participants would discount the future cash flows of a portfolio of corporate loans when assessing the fair value of such a portfolio.

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.

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

Debt securities in issue and other borrowed funds

The aggregate fair values 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. Quoted prices may be from inactive markets.

The fair value of debt securities in issue is above the carrying value as a result of the carrying value being net of merger fair value adjustments. The carrying values of debt securities in issue are expected to increase as the merger fair value adjustments continue to unwind, as shown in the following section.

Unwind of merger fair value adjustments

On the merger of the Bank and Britannia Building Society in August 2009 an exercise was undertaken to fair value the respective assets and liabilities of Britannia Building Society. These fair value adjustments are unwound on an EIR basis over the estimated behavioural lives of the assets and liabilities. As at 31 December 2015 the remaining merger fair value unwinds and the forecast unwind profiles can be summarised as follows:

	Carrying amount at year end	Remaining merger fair value to be unwound at year end	Actual unwind for the year to 31 December 2015	Forecast unwind 2016	Forecast unwind 2017	Forecast unwind 2018	Forecast unwind 2019+
As at 31 December 2015							
Assets							
Loans and advances to customers	**19,690.4**	**(21.6)**	**(20.1)**	**(2.3)**	**(2.1)**	**(1.9)**	**(15.3)**
Fair value adjustment for hedged risk	**94.0**	**(9.8)**	**(13.5)**	**(1.9)**	**(1.8)**	**(1.4)**	**(4.7)**
Other	**9,243.9**	**20.5**	**5.9**	**4.4**	**4.4**	**4.4**	**7.3**
Total assets	**29,028.3**	**(10.9)**	**(27.7)**	**0.2**	**0.5**	**1.1**	**(12.7)**
Liabilities							
Debt securities in issue	**2,554.3**	**(235.1)**	**(143.5)**	**(176.9)**	**(58.2)**	**–**	**–**
Deferred tax liabilities	**47.8**	**44.9**	**31.5**	**35.5**	**11.4**	**(0.4)**	**(1.6)**
Other	**25,062.9**	**–**	**–**	**–**	**–**	**–**	**–**
Total liabilities	**27,665.0**	**(190.2)**	**(112.0)**	**(141.4)**	**(46.8)**	**(0.4)**	**(1.6)**

Included in the actual unwind for the year to 31 December 2015 for loans and advances to customers is an amount of £17.4m relating to the two securitisation transactions with Warwick Finance Residential Mortgages Number One PLC and Warwick Finance Residential Mortgages Number Two PLC.

A breakdown of the unwind on debt securities in issue held at merger is as follows:

Issue name	Issue date	Contractual maturity date	Carrying amount at year end	Fair value at year end	Remaining merger fair value to be unwound at year end	Actual unwind for the year to 31 December 2015	Forecast unwind 2016	Forecast unwind 2017	Forecast unwind 2018
As at 31 December 2015									
Leek Finance Number Seventeen plc	April 2006	June 2016	**536.0**	**548.7**	**29.5**	**47.5**	**29.5**	**–**	**–**
Leek Finance Number Eighteen plc	October 2006	December 2016	**687.3**	**698.5**	**72.0**	**51.4**	**72.0**	**–**	**–**
Leek Finance Number Nineteen plc	April 2007	June 2017	**676.1**	**681.2**	**137.0**	**49.7**	**78.1**	**58.9**	**–**
Total Leek Notes			**1,899.4**	**1,928.4**	**238.5**	**148.6**	**179.6**	**58.9**	**–**

Of which liabilities held internally within the Bank are as follows:

Issue name	Carrying amount at year end	Fair value at year end	Remaining merger fair value to be unwound at year end	Actual unwind for the year to 31 December 2015	Forecast unwind 2016	Forecast unwind 2017	Forecast unwind 2018
As at 31 December 2015							
Internally Held Leek Notes	**537.7**	**527.3**	**3.4**	**5.1**	**2.7**	**0.7**	**–**

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

Fair values of financial assets and liabilities which are not carried at fair value and bases of valuation

Fair values are determined according to the hierarchy set out above.

	Carrying value	Level 1	Level 2	Level 3
As at 31 December 2015				
Financial assets				
Loans and advances to banks	**871.0**	**–**	**871.0**	**–**
Loans and advances to customers	**19,512.2**	**–**	**–**	**19,204.8**
Fair value adjustment for hedged risk	**94.0**	**–**	**–**	**94.0**
Investment securities	**15.0**	**13.3**	**–**	**–**
Financial liabilities				
Deposits by banks	**725.9**	**–**	**725.9**	**–**
Customer accounts	**22,732.0**	**–**	**22,737.0**	**–**
Debt securities in issue	**2,554.3**	**401.2**	**2,481.5**	**–**
Other borrowed funds	**459.9**	**–**	**498.7**	**–**

The carrying amount is a reasonable approximation of fair value for the following assets and liabilities: loans and advances to banks, other assets, deposits by banks and other liabilities.

	Carrying value	Level 1	Level 2	Level 3
As at 31 December 2014				
Financial assets				
Loans and advances to banks	1,608.4	–	1,608.4	–
Loans and advances to customers	25,190.8	–	–	23,657.6
Fair value adjustment for hedged risk	148.5	–	–	148.5
Investment securities	18.1	14.3	–	–
Financial liabilities				
Deposits by banks	615.4	–	615.4	–
Customer accounts	29,614.0	–	29,625.6	–
Debt securities in issue	3,443.6	789.1	2,689.8	–
Other borrowed funds	196.4	–	223.2	–

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

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 table below shows the carrying values and fair values of the assets transferred to securitisation vehicles and their associated liabilities. The carrying values presented below are the carrying amounts as recorded in the books of the subsidiary companies, some of these issued notes are held internally by the Bank and as such are not shown in the consolidated balance sheet of the Bank.

	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 fair value position
As at 31 December 2015					
Leek Finance Number Seventeen plc	**525.1**	**536.0**	**497.1**	**548.7**	**(51.6)**
Leek Finance Number Eighteen plc	**633.3**	**687.3**	**615.4**	**698.5**	**(83.1)**
Leek Finance Number Nineteen plc	**617.0**	**676.1**	**600.0**	**681.2**	**(81.2)**
Leek Finance Number Twenty plc[1]	**–**	**–**	**–**	**–**	**–**
Leek Finance Number Twenty One plc[1]	**–**	**–**	**–**	**–**	**–**
Leek Finance Number Twenty Two plc[1]	**–**	**–**	**–**	**–**	**–**
Silk Road Finance Number One plc[1]	**–**	**–**	**–**	**–**	**–**
Silk Road Finance Number Three plc	**343.9**	**351.2**	**342.7**	**350.6**	**(7.9)**
Cambric Finance Number One plc[1]	**–**	**–**	**–**	**–**	**–**
Meerbrook Finance Number Eight Ltd	**377.7**	**364.0**	**379.5**	**366.6**	**12.9**
	2,497.0	**2,614.6**	**2,434.7**	**2,645.6**	**(210.9)**

1. These companies were liquidated during the year.

The above carrying amount of associated liabilities can be reconciled to debt securities in issue, as follows:

	Carrying value
Carrying amount of associated liabilities as given above	**2,614.6**
Internally held fixed and floating rate notes	**(645.7)**
Loan facilities and subdebt not incuded in debt securities in issue	**(311.9)**
Non securitised debt securities	**1,122.6**
Merger fair value adjustment	**(244.8)**
Other adjustments	**19.5**
Debt securities in issue per financial liabilities	**2,554.3**

Notes to the Bank financial statements continued

For the year ended 31 December 2015

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

Of the notes listed above, those held by the Bank are as follows:

	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 fair value position
As at 31 December 2015					
Leek Finance Number Seventeen plc	**149.8**	**152.9**	**156.5**	**151.6**	**4.9**
Leek Finance Number Eighteen plc	**175.8**	**190.8**	**193.9**	**186.7**	**7.2**
Leek Finance Number Nineteen plc	**177.0**	**194.0**	**195.5**	**189.0**	**6.5**
Silk Road Finance Number Three plc	**105.8**	**108.0**	**105.4**	**106.3**	**(0.9)**
	608.4	**645.7**	**651.3**	**633.6**	**17.7**

The above carrying value and fair value of assets held for each entity has been determined by applying the proportion of internally held liabilities.

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.

The difference between the fair value and carrying value of the mortgages that have been securitised within Leek 17, 18 and 19 is 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 are 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.

The following table provides the fair value of the transferred assets and associated liabilities for 2014.

	Carrying amount of transferred assets not derecognised	Carrying amount of associated liabilities	Fair value of transferred assets not derecognised (restated)[1]	Fair value of associated liabilities	Net fair value position
As at 31 December 2014					
Leek Finance Number Seventeen plc	554.0	581.5	546.1	585.9	(39.8)
Leek Finance Number Eighteen plc	662.9	724.2	660.8	722.9	(62.1)
Leek Finance Number Nineteen plc	642.9	712.8	644.2	710.9	(66.7)
Leek Finance Number Twenty plc	1,340.1	1,319.7	1,338.9	1,269.6	69.3
Leek Finance Number Twenty One plc	763.6	775.4	788.6	719.3	69.3
Leek Finance Number Twenty Two plc	351.1	366.4	365.3	341.7	23.6
Silk Road Finance Number One plc	1,126.0	1,135.6	1,126.0	1,130.4	(4.4)
Silk Road Finance Number Three plc	451.3	459.8	457.7	463.1	(5.4)
Cambric Finance Number One plc	883.4	902.0	986.2	878.3	107.9
Meerbrook Finance Number Eight Ltd	564.5	564.5	570.3	458.2	112.1
	7,339.8	7,541.9	7,484.1	7,280.3	203.8

1. The 2014 comparative fair value of transferred assets not derecognised and resultant net fair value position has been recalculated to bring these in line with the methodology used in 2015.

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

Covered Bond Limited Liability Partnerships

Moorland Covered Bonds LLP was established as a result of a £1.4bn covered bond retained issuance. Loans and advances to customers of £1.9bn were transferred to Moorland Covered Bonds LLP. The transfer was funded by a loan of £1.4bn and capital contribution of £0.5bn. During October 2011 the £1.4bn loan was repaid. Following additional capital contribution repayment and on achieving Regulated Covered Bond status there was a public issuance of notes in November 2011 totalling £0.6bn. At the period end the Bank held a loan of £0.6bn (2014: £0.6bn) and a capital contribution of £0.6bn (2014: £0.7bn) with Moorland Covered Bonds LLP.

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

	Carrying amount of transferred loans and advances to customers	Carrying amount of fixed and floating rate notes	Fair value of transferred loans and advances to customers	Fair value of fixed and floating rate notes	Net fair value position
As at 31 December 2015					
Moorland Covered Bonds LLP	**1,215.4**	**596.9**	**1,222.6**	**668.1**	**554.5**
As at 31 December 2014					
Moorland Covered Bonds LLP	1,092.1	596.5	1,084.9	671.5	413.4

Assets pledged

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

	Carrying amount of assets not derecognised	Carrying amount of associated liabilities	Fair value of assets not derecognised	Fair value of associated liabilities	Net fair value position
As at 31 December 2015					
Investment securities sold under repurchase agreements	**721.7**	**671.2**	**721.7**	**671.2**	**50.5**
As at 31 December 2014					
Investment securities sold under repurchase agreements	–	–	–	–	–

Associated liabilities are included within deposits by banks.

Assets sold under repurchase agreements include mortgage backed securities (£204.7m of assets and associated liabilities of £159.6m) and UK government gilts (£517.0m of assets and associated liabilities of £511.6m).

40. Share-based payments

The Bank has made grants to senior employees in the year under the Long Term Incentive Plan (LTIP) and the Transitional Deferral Awards Plan (TDAP).

For LTIP, a grant as a proportion of employee's salary is denominated in notional shares using the Bank's grey market share price. They are cash settled with performance based vesting conditions over a period of 3 years, and a further 2 year holding period, with other non-vesting conditions. Awards are subject to malus and clawback in accordance with regulatory requirements. As cash settled share based payment arrangements, the services acquired and the liability incurred are measured at the fair value of the liability and recognised as employees render services, as required by IFRS 2. Until settlement, the fair value of the liability is re-measured over the vesting period.

The performance measures and any restrictions that apply are set out in more detail the Directors' Remuneration report.

25% of the awards will vest contingent on market based performance measures being met, and such market based conditions are required to be included in the estimation of fair value. Accordingly the fair value of these grants has been determined using a Monte Carlo option pricing model.

The remaining 75% of awards are subject to non-market based performance measures which, in accordance with IFRS 2, are not required to be incorporated into the calculation of fair value. Therefore the fair value is simply equal to the share price at the reporting date (£1.50).

The charge to the income statement in 2015 for the Bank was £0.8m (2014: £nil), inclusive of National Insurance.

All amounts are stated in £m unless otherwise indicated

40. Share-based payments continued

The fair value of the award subject to market based performance measures and the assumptions used in determining the fair value are as follows.

	LTIP 2015
Grant date	18 June 2015
Grey share price at grant date	£2.28
Notional shares awarded with market based performance measures	1,020,318
Vesting period	3 years
Expected volatility	28.0%
Expected term remaining	4 years
Exercise price	n/a
Risk free rate	1.2%
Fair value per award	£0.06

Expected volatility was based on the historical volatility of similar listed entities. The risk free interest rate was based on zero coupon UK government bonds as at the date of grant with similar remaining term to the expected life of the awards.

For TDAP, a grant as a proportion of employee's salary is denominated in notional shares using the Bank's grey market share price. They are cash settled with a performance based vesting condition over a period of 4 years, and a further 6 month holding period. Awards are subject to malus and clawback in accordance with regulatory requirements. As cash settled share based payment arrangements, the services acquired and the liability incurred are measured at the fair value of the liability and recognised as employees render services, as required by IFRS 2. Until settlement, the fair value of the liability is re-measured over the vesting period.

The performance measure and any restrictions that apply are set out in more detail the Directors' Remuneration Report.

The award is subject to a non-market based performance measure and, in accordance with IFRS 2, is not required to be incorporated into the calculation of fair value. Therefore the fair value is simply equal to the share price at the reporting date (£1.50).

The charge to the income statement in 2015 for the Bank was £0.1m (2014: £nil), inclusive of National Insurance.

A reconciliation of the grants outstanding during the year is as follows.

	Number of notional shares LTIP	Number of notional shares TDAP
Outstanding at the beginning of the year	–	–
Granted during the year	4,081,273	147,632
Forfeited during the year	–	–
Exercised during the year	–	–
Expired during the year	–	–
Outstanding at the end of the year	4,081,273	147,632

The conditional entitlements outstanding under the schemes at 31 December 2015 and 31 December 2014 were:

Award	Grant date	Vesting period	Expected settlement date	Number 2015	Number 2014
LTIP	18 June 2015	3 years	March 2020	4,081,273	–
TDAP	18 June 2015	4 years	June 2019	147,632	–

41. Interests in unconsolidated structured entities

During 2015, the Bank deleveraged mortgage assets with a total carrying value of total of £3,145m through two securitisation transactions. In both transactions, the assets were transferred to an unconsolidated structured entity as defined in IFRS 12, Disclosure of Interest in Other Entities.

The Bank completed the first securitisation in May, transferring the assets to Warwick Finance Residential Mortgages Number One PLC. The second transfer took place in September, with the assets being transferred to Warwick Finance Residential Mortgage Number Two PLC.

The table below shows only the continuing involvement the Bank retains in the two unconsolidated SPEs, being senior Notes issued by the SPEs. These notes are reported as Investment Securities – Available for Sale. The maximum exposure to loss is the carrying value of these Notes as at 31 December 2015.

	Carrying amount of continuing involvement in statement of financial position		Fair value of continuing involvement		Maximum exposure to loss
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	£m
31 December 2015	**1,599.8**	**–**	**1,599.8**	**–**	**1,599.8**

	Gain or loss recognised at transfer date £m	Income/ (expenses) recognised in reporting period £m	FV movement recognised in OCI £m	Income/ (expenses) recognised cumulatively £m
31 December 2015	**(43.4)**	**13.4**	**0.2**	**(29.8)**

In addition to the Notes issued, the Bank also has a requirement to fund any conduct redress on the mortgages. The Bank has currently funded £8.8m however, anything above/below this figure will be due from/back to the Bank. This commitment has been assessed as de minimus in the context of the overall transaction, and consequently does not affect the conclusion that substantially all the risks and rewards of the mortgage assets which have been transferred and therefore derecognised from the balance sheet.

Until 31 July 2015, Bank provided asset management services for the mortgages through its 100% owned subsidiary, Western Mortgage Services (WMS) and earned £0.7m for this service. Bank sold WMS on 1 August 2015 and since this date, the Bank has provided servicing only for complex cases. As of 31 December 2015, a minimal amount of complex cases have passed back to the Bank, and the Bank has earned a negligible amount for the provision of this service.

42. Post balance sheet events

It is a requirement of IAS 10 (Events after the balance sheet date) that these financial statements reflect events arising after 31 December 2015. The following events have occurred between 31 December 2015 and 31 March 2016 (the date of approval of these financial statements) and represent 'non adjusting' post balance sheet events:

Acquisition of Britannia Pension Trustees Limited

On 17 March 2016 the Bank acquired 100% of the issued share capital of Britannia Pension Trustees Limited from The Co-operative Banking Group Limited for consideration of £1.

Britannia Pension Trustees Limited is the sole trustee of the Britannia Pension Scheme and does not operate any trading activity.

Branch Closures

Board approval for the closure of an additional 54 branches during 2016 was obtained in December 2015 as part of the ongoing simplification and cost reduction scheme and in response to a 29% year on year reduction in branch transactions.

Communications of the closures to customers began in January 2016 and expect to be concluded by the end of March 2016. The impact of the closures to the Bank will be the recognition of a £8.7m provision relating to closure costs.

The Company financial statements

The Company balance sheet

At 31 December 2015

All amounts are stated in £m unless otherwise indicated

	Note	2015	2014
Assets			
Cash and balances at central banks	3	**2,670.1**	4,765.3
Loans and advances to banks	4	**452.1**	670.1
Loans and advances to customers	5a	**12,481.1**	15,976.2
Fair value adjustments for hedged risk	5b	**94.0**	150.8
Investment securities – loans and receivables	6a	**66.1**	73.5
Investment securities – available for sale	6b	**4,296.8**	2,828.6
Investment securities – fair value through income or expense	6c	**582.4**	1,236.9
Derivative financial instruments	7	**193.2**	289.5
Equity shares	8	**53.7**	2.8
Investments in subsidiaries/Group undertakings	23	**1,214.4**	1,061.5
Non-current assets classified as held for sale	2	**3.4**	332.5
Investment properties	10	**2.1**	2.1
Property, plant and equipment	11	**42.2**	63.1
Intangible fixed assets	9	**142.8**	103.4
Amounts owed by other Co-operative Bank undertakings	24	**8,195.0**	12,599.2
Other assets	12	**192.8**	221.6
Prepayments and accrued income	13	**43.5**	11.8
Deferred tax assets	21	**2.0**	2.5
Total assets		**30,727.7**	40,391.4
Liabilities			
Deposits by banks	14	**715.9**	605.1
Customer accounts		**23,135.3**	28,820.4
Customer accounts – capital bonds	15	**77.4**	263.8
Debt securities in issue	16	**1,005.7**	1,433.1
Derivative financial instruments	7	**403.2**	595.5
Other borrowed funds	17	**459.9**	196.4
Amounts owed to other Co-operative Bank undertakings	24	**3,186.4**	6,033.0
Other liabilities	18	**44.8**	152.9
Accruals and deferred income	19	**126.2**	12.3
Provisions for liabilities and charges	20	**458.5**	546.3
Current tax liabilities		**0.3**	0.3
Total liabilities		**29,613.6**	38,659.1

The Company balance sheet continued

At 31 December 2015

All amounts are stated in £m unless otherwise indicated

	Note	2015	2014
Capital and reserves attributable to the Company's equity holders			
Ordinary share capital	25	**22.6**	22.6
Share premium account	25	**1,736.9**	1,736.9
Retained earnings		**(1,145.6)**	(520.8)
Available for sale reserve		**55.6**	24.7
Capital redemption reserve		**410.0**	410.0
Cash flow hedging reserve		**34.6**	58.9
Total equity		**1,114.1**	1,732.3
Total liabilities and equity		**30,727.7**	40,391.4

The notes on pages 249 to 277 form part of these financial statements.

Approved by the Board on 31 March 2016.

Dennis Holt, Chairman
Niall Booker, Chief Executive

The Company statement of cash flows

For the year ended 31 December 2015

All amounts are stated in £m unless otherwise indicated

	2015	2014
Cash flows used in operating activities		
Loss before taxation	**(627.8)**	(384.6)
Adjustments for:		
(Increase)/decrease in prepayments and accrued income	**(31.7)**	3.9
Increase/(decrease) in accruals and deferred income	**113.9**	(39.6)
Interest payable in respect of other borrowed funds	**28.6**	22.8
Effect of exchange rate movements	**2.5**	3.8
Fair value of movements on investment properties	**–**	(0.2)
Impairment gains on loans and advances	**(29.1)**	(151.9)
Movements on investment impairments	**–**	(20.0)
Depreciation and amortisation	**39.2**	39.2
Interest amortisation	**3.4**	0.6
Fair value movements on financial assets and liabilities	**38.8**	(96.0)
Impairment of property, plant and equipment	**–**	12.2
Impairment of intangible fixed assets	**0.3**	7.6
Gains on disposal of property, plant, equipment and software	**(3.0)**	(0.2)
Net loss on sale of subsidiaries	**5.0**	–
Net impairment write back of investment in subsidiaries	**(10.0)**	–
Unwind of fair value adjustments arising on transfer of engagements	**(9.4)**	–
	(479.3)	(602.4)
Increase/(Decrease) in deposits by banks	**110.8**	(2,258.2)
Decrease in customer accounts and capital bonds	**(5,871.5)**	(2,629.0)
Decrease in debt securities in issue	**(427.4)**	(70.8)
Decrease in loans and advances to banks	**15.9**	5.3
Decrease in loans and advances to customers	**3,524.2**	4,471.9
Decrease/(Increase) in amounts owed by Co-operative Bank undertakings	**4,404.2**	(712.4)
(Decrease)/increase in amounts owed to Co-operative Bank undertakings	**(2,846.6)**	78.7
Net movement of other assets and other liabilities	**122.9**	(242.7)
Income tax (paid)/received	**(0.1)**	5.6
Net cash flows used in operating activities	**(1,446.9)**	(1,954.0)
Cash flows from investing activities		
Purchase of tangible and intangible fixed assets	**(79.7)**	(61.7)
Proceeds from sale of fixed assets	**21.1**	8.3
Purchase of investment securities	**(1,918.7)**	(1,352.0)
Proceeds from sale and maturity of investment securities	**1,054.5**	1,732.1
Net movement on investments in Co-operative Bank undertakings	**(153.8)**	391.9
Proceeds from sale of subsidiary	**5.9**	–
Net cash flows from investing activities	**(1,070.7)**	718.6

The Company statement of cash flows continued

For the year ended 31 December 2015

All amounts are stated in £m unless otherwise indicated

	Note	2015	2014
Cash flows from financing activities			
Interest paid on other borrowed funds		**(28.6)**	(22.8)
Issuance of other borrowed funds		**249.0**	–
Capital commitment received from The Co-operative Group		**–**	313.0
Costs incurred relating to the May 2014 Capital Raise		**–**	(12.8)
Cash proceeds relating to the May 2014 Capital Raise		**–**	400.0
Net cash flows from financing activities		**220.4**	677.4
Decrease in cash and cash equivalents		**(2,297.2)**	(558.0)
Cash and cash equivalents at the beginning of the financial year		**5,373.9**	5,931.9
Cash and cash equivalents at the end of the financial year		**3,076.7**	5,373.9
Cash and balances with central banks	3	**2,624.6**	4,707.5
Loans and advances to banks	4	**452.1**	666.4
		3,076.7	5,373.9

The Company statement of changes in equity

For the year ended 31 December 2015

All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Company						
	Share capital	**Share premium**	**Available for sale reserve**	**Cash flow hedging reserve**	**Capital redemption reserve**	**Retained earnings**	**Total equity**
2015							
Balance at the beginning of the year	**22.6**	**1,736.9**	**24.7**	**58.9**	**410.0**	**(520.8)**	**1,732.3**
Total comprehensive (expense)/income for the year	**–**	**–**	**30.9**	**(24.3)**	**–**	**(624.8)**	**(618.2)**
Liability Management Exercise							
Issuance of new share capital	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Balance at the end of the year	**22.6**	**1,736.9**	**55.6**	**34.6**	**410.0**	**(1,145.6)**	**1,114.1**
2014							
Balance at the beginning of the year (restated)	12.5	1,359.8	(14.1)	13.1	410.0	(208.1)	1,573.2
Total comprehensive (expense)/income for the year	–	–	38.8	45.8	–	(312.7)	(228.1)
Liability Management Exercise							
Issuance of new share capital	10.1	377.1	–	–	–	–	387.2
Balance at the end of the year	22.6	1,736.9	24.7	58.9	410.0	(520.8)	1,732.3

The notes on pages 249 to 277 form part of these financial statements.

Notes to the Company financial statements

For the year ended 31 December 2015

All amounts are stated in £m unless otherwise indicated

1. Net loss attributable to equity shareholders of the Company

On including the Company financial statements here together with the Bank 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 financial statements.

	2015	2014
Net loss attributable to equity shareholders of the Company	**(624.8)**	(312.7)

2. Non-current assets classified as held for sale

	Note	**2015**	2014
Property, plant and equipment	11	**3.4**	9.1
Intangible assets		**–**	–
Loans and advances to customers	5a	**–**	323.4
Cash and cash equivalents		**–**	–
Other receivables		**–**	–
Investment in Group undertakings		**–**	–
		3.4	332.5

Non-current assets presented as held for sale in 2015 relate solely to a number of branch assets which are currently being marketed for sale, with the expectation that these sales will be completed by the end of 2016. Impairment losses of £0.3m were recognised on classification of these assets as held for sale.

All assets classified as held for sale in 2014 were sold in 2015.

3. Cash and balances at central banks

	2015	2014
Cash in hand	**54.7**	218.0
Balances with the Bank of England other than mandatory reserve deposits	**2,569.9**	4,489.5
Included in cash and cash equivalents	**2,624.6**	4,707.5
Mandatory reserve deposits with the Bank of England	**45.5**	57.8
	2,670.1	4,765.3

Mandatory reserve deposits are not available for use in the Company's day-to-day operations, are non-interest bearing and are not included in cash and cash equivalents.

4. Loans and advances to banks

	2015	2014
Items in course of collection from other banks	**18.3**	49.3
Placements with other banks	**433.8**	617.1
Included in cash and cash equivalents	**452.1**	666.4
Other loans and advances to banks	**–**	3.7
	452.1	670.1

5. a) Loans and advances to customers

	Note	**Total 2015**	2014
Gross loans and advances		**12,709.8**	16,644.9
Less: allowance for losses		**(228.7)**	(345.3)
Classified as held for sale	2	**–**	(323.4)
		12,481.1	15,976.2

Loans and advances to customers include £174.0m (2014: £171.4m) of financial assets at fair value through income or expense designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency, and £4.2m of financial assets held for trading (2014: £3.9m).

All amounts are stated in £m unless otherwise indicated

5. a) Loans and advances to customers continued

Allowance for losses on loans and advances

	Core		Non-core		
	Individual	**Collective**	**Individual**	**Collective**	**Total**
2015					
At the beginning of the year	**3.2**	**109.1**	**221.4**	**11.6**	**345.3**
Balances with debt collection agencies	**–**	**–**	**–**	**–**	**–**
(Release)/charge against profits	**(1.4)**	**4.2**	**12.7**	**(6.4)**	**9.1**
Amounts written off	**1.3**	**(8.8)**	**(116.7)**	**2.1**	**(122.1)**
Unwind of discount allowance	**–**	**(2.2)**	**(1.4)**	**–**	**(3.6)**
Interest charged on impaired loans	**–**	**–**	**–**	**–**	**–**
At the end of the year	**3.1**	**102.3**	**116.0**	**7.3**	**228.7**

Core provisions are analysed in further detail below:

	Core				
	Retail		BaCB		
	Individual	**Collective**	**Individual**	**Collective**	**Total Core**
2015					
At the beginning of the year	**1.8**	**106.9**	**1.4**	**2.2**	**112.3**
Balances with debt collection agencies	**–**	**–**	**–**	**–**	**–**
(Release)/charge against profits	**(1.5)**	**5.6**	**0.1**	**(1.4)**	**2.8**
Amounts written off	**1.8**	**(8.8)**	**(0.5)**	**–**	**(7.5)**
Unwind of discount allowance	**–**	**(2.2)**	**–**	**–**	**(2.2)**
Interest charged on impaired loans	**–**	**–**	**–**	**–**	**–**
At the end of the year	**2.1**	**101.5**	**1.0**	**0.8**	**105.4**

	Core		Non-core		
	Individual	Collective	Individual	Collective	Total
2014					
At the beginning of the year	3.0	166.7	474.8	33.9	678.4
Balances with debt collection agencies	–	39.6	–	–	39.6
Charge/(release) against profits	1.0	(3.1)	(128.1)	(22.3)	(152.5)
Amounts written off	(0.8)	(89.9)	(121.5)	–	(212.2)
Unwind of discount allowance	–	(4.2)	(3.9)	–	(8.1)
Interest charged on impaired loans	–	–	0.1	–	0.1
At the end of the year	3.2	109.1	221.4	11.6	345.3

	Core				
	Retail		BaCB		
	Individual	Collective	Individual	Collective	Total Core
2014					
At the beginning of the year	2.5	161.4	0.5	5.3	169.7
Balances with debt collection agencies	–	39.6	–	–	39.6
(Release)/charge against profits	(0.3)	–	1.3	(3.1)	(2.1)
Amounts written off	(0.4)	(89.9)	(0.4)	–	(90.7)
Unwind of discount allowance	–	(4.2)	–	–	(4.2)
Interest charged on impaired loans	–	–	–	–	–
At the end of the year	1.8	106.9	1.4	2.2	112.3

All amounts are stated in £m unless otherwise indicated

5. a) Loans and advances to customers continued

Loans and advances to customers include finance lease receivables:

	2015	2014
Gross investment in finance leases may be analysed as follows:		
No later than one year	**1.9**	8.3
Later than one year and no later than five years	**7.2**	31.5
Later than five years	**14.9**	46.8
	24.0	86.6
Unearned future finance income on finance leases	**(8.2)**	(25.6)
Net investment in finance leases	**15.8**	61.0
The net investment in finance leases may be analysed as follows:		
No later than one year	**1.0**	4.6
Later than one year and no later than five years	**4.1**	19.8
Later than five years	**10.7**	36.6
	15.8	61.0

There are no unguaranteed residual values for any of the finance leases.

5. b) Fair value adjustments for hedged risk

The Company 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.

	2015	2014
Gross fair value adjustments for hedged risk	**98.0**	199.1
Less: impairment provision	**(4.0)**	(48.3)
	94.0	150.8

Movements on impairment provision on fair value adjustments for hedged risk are shown below:

	2015	2014
At the beginning of the year	**48.3**	46.8
Charge against profits	**(44.3)**	1.5
At the end of the year	**4.0**	48.3

All amounts are stated in £m unless otherwise indicated

6. Investment securities

a) Loans and receivables

	2015	2014
Listed	**66.1**	73.5
Unlisted	**–**	–
Total gross investment securities – loans and receivables	**66.1**	73.5
Less: allowance for losses	**–**	–
Total net investment securities – loans and receivables	**66.1**	73.5

Movement in investment securities – loans and receivables

	2015	2014
At the beginning of the year	**73.5**	83.1
Disposals and maturities	**(9.7)**	(12.5)
Exchange adjustments	**(2.4)**	(3.8)
Amortisation	**3.2**	4.7
Release and utilisation of impairment provision	**–**	6.4
Movement in interest accrual	**1.5**	(4.4)
At the end of the year	**66.1**	73.5

b) Available for sale

	2015	2014
Listed	**4,296.8**	2,828.6
Unlisted	**–**	–
Total gross investment securities – available for sale	**4,296.8**	2,828.6
Less: allowance for losses	**–**	–
Total net investment securities – available for sale	**4,296.8**	2,828.6

Movement in investment securities – available for sale

	2015	2014
At the beginning of the year	**2,828.6**	2,477.2
Acquisitions	**1,916.3**	1,013.1
Disposals and maturities	**(404.9)**	(801.3)
Fair value movements through equity	**(19.0)**	44.7
Fair value movements through income or expense	**(17.7)**	81.5
Amortisation	**(6.6)**	(8.9)
Release and utilisation of impairment provision	**–**	20.0
Movement in interest accrual	**0.1**	2.3
At the end of the year	**4,296.8**	2,828.6

All amounts are stated in £m unless otherwise indicated

6. Investment securities continued

Impairment analysis of investment securities – available for sale

	2015	2014
At the beginning of the year	–	20.0
Release for the year	–	(1.1)
Utilised during the year	–	(18.9)
At the end of the year	–	–

c) Fair value through income or expense

	2015	2014
Listed	**582.4**	1,236.9
Unlisted	–	–
Total gross investment securities – fair value through income or expense	**582.4**	1,236.9
Less: allowance for losses	–	–
Total net investment securities – fair value through income or expense	**582.4**	1,236.9

Movement in investment securities – fair value through income or expense

	2015	2014
At the beginning of the year	**1,236.9**	1,743.4
Acquisitions	–	338.8
Disposals and maturities	**(639.9)**	(893.1)
Fair value movements through profit or loss	**(10.7)**	53.4
Movement in interest accrual	**(3.9)**	(5.6)
At the end of the year	**582.4**	1,236.9

d) Analysis of investment securities by issuer

	2015	2014
Investment securities issued by public bodies:		
Government securities	**2,518.0**	3,210.3
Other public sector securities	**87.2**	145.9
	2,605.2	3,356.2
Other debt securities:		
Other floating rate notes	**674.2**	709.3
Mortgage backed securities	**1,665.9**	73.5
	2,340.1	782.8
Total investment securities	**4,945.3**	4,139.0

Other floating-rate notes (FRNs) relate to sterling denominated FRNs with maturities ranging from one month to six years from the balance sheet date.

All amounts are stated in £m unless otherwise indicated

7. Derivative financial instruments

The Company has entered, as principal, into various derivatives either as economic hedges which are treated as held for trading (not in a qualifying hedge relationship), or in a qualifying hedge accounting relationship for the management of interest rate risk and foreign exchange rate risk. Positive and negative fair values have not been netted off as the Bank does not have a legal right of offset.

Non-trading derivatives

Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions of the Company. 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 Company has entered into fair value hedges to mitigate price movements due to interest rate sensitivities.

	2015 Fair value		2014 Fair value (re-presented)[1]	
	Assets	**Liabilities**	Assets	Liabilities
Derivatives held for non-trading purposes				
Derivatives designated as cash flow hedges:				
Interest rate swaps	**35.1**	**(9.2)**	44.8	(16.7)
Derivatives designated as fair value hedges:				
Interest rate swaps	**10.8**	**(189.6)**	0.5	(341.1)
Cross currency interest rate swaps	**–**	**–**	4.8	(17.8)
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	**124.2**	**(138.6)**	173.7	(150.6)
Cross currency interest rate swaps	**2.2**	**(0.3)**	–	–
Forward currency transactions	**2.1**	**(4.0)**	13.9	(0.6)
OTC interest rate options	**0.2**	**(0.2)**	0.9	(0.1)
Equity swaps	**18.6**	**–**	50.9	(1.1)
Credit default swaps	**–**	**(61.3)**	–	(67.5)
Total derivative assets/(liabilities) held for non-trading purposes	**193.2**	**(403.2)**	289.5	(595.5)
Total recognised derivative assets/(liabilities)	**193.2**	**(403.2)**	289.5	(595.5)

1. The comparative for 2014 has been re-presented to correctly classify the Calico Finance Number One Limited CDS within 'Credit default swaps' from 'Forward currency transactions'.

Refer to note 19 in the notes to the Bank financial statements for further information on derivatives held by the Bank.

8. Equity shares

	2015	2014
Investment securities		
Listed	**0.1**	0.1
Unlisted	**53.6**	2.7
	53.7	2.8
Included above are the following unlisted trade investments:		
Visa Europe – 1 ordinary share of €10 each (2014: 1)	**51.2**	–
VocaLink Holdings Limited – 4,416,165 ordinary shares of £1 each (2014: 4,416,165)	**2.4**	2.7

The fair value of Visa Europe has been remeasured based on an offer to purchase the Company's share by Visa Inc. This is referred to in more detail in the detailed financial review.

All amounts are stated in £m unless otherwise indicated

9. Intangible fixed assets

	2015			2014		
	Internally generated intangible assets	**Other intangible assets**	**Total**	Internally generated intangible assets	Other intangible assets	Total
Cost						
At the beginning of the year	**471.2**	**46.0**	**517.2**	451.4	46.0	497.4
Additions	**73.2**	**–**	**73.2**	36.2	–	36.2
Disposals	**(2.4)**	**–**	**(2.4)**	(8.8)	–	(8.8)
Impairment	**(0.3)**	**–**	**(0.3)**	(7.6)	–	(7.6)
Write off of fully amortised assets	**(296.1)**	**–**	**(296.1)**	–	–	–
Transfer to property, plant and equipment	**(3.7)**	**–**	**(3.7)**	–	–	–
At the end of the year	**241.9**	**46.0**	**287.9**	471.2	46.0	517.2
Accumulated amortisation and impairment						
At the beginning of the year	**387.3**	**26.5**	**413.8**	365.5	22.0	387.5
Charge for the year	**25.0**	**4.5**	**29.5**	21.8	4.5	26.3
Write off of fully amortised assets	**(296.1)**	**–**	**(296.1)**	–	–	–
Disposals	**(2.1)**	**–**	**(2.1)**	–	–	–
At the end of the year	**114.1**	**31.0**	**145.1**	387.3	26.5	413.8
Net book value						
At the end of the year	**127.8**	**15.0**	**142.8**	83.9	19.5	103.4
At the beginning of the year	**83.9**	**19.5**	**103.4**	85.9	24.0	109.9

Internally generated intangible assets consist of software development costs. Acquired computer software licences are capitalised on the basis of cost incurred to acquire and bring the software to use.

Other intangible assets consist of a core deposit intangible of £15.0m (2014: £19.5m).

Internally generated assets include £67.5m (2014: £26.7m) of assets in the course of construction.

10. Investment properties

	2015	2014
Fair value		
At the beginning of the year	**2.1**	1.9
Disposals	**(0.1)**	–
Changes in fair value	**0.1**	0.2
At the end of the year	**2.1**	2.1

At the year end, investment properties relates solely to the Company's stake in residential shared ownership properties. Shared ownership properties are carried at fair value, being the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction, measured under a level 3 of the fair value hierarchy (see Bank note 39). Fair value is calculated by using recent valuations of individual assets within the portfolio, indexed linked to the balance sheet date using the relevant regional house price index and the resulting income or expense is recorded in the Company's income statement.

All amounts are stated in £m unless otherwise indicated

11. Property, plant and equipment

2015	Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost					
At the beginning of the year	**32.1**	**25.1**	**142.1**	**1.0**	**200.3**
Additions	**–**	**–**	**4.0**	**2.5**	**6.5**
Disposals	**(4.7)**	**(1.4)**	**(50.4)**	**–**	**(56.5)**
Transfer to intangibles	**–**	**–**	**4.9**	**(1.2)**	**3.7**
Classified as held for sale	**(4.2)**	**–**	**–**	**–**	**(4.2)**
Impairment	**–**	**–**	**–**	**–**	**–**
At the end of the year	**23.2**	**23.7**	**100.6**	**2.3**	**149.8**
Accumulated depreciation					
At the beginning of the year	**5.2**	**24.4**	**107.6**	**–**	**137.2**
Charge for the year	**0.8**	**0.6**	**8.3**	**–**	**9.7**
Disposals	**(0.5)**	**(1.4)**	**(36.6)**	**–**	**(38.5)**
Classified as held for sale	**(0.8)**	**–**	**–**	**–**	**(0.8)**
Impairment	**–**	**–**	**–**	**–**	**–**
At the end of the year	**4.7**	**23.6**	**79.3**	**–**	**107.6**
Net book value					
At the end of the year	**18.5**	**0.1**	**21.3**	**2.3**	**42.2**
At the beginning of the year	**26.9**	**0.7**	**34.5**	**1.0**	**63.1**

2014	Note	Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost						
At the beginning of the year		34.2	25.1	138.2	13.7	211.2
Additions		–	–	17.9	7.6	25.5
Disposals		(2.1)	–	(10.1)	–	(12.2)
Impairment		–	–	–	(11.1)	(11.1)
Transfers between categories		–	–	9.2	(9.2)	–
Transfer to non-current assets held for sale	2	–	–	(13.1)	–	(13.1)
At the end of the year		32.1	25.1	142.1	1.0	200.3
Accumulated depreciation						
At the beginning of the year		4.4	22.5	104.4	–	131.3
Charge for the year		0.8	1.9	10.2	–	12.9
Disposals		(0.3)	–	(3.7)	–	(4.0)
Impairment		0.3	–	0.7	–	1.0
Transfers between categories		–	–	–	–	–
Transferred to non-current assets held for sale	2	–	–	(4.0)	–	(4.0)
At the end of the year		5.2	24.4	107.6	–	137.2
Net book value						
At the end of the year		26.9	0.7	34.5	1.0	63.1
At the beginning of the year		29.8	2.6	33.8	13.7	79.9

As part of the separation activity in November 2014, the Company purchased the legal title of all Company specific assets held by CFSMS (shared assets remained with CFSMS). The carrying value of these assets on the balance sheet at 31 December 2014 was £42.9m.

All amounts are stated in £m unless otherwise indicated

12. Other assets

	2015	2014
Amounts recoverable within one year:		
Trade debtors	**111.6**	24.3
Other assets	**–**	60.1
Amounts owed by The Co-operative Group	**37.5**	58.9
Amounts recoverable after more than one year:		
Amounts owed by The Co-operative Group	**43.7**	78.3
	192.8	221.6

Amounts owed by The Co-operative Group includes group relief recoverable of £43.7m (2014: £101.3m).

Further details of the Company's related party transactions with The Co-operative Group are contained in note 24.

13. Prepayments and accrued income

	2015	2014
Amounts recoverable within one year	**35.4**	5.8
Amounts recoverable after more than one year	**8.1**	6.0
	43.5	11.8

Following separation from CFSMS, items previously classified as other assets are now classified as prepayments and accrued income.

14. Deposits by banks

	2015	2014
Items in course of collection	**31.8**	37.9
Deposits from other banks	**684.1**	567.2
	715.9	605.1

Included within deposits from other banks are liabilities of £671.2m (2014: £280m) secured on investment securities with a carrying value of £710.4m (2014: £280m).

15. Customer accounts – capital bonds

	2015	2014
Retail	**77.4**	263.8

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. They 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 Company would contractually be required to pay at maturity for all the capital bonds is £77.4m (2014: £264.3m).

The Company 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 £20.9m (2014: £37.8m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the year is £nil (2014: loss of £1.5m).

All amounts are stated in £m unless otherwise indicated

16. Debt securities in issue

	2015	2014
Fixed and floating rate notes	**1,005.7**	1,433.1

The Company 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.

The notes (covered bonds – secured, certificates of deposit and euro medium term notes – unsecured) require the Company to repay contractual amounts due on specified maturity dates.

17. Other borrowed funds

	2015	2014
Fixed rate subordinated notes 2025	**250.0**	–
Fixed rate subordinated notes 2023	**206.0**	206.0
Issue costs, discounts and accrued interest	**1.0**	(9.6)
Fair value hedge accounting adjustment	**2.9**	–
	459.9	196.4

The 2025 subordinated notes were issued on 1 July 2015 and mature on 1 July 2020. These notes carry an annual interest rate of 8.5% to maturity and Interest is payable yearly in arrears. The 2023 subordinated notes were issued on 20 December 2013 and mature on 20 December 2023. These notes carry an annual interest rate of 11% to maturity and Interest is payable quarterly in arrears.

The notes are admitted to trading on the London Stock Exchange; they are Tier 2 capital and an unsecured obligation of the bank.

18. Other liabilities

	2015	2014
Amounts falling due within one year:		
Amounts owed to The Co-operative Banking Group	**–**	126.0
Other creditors	**36.8**	22.8
Amounts falling due after one year:		
Other creditors	**8.0**	4.1
	44.8	152.9

Other creditors of the Company include finance lease obligations as follows:

	Present value of lease payments		Future minimum lease payments	
	2015	2014	2015	2014
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**	1.3	**1.6**	1.6
	1.3	1.4	**1.7**	1.7

Further details of the Company's related party transactions with The Co-operative Banking Group are contained in note 24.

19. Accruals and deferred income

	2015	2014
Amounts falling due within one year	**126.2**	12.3
Amounts falling due after one year	**–**	–
	126.2	12.3

Following separation from CFSMS in 2015, items previously classified as other liabilities are now classified as accruals and deferred income.

All amounts are stated in £m unless otherwise indicated

20. Provisions for liabilities and charges

2015	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
At the beginning of the year	23.4	12.6	73.6	299.0	112.3	25.4	546.3
Transferred from CFSMS	23.8	–	–	–	–	6.6	30.4
Provided/(released) in the year:							
Interest income	–	–	–	58.3	–	–	58.3
Operating expense	3.4	18.9	–	–	8.9	14.5	45.7
Provision for customer redress	–	–	71.8	68.7	–	(0.9)	139.6
Utilised during the year	(7.9)	(20.7)	(58.4)	(196.7)	(56.9)	(21.2)	(361.8)
Transfer to liabilities associated with non-current assets held for sale	–	–	–	–	–	–	–
At the end of the year	42.7	10.8	87.0	229.3	64.3	24.4	458.5
Provisions were analysed as follows:							
Amounts falling due within one year	25.9	10.8	40.7	206.7	64.3	22.7	371.1
Amounts falling due after one year	16.8	–	46.3	22.6	–	1.7	87.4
Total provisions	42.7	10.8	87.0	229.3	64.3	24.4	458.5

2014	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
At the beginning of the year	21.6	13.2	133.8	222.6	39.4	30.6	461.2
Provided/(released) in the year:							
Net interest income	–	–	–	48.0	–	–	48.0
Operating expense	2.3	24.3	–	4.0	94.5	(3.1)	122.0
Provision for customer redress	–	–	5.0	62.7	–	3.5	71.2
Utilised during the year	(0.5)	(24.9)	(65.2)	(38.3)	(21.6)	(21.4)	(171.9)
Increase in discount on loans identified for disposal	–	–	–	–		15.8	15.8
At the end of the year	23.4	12.6	73.6	299.0	112.3	25.4	546.3
Provisions were analysed as follows:							
Amounts falling due within one year	12.6	12.6	60.0	286.4	89.5	25.0	486.1
Amounts falling due after one year	10.8	–	13.6	12.6	22.8	0.4	60.2
	23.4	12.6	73.6	299.0	112.3	25.4	546.3

The Directors consider conduct and legal provisions a critical accounting judgement. Further details are provided in note 2 to the Bank financial statements.

Details of the Company's FSCS levy and PPI provision are as set out in note 32 to the Bank financial statements.

Property

The Company has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases. In addition, dilapidation provisions are recorded to the extent that the Company has incurred dilapidations and/or the dilapidation clause within the contract has been invoked. During the year £0.3m (2014: £2.3m) has been provided for this.

Conduct/legal provisions

During the year the Company provided an additional £58.3m (2014: £48.0m) in respect of potential customer redress following identification of breaches of the Consumer Credit Act.

The £68.7m charged through potential customer redress consists of £40.4m in relation to CCA delivery costs, a £16.8m in relation to packaged accounts and a £11.5m increase in other conduct related provisions.

All amounts are stated in £m unless otherwise indicated

20. Provisions for liabilities and charges continued

Other

Details of the property provisions, FSCS levy and PPI provision are as set out in note 32 to the Bank financial statements.

21. Deferred tax

Deferred taxes are calculated on all temporary differences under the liability method using the most appropriate tax rate in respect of each temporary difference (2014: 20%).

During the year, effective from 1 April 2015, the standard rate of corporation tax in the UK changed from 21% to 20%. Reductions in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and 18% (effective from 1 April 2020) were substantively enacted on 18 November 2015. A banking surcharge tax of 8% will also apply to the Bank (effective from 1 January 2016) and this change was substantively enacted on 18 November 2015. Deferred tax has been calculated by reference to the most appropriate rate based on forecasts. On 16 March 2016, the Chancellor of the Exchequer announced a further reduction of the corporation tax rate to 17% effective from 1 April 2020; this change has not yet been substantively enacted.

The movements on the deferred tax asset accounts are as follows:

	2015	2014
Deferred tax at the beginning of the year	**2.5**	2.8
Credited/(charged) to the income statement:		
Current year	**5.3**	8.6
Prior year	**1.8**	(0.2)
Impact of corporation tax rate change	**4.9**	
	12.0	8.4
Charged to other comprehensive income:		
Cash flow hedges	**–**	(8.7)
Available for sale	**(12.5)**	–
	(12.5)	(8.7)
Deferred tax at the end of the year	**2.0**	2.5
Components of net deferred tax:		
Deferred tax asset	**26.3**	14.6
Deferred tax liability	**(24.3)**	(12.1)
	2.0	2.5

The deferred tax asset above includes an offset for those deferred tax liabilities that are permissible to be offset.

Net deferred tax assets expected to be recoverable after one year are £2.0m (2014: £2.5m).

	2015	2014
Deferred tax comprises:		
Capital allowances on fixed assets and assets leased to customers	**22.3**	14.6
Cash flow hedges	**(11.2)**	(11.5)
Unrealised appreciation on investments	**(13.1)**	(0.6)
Capital losses	**4.0**	–
	2.0	2.5

The deferred tax credit in the income statement comprises:

	2015	2014
Capital allowances on fixed assets and assets leased to customers	**(7.7)**	(4.4)
FSCS levy provision	**–**	(5.2)
Cash flow hedges	**(0.3)**	1.2
Capital losses	**(4.0)**	–
	(12.0)	(8.4)

All amounts are stated in £m unless otherwise indicated

21. Deferred tax continued

Deferred tax assets totalling £352.9m (2014: £292.9m) have not been recognised where doubt exists over the availability of sufficient future taxable profits. Deferred tax has not been recognised in respect of trading losses of £1,669.8m (with deferred tax of £300.6m) and other temporary differences of £200.7m (with deferred tax of £52.3m). Deferred tax assets of £77.8m (2014: £22.3m) in respect of the current year have not been recognised.

During the year, effective from 1 April 2015, new tax legislation was introduced to restrict the proportion of banks' annual taxable profits that can be offset by tax losses arising prior to this date to 50%. On 16 March 2016, the Chancellor of the Exchequer announced that the proportion will be restricted further to 25% effective from 1 April 2016.

22. Contingent liabilities

The tables below provide 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 CRD IV rules.

The contingent liabilities, as detailed below, arise in the normal course of banking business and it is not practical to quantify their future financial effect.

		Unaudited		Unaudited
	Contract amount 2015	**Risk weighted amount 2015**	Contract amount 2014 (re-presented)	Risk weighted amount 2014 (re-presented)
Contingent liabilities:				
Guarantees and irrevocable letters of credit	**21.0**	**15.0**	43.0	17.8
Other commitments:				
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[1]	**2,108.0**	**281.4**	2,543.5	384.7
	2,129.0	**296.4**	2,586.5	402.5

1. Undrawn loan commitments include revocable commitments which are unused credit card limits of £1,557.6m (2014: £1,787.3m).

During 2015, the Company reviewed its interpretation of items comprising Forward Asset Purchases and now considers that they do not classify as other commitments. The effect of re-presentation is to reduce other commitments by £154.9m at December 2014.

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Company's day-to-day operations. Mandatory reserve deposits are also held with the Bank of England in accordance with statutory requirement.

See note 26 for further details of assets pledged.

Commitments under operating leases

The Company 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 Company will be required to make over the remaining lives of the leases.

	Land and buildings 2015	**Equipment 2015**	Land and buildings 2014	Equipment 2014
Falling due:				
Within one year	**14.0**	**–**	19.5	0.1
Between one and five years	**30.2**	**–**	46.5	0.3
In five years or more	**84.3**	**–**	51.5	–
	128.5	**–**	117.5	0.4

The Company 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 Company was £13.9m (2014: £5.0m).

Commitments to financially support subsidiary undertakings

Where relevant, the Company has committed to financially support certain subsidiary undertakings including consolidated structured entities.

All amounts are stated in £m unless otherwise indicated

23. Investments in subsidiaries/Group undertakings

	2015			2014		
	Ordinary shares	**Capital contributions**	**Total**	Ordinary shares	Capital contributions	Total
At the beginning of the year	**544.5**	**517.0**	**1,061.5**	569.5	883.9	1,453.4
Additions	**–**	**131.5**	**131.5**	–	–	–
Repayments	**–**	**–**	**–**	(25.0)	(366.9)	(391.9)
Reclassification	**11.4**	**–**	**11.4**	–	–	–
Impairment (Write back)	**11.6**	**–**	**11.6**	–	–	–
Impairment (Write down)	**(1.6)**	**–**	**(1.6)**	–	–	–
At the end of the year	**565.9**	**648.5**	**1,214.4**	544.5	517.0	1,061.5

Subsidiary undertakings

Principal subsidiary undertakings which are registered in England and operating in the UK:

		% Shareholding 2015	% Shareholding 2014
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%
Moorland Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	**100%**	100%

Investments in equity shares and loans with subsidiary undertakings are shown net of impairments.

Southside Regeneration Limited was sold on 30 June 2015.

The majority of the Company's shareholding in Unity Trust Bank was disposed of on 14 December 2015, resulting in a loss of control, as defined under IFRS. Therefore, on this date, Unity Trust Bank ceased to be a subsidiary of the Company.

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
Platform Group Holdings Limited	Holding company

Western Mortgage Services Limited was sold on 1 August 2015.

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.

All amounts are stated in £m unless otherwise indicated

23. Investments in subsidiaries/Group undertakings continued

Registered in the Isle of Man and operating overseas:

Britannia International Limited	Deposit taking

On 10 January 2014, The Co-operative Bank plc announced that in line with its wider strategy of simplifying the business it is to wind down Britannia International operations. Operations have been gradually scaled down and customer accounts closed in an orderly manner throughout 2014. Any remaining customer accounts were closed on 27 February 2015 and placed into a scheme to manage these funds. Full details of this scheme have been communicated to all affected customers.

Britannia International Limited Company surrendered its Class 1 Deposit-Taking Licence to the Isle of Man Financial Supervision Commission during 2015.

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
Meerbrook Finance Number Four Limited	Securitisation company
Meerbrook Finance Number Eight Limited	Securitisation company
Silk Road Finance Number Three 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 Company. See note 24 for the related party disclosures.

The following securitisation vehicles were dissolved by the Bank during 2015:

		Date of dissolution
Leek Finance Number Twenty plc	Securitisation company	29 September 2015
Leek Finance Number Twenty One plc	Securitisation company	29 September 2015
Leek Finance Number Twenty Two plc	Securitisation company	29 September 2015
Meerbrook Finance Number One Limited	Securitisation company	3 February 2015
Meerbrook Finance Number Two Limited	Securitisation company	3 February 2015
Meerbrook Finance Number Three Limited	Securitisation company	3 February 2015
Silk Road Finance Number One plc	Securitisation company	30 June 2015
Silk Road Finance Number Two plc	Securitisation company	30 June 2015
Cambric Finance Number One plc	Securitisation company	29 September 2015

See note 39 to the Bank financial statements for further details of securitisation vehicles.

Joint Ventures

The Bank has investments in the following joint ventures:

	% Ownership 2015	% Ownership 2014
Britannia Personal Lending Limited	**49%**	49%
Britannia New Homes (Scotland) Limited[1]	**50%**	50%

1. Britannia new Homes (Scotland) Limited is a dormant company

See note 36 to the Bank financial statements for further details of joint ventures.

All amounts are stated in £m unless otherwise indicated

23. Investments in subsidiaries/Group undertakings continued

Dormant Companies

The Bank has investments in the following dormant subsidiaries all of which are registered in England with the exception of Britannia LAS Direct Limited which is registered in Scotland:

Britannia (Isle of Man) Limited
Britannia Building Society Land and Development Company (Midlands) Limited
Britannia LAS Direct Limited
Cambrian Care Limited
Cleveland Finance Limited
Cleveland Guaranty Limited
Co-operatlve Bank (Insurance Services) Limited
Day & Son (Builders) Limited
First Co-operative Finance Limited
Haydn Evans Construction (South Wales) Limited
Larchvale Limited
PCSL Services No 1 Limited
Phoenix Credit Services Limited
Second Pioneers Leasing Limited
The Co-operative Bank Pension Trust Limited
Verso Limited

24. Related party transactions

Parent, subsidiary and ultimate controlling party

At 31 December 2015, the Company is an associate of, and therefore a related party of, The Co-operative Group as The Co-operative Group owns 20.16% of the Bank's ordinary shares, is entitled to Bank Board representation and there are material transactions between the two companies.

Transactions with CFS Management Services Limited

The Company has a significant relationship with CFS Management Services Limited (CFSMS). CFSMS is a subsidiary of The Co-operative Banking Group Limited and undertakes the provision of supplies and services to the Company. This relationship was in place for the whole of the year but will eventually be terminated after full separation is affected.

Further details of transactions with CFSMS are disclosed in note 37 to the Bank financial statements.

The Company has a significant relationship with The Co-operative Group. As part of the Recapitalisation Plan and in contemplation of the Company ceasing to be a wholly owned subsidiary of The Co-operative Group, the Bank entered into the agreements and several other arrangements with The Co-operative Group. Further details of the transactions with The Co-operative Group are disclosed in note 37 to the Bank financial statements.

Balances with other Co-operative Bank undertakings

The following tables show the value of transactions with The Co-operative Bank plc undertakings during the year.

Amounts owed by Co-operative Bank undertakings	2015	Restated 2014
Amounts owed by Co-operative Bank subsidiaries (excluding special purpose entities)	**7,056.1**	6,489.8
Amounts owed by Co-operative Bank subsidiaries – special purpose entities	**1,138.9**	6,109.4
	8,195.0	12,599.2
Cash balances deposited with the Company by Co-operative Bank subsidiaries (excluding special purpose entities)	**132.6**	–
	8,327.6	12,599.2

Amounts owed to Co-operative Bank undertakings	2015	2014
Amounts owed to Co-operative Bank subsidiaries (excluding special purpose entities)	**1,956.0**	3,189.4
Amounts owed to Co-operative Bank subsidiaries – special purpose entities	**1,230.4**	2,843.6
	3,186.4	6,033.0

Interest accrues on outstanding balances at a transfer price rate in place between the Company and its subsidiaries.

All amounts are stated in £m unless otherwise indicated

24. Related party transactions continued

In addition to the above balances with special purpose entities (SPEs), the Company holds floating rate notes in Leek Finance Number Seventeen plc of £12.2m (2014: £14.5m), in Leek Finance Number Eighteen plc of £17.0m (2014: £20.1m) and in Leek Finance Number Nineteen plc of £22.8m (2014: £27.3m) included within investment securities – available for sale.

The loans owed to the SPEs comprise cash balances deposited with the Company.

There are no formal repayment terms with subsidiary companies.

Balances with other Co-operative Group undertakings

The tables below provide an analysis of balances with The Co-operative Group and its undertakings at 31 December 2015 and 31 December 2014 and their location within the Bank's balance sheet.

	2015			
	Loans & advances to customers	**Other assets**	**Customer accounts**	**Other liabilities**
The Co-operative Group	**1.0**	**45.2**	**(100.1)**	**–**
The Co-operative Banking Group Ltd	**–**	**–**	**(0.3)**	**–**
Subsidiaries of The Co-operative Banking Group Ltd	**–**	**19.2**	**(4.6)**	**(6.1)**
	1.0	**64.4**	**(105.0)**	**(6.1)**

	2014			
	Loans & advances to customers	Other assets	Customer accounts	Other liabilities
The Co-operative Group	51.0	101.5	(163.7)	–
The Co-operative Banking Group Ltd	–	–	(55.5)	–
Subsidiaries of The Co-operative Banking Group Ltd	–	35.7	(27.3)	(126.0)
	51.0	137.2	(246.5)	(126.0)

The following tables show the value of transactions with The Co-operative Bank plc undertakings during the year.

2015	Interest and fees paid to Company	Interest and fees received from Company	Staff recharges paid to Company	Rent received from Company	Administration recharge paid to Company
Transactions with Co-operative Bank subsidiaries (excluding special purpose entities)	**80.7**	**25.6**	**6.6**	**0.4**	**3.9**
Transactions with Co-operative Bank subsidiaries – special purpose entities	**48.2**	**15.4**	**–**	**–**	**–**
2014					
Transactions with Co-operative Bank subsidiaries (excluding special purpose entities)	60.8	8.2	7.6	0.6	7.7
Transactions with Co-operative Bank subsidiaries – special purpose entities	92.5	1.5	–	–	–

Transactions with Directors, key management personnel and close family

Details of the Company's transactions with Directors, key management personnel and close family are as set out in note 37 to the Bank financial statements.

25. Share capital

	No. of shares (millions) 2015	Share capital 2015	No. of shares (millions) 2014	Share capital 2014
Allotted, called up and fully paid (ordinary shares of 5p each)				
At the beginning of the period	**451.5**	**22.6**	250.0	12.5
Issue of new ordinary shares	**–**	**–**	200.5	10.0
Issue of new bonus shares	**–**	**–**	1.0	0.1
At the end of the period	**451.5**	**22.6**	451.5	22.6
Share premium account				
At the beginning of the period		**1,736.9**		1,359.8
Issue of new ordinary shares		**–**		377.2
Issue of new bonus shares		**–**		(0.1)
At the end of the period		**1,736.9**		1,736.9

The £400.0m capital raising completed in May 2014 resulted in an issuance of new ordinary share capital of £10.0m and a gross increase in share premium of £390.0m. Bonus shares of £0.1m were also issued. As part of the capital raising the Bank incurred transaction costs of £12.8m. These were offset against the gross share premium amount, giving a net increase in capital of £387.2m, of which £377.1m was recorded as share premium.

No additional shares were issued during 2015.

The number of ordinary shares in issue at 31 December 2015 was 451,456,510 (2014: 451,456,510). The ordinary shareholders have one vote for every share held.

See note 38 to the Bank financial statements for further details on share capital.

All amounts are stated in £m unless otherwise indicated

26. 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. The tables below analyse the balance sheet carrying values of financial assets and liabilities by classification.

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
As at 31 December 2015							
Assets							
Cash and balances at central banks	–	–	2,670.1	–	–	–	2,670.1
Loans and advances to banks	–	–	452.1	–	–	–	452.1
Loans and advances to customers	4.2	174.0	12,302.9	–	–	–	12,481.1
Fair value adjustments for hedged risk	–	–	94.0	–	–	–	94.0
Investment securities	–	582.4	66.1	4,296.8	–	–	4,945.3
Derivative financial instruments	147.3	–	–	–	–	45.9	193.2
Amounts owed by other Co-operative Bank undertakings	–	–	8,195.0	–	–	–	8,195.0
Equity shares	–	–	–	53.7	–	–	53.7
Other assets	–	–	192.8	–	–	–	192.8
Total financial assets	151.5	756.4	23,973.0	4,350.5	–	45.9	29,277.3
Non-financial assets							1,450.4
Total assets							30,727.7
Liabilities							
Deposits by banks	–	–	–	–	715.9	–	715.9
Customer accounts	–	–	–	–	23,135.3	–	23,135.3
Customer accounts – capital bonds	–	77.4	–	–	–	–	77.4
Debt securities in issue	–	–	–	–	1,005.7	–	1,005.7
Derivative financial instruments	204.4	–	–	–	–	198.8	403.2
Other borrowed funds	–	–	–	–	459.9	–	459.9
Amounts owed by other Co-operative Bank undertakings	–	–	–	–	3,186.4	–	3,186.4
Other liabilities	–	–	–	–	44.8	–	44.8
Total financial liabilities	204.4	77.4	–	–	28,548.0	198.8	29,028.6
Non-financial liabilities							585.0
Total liabilities							29,613.6
Capital and reserves							1,114.1
Total liabilities and equity							30,727.7

Whilst the Company does not hold any derivative financial instruments that are considered 'derivatives held for trading purposes' as shown in note 7, IAS 39 requires derivative financial instruments that are not in a hedging relationship to be classified as 'held for trading'.

The above fair values have been calculated in accordance with IFRS 13, which values assets individually rather than as a portfolio.

All amounts are stated in £m unless otherwise indicated

26. 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	Derivatives in a hedging relationship	Total
As at 31 December 2014							
Assets							
Cash and balances at central banks	–	–	4,765.3	–	–	–	4,765.3
Loans and advances to banks	–	–	670.1	–	–	–	670.1
Loans and advances to customers	3.9	171.4	15,800.9	–	–	–	15,976.2
Fair value adjustments for hedged risk	–	–	150.8	–	–	–	150.8
Investment securities	–	1,236.9	73.5	2,828.6	–	–	4,139.0
Derivative financial instruments	239.4	–	–	–	–	50.1	289.5
Equity shares	–	–	–	2.8	–	–	2.8
Amounts owed by other Co-operative Bank undertakings	–	–	12,599.2	–	–	–	12,599.2
Other assets	–	–	221.6	–	–	–	221.6
Total financial assets	243.3	1,408.3	34,281.4	2,831.4	–	50.1	38,814.5
Non-financial assets							1,576.9
Total assets							40,391.4
Liabilities							
Deposits by banks	–	–	–	–	605.1	–	605.1
Customer accounts	–	–	–	–	28,820.4	–	28,820.4
Customer accounts – capital bonds	–	263.8	–	–	–	–	263.8
Debt securities in issue	–	–	–	–	1,433.1	–	1,433.1
Derivative financial instruments	219.9	–	–	–	–	375.6	595.5
Other borrowed funds	–	–	–	–	196.4	–	196.4
Amounts owed by other Co-operative Bank undertakings	–	1,126.0	–	–	4,907.0	–	6,033.0
Other liabilities	–	–	–	–	152.9	–	152.9
Total financial liabilities	219.9	1,389.8	–	–	36,114.9	375.6	38,100.2
Non-financial liabilities							558.9
Total liabilities							38,659.1
Capital and reserves							1,732.3
Total liabilities and equity							40,391.4

All amounts are stated in £m unless otherwise indicated

26. Fair values of financial assets and liabilities continued

a) Use of financial instruments

Refer to note 39 in the Bank financial statements for details for the use of financial instruments by the Company.

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
As at 31 December 2015				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	–	4.2	–	4.2
Designated at fair value:				
Loans and advances to customers	–	168.5	5.5	174.0
Investment securities	582.4	–	–	582.4
Available for sale financial assets:				
Investment securities	2,697.0	–	1,599.8	4,296.8
Equity shares	0.1	2.4	51.2	53.7
Derivative financial instruments	–	193.2	–	193.2
Non-financial assets				
Investment properties	–	–	2.1	2.1
Total assets carried at fair value	3,279.5	368.3	1,658.6	5,306.4
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	–	77.4	–	77.4
Amounts owed to other Co-operative Bank undertakings	–	–	–	–
Derivative financial instruments	–	341.9	61.3	403.2
Total liabilities carried at fair value	–	419.3	61.3	480.6

All amounts are stated in £m unless otherwise indicated

26. Fair values of financial assets and liabilities continued

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
As at 31 December 2014				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	–	3.9	–	3.9
Designated at fair value:				
Loans and advances to customers	–	164.7	6.7	171.4
Investment securities	1,236.9	–	–	1,236.9
Available for sale financial assets:				
Investment securities	2,828.6	–	–	2,828.6
Equity shares	0.1	2.7	–	2.8
Derivative financial instruments	–	289.5	–	289.5
Non-financial assets				
Investment properties	–	–	2.1	2.1
Total assets carried at fair value	4,065.6	460.8	8.8	4,535.2
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	–	263.8	–	263.8
Amounts owed to other Co-operative Bank undertakings	–	–	1,126.0	1,126.0
Derivative financial instruments	–	595.5	–	595.5
Total liabilities carried at fair value	–	859.3	1,126.0	1,985.3

26. Fair values of financial assets and liabilities continued

The carrying values of financial instruments measured at fair value are determined in compliance with the accounting policies in note 1 of the Bank financial statements 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 primarily relate to Corporate loans of £159.1m (2014: £164.7m) which are fair valued through profit or loss 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

Over-the-counter (i.e. 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.

Equity shares

Equity shares relate to investments held in VocaLink Holdings Limited which are unquoted shares. The valuation of VocaLink is based on the Bank's percentage shareholding and the net asset value of the consolidated Group according to its most recently published financial statements.

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 £5.5m (2014: £6.7m) which are fair valued through profit or loss using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has decreased the valuation by £0.2m in 2015 (2014: £0.5m decrease). A reasonable change in the assumptions would not result in any material change in the valuation.

Investment securities – available for sale

Investment securities – available for sale include MBS of £1,599.8m (2014: nil), which are fair valued through other comprehensive income. The Company uses an independent third party valuation agent which provides prices obtained from large financial institutions. The prices are indicative values only and do not represent an offer to purchase the securities.

The Bank own a significant portion of the MBS issuance and the trading volume of the remaining portions in the market is not readily available.

These MBS represent the Bank's interest in unconsolidated structured entities.

A 1% increase or decrease in the price of the notes will result in the value increasing or decreasing by approximately £16m respectively.

All amounts are stated in £m unless otherwise indicated

26. Fair values of financial assets and liabilities continued

Equity shares

Equity shares include the Company's share in Visa Europe Limited, which are classified as available for sale, with any movements in fair value being recognised through other comprehensive income. The fair value of the Visa Europe share has been calculated based on an offer to purchase the Company's share, which has been accepted, and is expected to complete during 2016. The fair value of the consideration offered has been considered when calculating the fair value of the Visa Europe share.

If the illiquidity premium to the discount rate was assumed to be double (2% instead of 1%), it would result in a reduction in the overall fair value of the equity shares of £2.6m (5%) at 31 December 2015. Therefore, this valuation model is not deemed to be materially sensitive to this input, with a 100% increase resulting in a 5% change in valuation.

Investment properties

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

Amounts owed to other Co-operative Bank undertakings

Amounts owed to Co-operative Bank undertakings are to the Silk Road Finance Number One plc (Silk Road 1) subsidiary, relating to the legal transfer of loans and advances on securitisation. Silk Road 1 was liquidated in 2015.

Derivative liabilities

As part of a synthetic securitisation structure the Bank has entered into credit default swaps with two of its subsidiaries, Platform Funding Ltd and Calico Finance Number One Limited. The CDSs are valued by an independent third party value agent and are subject to a range of estimations which include recovery rates, the mortgage portfolio hazard rate and mortgage portfolio correlation, all of which introduce uncertainty to the estimation of the fair value. As these CDSs are wholly internal to the consolidated Bank, there are no external parties or markets affected by the valuation assumptions. Under certain circumstances the option exists to call the externally issued notes early and collapse the structure, at which point the notional amount of the derivatives would contractually revert to zero without any break fees payable by any of the companies involved. The methodology applied by the Bank provides a best estimate of the fair value of the CDSs given the inherent uncertainties.

A significant assumption in the modelling is the correlation level between the mezzanine tranche and the other tranches in the structure. If the assumed correlation changes by 10%, the valuation is estimated to decrease (for a higher correlation) or increase (for a lower correlation) by approximately 9%.

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, transfers out and repayments**	**Other comprehensive income**	**Income Statement**	**Fair value at the end of the year**
As at 31 December 2015						
Loans and advances to customers	**6.7**	**–**	**(1.0)**	**–**	**(0.2)**	**5.5**
Derivative assets	**–**	**–**	**–**	**–**	**–**	**–**
Derivative liabilities	**(67.5)**	**–**	**–**	**–**	**6.2**	**(61.3)**
Investment securities	**–**	**1,685.5**	**(86.8)**	**1.1**	**–**	**1,599.8**
Equity shares	**–**	**–**	**–**	**51.2**	**–**	**51.2**
Investment properties	**2.1**	**–**	**(0.1)**	**–**	**0.1**	**2.1**
Amounts owed to other Co-operative Bank undertakings	**(1,126.0)**	**–**	**1,088.3**	**–**	**37.7**	**–**
	(1,184.7)	**1,685.5**	**1,000.4**	**52.3**	**43.8**	**1,597.3**

	Fair value at the beginning of the year	Purchases and transfers in	Sales, transfers out and repayments	Other comprehensive income	Income Statement	Fair value at the end of the year
As at 31 December 2014 (restated)[1]						
Loans and advances to customers	8.7	–	(1.5)	–	(0.5)	6.7
Derivative assets	10.6	–	(10.6)	–	–	–
Derivative liabilities	(76.1)	–	26.1	–	(17.5)	(67.5)
Investment securities	–	–	–	–	–	–
Equity shares	–	–	–	–	–	–
Investment properties	1.9	–	–	–	0.2	2.1
Amounts owed to other Co-operative Bank undertakings	(1,466.4)	–	343.3	–	(2.9)	(1,126.0)
	(1,521.3)	–	357.3	–	(20.7)	(1,184.7)

1. The 2014 comparative figures have been recalculated to bring these in line with the methodology used in 2015.

All amounts are stated in £m unless otherwise indicated

26. 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 in note 1 of the Bank financial statements.

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.

	Carrying value	Fair value
As at 31 December 2015		
Financial assets		
Loans and advances to banks	**452.1**	**452.1**
Loans and advances to customers	**12,302.9**	**12,309.1**
Fair value adjustments to hedged risk	**94.0**	**94.0**
Investment securities	**66.1**	**70.5**
Amounts owed to other Co-operative Bank undertakings	**8,195.0**	**8,247.5**
Other assets	**192.8**	**192.8**
Financial liabilities		
Deposits by banks	**715.9**	**715.9**
Customer accounts	**23,135.3**	**23,140.4**
Debt securities in issue	**1,005.7**	**1,063.1**
Other borrowed funds	**459.9**	**498.7**
Amounts owed to other Co-operative Bank undertakings	**3,186.4**	**3,215.6**
Other liabilities	**44.8**	**44.8**

	Carrying value	Fair value (restated)[1]
As at 31 December 2014		
Financial assets		
Loans and advances to banks	670.1	670.1
Loans and advances to customers	15,800.9	15,655.8
Fair value adjustments to hedged risk	150.8	150.8
Investment securities	73.5	78.9
Amounts owed to other Co-operative Bank undertakings	12,599.2	12,352.3
Other assets	221.6	221.6
Financial liabilities		
Deposits by banks	605.1	605.1
Customer accounts	28,820.4	28,831.7
Debt securities in issue	1,433.1	1,469.9
Other borrowed funds	196.4	223.2
Amounts owed to other Co-operative Bank undertakings	4,907.0	4,934.1
Other liabilities	152.9	152.9

1. The 2014 comparative fair value of customer accounts has been recalculated to bring these in line with the methodology used in 2015.

26. 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 amortised cost value of all loans and advances to banks are deemed to be a close approximation of their fair value 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 in total is circa 100% of the carrying value as at 31 December 2015.

The fair value of loans and advances to customers is calculated by segmenting the overall balance into Retail 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. The market rate applied in the calculation is the average market rate for new originations of mortgages with similar characteristics to the book of mortgages being valued. This rate is assumed to encompass the time value of money, plus a risk premium to account for the inherent uncertainty in the timing and amount of future cash flows arising from a book of mortgage assets.

Forecast principal repayments are based on redemption at the earlier of maturity or re-pricing 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 that there would be no other factors which market participants would take into account when assessing the fair value of the Retail mortgage assets. It is assumed there is no fair value adjustment required in respect of interest rate movement on standard variable rate mortgage assets, as the interest rate being charged is assumed to be equal to the market rate for those mortgage assets.

ii. Corporate

As part of the implementation of the Bank's strategy for Non-core assets, certain assets have either already been sold after the 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 cash flow income approach has been used. Under this approach, value is measured by determining expected cash flows, derived using redemption profiles, from the portfolio and then considering credit costs, funding costs and tax to derive equity cash flows which are discounted at an appropriate blended cost of capital. The blended cost of capital is taken as an average of quoted cost of capital of the five largest listed banks in the UK, as this is assumed to represent the rate at which market participants would discount the future cash flows of a portfolio of corporate loans when assessing the fair value of such a portfolio.

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.

Amounts owed to other Co-operative Bank undertakings

Amounts owed by other Co-operative Bank undertakings include debt securities and subordinated debt held in the Bank's own securitisation vehicles. Fair value is based on available market prices, where these are not available quoted market prices for similar debt securities, with adjustments to take into account the subordination of the particular loan note, have been used to estimate fair value.

Debt securities in issue and other borrowed funds

The aggregate fair values 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. Quoted prices may be from inactive markets.

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.

Amounts owed to other Co-operative Bank undertakings

Amounts owed to other Co-operative Bank undertakings relate to deemed loans owed to the Bank's own securitisation vehicles, these have been modelled using expected cash flows, based on redemption profiles, discounted at a market rate.

Fair values of financial assets and liabilities which are not carried at fair value and bases of valuation

Fair values are determined according to the hierarchy set out above.

All amounts are stated in £m unless otherwise indicated

26. Fair values of financial assets and liabilities continued

	Carrying value	Level 1	Level 2	Level 3
As at 31 December 2015				
Financial assets				
Loans and advances to banks	**452.1**	**–**	**452.1**	**–**
Loans and advances to customers	**12,302.9**	**–**	**–**	**12,309.1**
Fair value adjustment for hedged risk	**94.0**	**–**	**–**	**94.0**
Investment securities	**66.1**	**70.5**	**–**	**–**
Amounts owed to other Co-operative Bank undertakings	**8,195.0**	**–**	**853.3**	**7,394.2**
Financial liabilities				
Deposits by banks	**715.9**	**–**	**715.9**	**–**
Customer accounts	**23,135.3**	**–**	**23,140.4**	–
Debt securities in issue	**1,005.7**	**401.3**	**661.8**	**–**
Other borrowed funds	**459.9**	**–**	**498.7**	**–**
Amounts owed to other Co-operative Bank undertakings	**3,186.4**	**–**	**–**	**3,215.6**

The carrying amount is a reasonable approximation of fair value for the following assets and liabilities: loans and advances to banks, other assets, deposits by banks and other liabilities.

	Carrying value	Level 1 (restated)[1]	Level 2 (restated)[1]	Level 3
As at 31 December 2014				
Financial assets				
Loans and advances to banks	670.1	–	670.1	–
Loans and advances to customers	15,800.9	–	–	15,655.8
Fair value adjustment for hedged risk	150.8	–	–	150.8
Investment securities	73.5	78.9	–	–
Amounts owed to other Co-operative Bank undertakings	12,599.2	–	5,203.3	7,149.0
Financial liabilities				
Deposits by banks	605.1	–	605.1	–
Customer accounts	28,820.4	–	28,831.7	–
Debt securities in issue	1,433.1	789.1	680.8	–
Other borrowed funds	196.4	–	223.2	–
Amounts owed to other Co-operative Bank undertakings	4,907.0	–	–	4,934.1

1. The 2014 comparative fair value of customer accounts has been recalculated to bring these in line with the methodology used in 2015 and investment securities has been changed from level 2 to level 1.

d) Fair value of transferred assets and associated liabilities

Assets pledged

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

	Carrying amount of assets not derecognised	Carrying amount of associated liabilities	Fair value of assets not derecognised	Fair value of associated liabilities	Net fair value position
As at 31 December 2015					
Investment securities sold under repurchase agreements	**721.7**	**671.2**	**721.7**	**671.2**	**50.5**
Amounts owed to other Co-operative Bank undertakings sold under repurchase agreements	**–**	**–**	**–**	**–**	**–**

All amounts are stated in £m unless otherwise indicated

26. Fair values of financial assets and liabilities continued

	Carrying amount of assets not derecognised	Carrying amount of associated liabilities	Fair value of assets not derecognised	Fair value of associated liabilities	Net fair value position
As at 31 December 2014					
Investment securities sold under repurchase agreements	280.0	280.0	280.0	280.0	–
Amounts owed to other Co-operative Bank undertakings sold under repurchase agreements	1,141.9	500.3	744.2	500.3	243.9

Assets sold under repurchase agreements include mortgage backed securities (£204.7m of assets and associated liabilities of £159.6m) and UK government gilts (£517.0m of assets and associated liabilities of £511.6m).

27. Company analysis of credit risk exposure

			Investment securities				
2015	**Loans and advances to banks**	**Loans and advances to customers**	**Loans and receivables**	**Available for sale**	**Fair value through income or expense**	**Derivative financial instruments**	**Total**
Analysis of balance in note	4	5	6	6	6	7	
Gross balance	**452.1**	**12,709.8**	**66.1**	**4,296.8**	**582.4**	**193.2**	**18,300.4**
Less: allowance for losses	**–**	**(228.7)**	**–**	**–**	**–**	**–**	**(228.7)**
	452.1	**12,481.1**	**66.1**	**4,296.8**	**582.4**	**193.2**	**18,071.7**
Analysis of credit risk exposure							
Not impaired	**452.1**	**12,107.3**	**66.1**	**4,296.8**	**582.4**	**193.2**	**17,697.9**
Impaired	**–**	**602.5**	**–**	**–**	**–**	**–**	**602.5**
	452.1	**12,709.8**	**66.1**	**4,296.8**	**582.4**	**193.2**	**18,300.4**
Credit commitments	**–**	**2,246.5**	**–**	**–**	**–**	**–**	**2,246.5**
Gross credit risk exposure	**452.1**	**14,956.3**	**66.1**	**4,296.8**	**582.4**	**193.2**	**20,546.9**
Less allowances for losses	**–**	**(228.7)**	**–**	**–**	**–**	**–**	**(228.7)**
Net credit risk exposure	**452.1**	**14,727.6**	**66.1**	**4,296.8**	**582.4**	**193.2**	**20,318.2**

			Investment securities				
2014	Loans and advances to banks	Loans and advances to customers	Loans and receivables	Available for sale	Fair value through income or expense	Derivative financial instruments	Total
Analysis of balance in note	4	5	6	6	6	7	
Gross balance	670.1	16,644.9	73.5	2,828.6	1,236.9	289.5	21,743.5
Less: allowance for losses	–	(345.3)	–	–	–	–	(345.3)
	670.1	16,299.6	73.5	2,828.6	1,236.9	289.5	21,398.2
Analysis of credit risk exposure							
Not impaired	670.1	15,611.8	73.5	2,828.6	1,236.9	287.4	20,708.3
Impaired	–	1,033.1	–	–	–	2.1	1,035.2
	670.1	16,644.9	73.5	2,828.6	1,236.9	289.5	21,743.5
Credit commitments	154.9	2,585.8	–	–	–	–	2,740.7
Gross credit risk exposure	825.0	19,230.7	73.5	2,828.6	1,236.9	289.5	24,484.2
Less allowances for losses	–	(345.3)	–	–	–	–	(345.3)
Net credit risk exposure	825.0	18,885.4	73.5	2,828.6	1,236.9	289.5	24,138.9

Previously, the credit fair value adjustments have been disclosed separately in the above table; the table has now been revised to set off the credit fair value adjustments within the not impaired and impaired gross balances, to better show their gross carrying values in the Company.

The risk management disclosures on pages 98 to 144 apply to the Company where relevant and therefore no additional disclosures are included in this note.

28. Post balance sheet events

It is a requirement of IAS 10 (Events after the balance sheet date) that these financial statements reflect events arising after 31 December 2015. The following events have occurred between 31 December 2015 and 31 March 2016 (the date of approval of these financial statements) and represent 'non adjusting' post balance sheet events:

Acquisition of Britannia Pension Trustees Limited

On 17 March 2016 the Company acquired 100% of the issued share capital of Britannia Pension Trustees Limited from The Co-operative Banking Group Limited for consideration of £1.

Britannia Pension Trustees Limited is the sole trustee of the Britannia Pension Scheme and does not operate any trading activity.

Branch Closures

Board approval for the closure of an additional 54 branches during 2016 was obtained in December 2015 as part of the ongoing simplifiction and cost reduction scheme and in response to a 29% year on year reduction in branch transactions.

Communications of the closures to customers began in January 2016 and expect to be concluded by the end of March 2016. The impact of the closures to the Company will be the recognition of a £8.7m provision relating to closure costs.

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Other information

Shareholder information

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Glossary

For the year ended 31 December 2015

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

Terminology	Definition
Almost prime	Loans to borrowers with very low levels of adverse credit history, originated by Platform prior to September 2013. All loans are 'non-conforming' lending (see Non-conforming).
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.
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.
Banking Group	The Co-operative Banking Group Ltd and its subsidiaries, which included the Bank until legal separation occurred on 20 December 2013.
Basel II	A statement of best practice issued by the Basel Committee on Banking Supervision, that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the FSA Handbook. Basel 2.5 was an interim strengthening of requirements laid out in Basel II, with changes focussing on trading book and securitisations. Basel 2.5 was implemented within the UK in 2011 via the FSA's policy statement PS11/12. References to Basel II within these disclosures in accordance with Basel 2.5.
Basel III	A strengthening of the requirements laid out in Basel II, to be phased into the Bank from 2014 ahead of full implementation by 2022. Basel III is implemented within the UK through CRD IV.
Basis points (bps)	One hundredth of a percent (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 PRA's requirements for capital and liquidity.
BaCB (Business and Commercial Banking)	The Core segment of the Bank which specialises in lending to businesses.
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 1 capital plus Tier 2 capital, all divided by RWAs.
Capital Requirements Directive (CRD IV)	Capital Requirements Directive is a European regulation that applies directly to UK financial institutions, is part of the CRD IV package. Broadly, it contains a supervisory framework to ensure firms are able to meet their liabilities as they fall due, implementing the Basel III set of reform measure.
Capital Requirements Regulation (CRR)	CRR is a European regulation that applies directly to UK financial institutions. Broadly, it implements the Pillar 3 aspects of Basel III in relation to capital adequacy and new liquidity requirements. CRR is part of CRD IV.
Capital resources	Capital held, allowable under regulatory rules, less certain regulatory adjustments and deductions that are required to be made. Capital includes retained earnings, share premium and minority interests.
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 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.

Terminology	Definition
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	Commercial real estate includes office buildings, industrial property, malls, retail stores, shopping centres, multifamily housing buildings, warehouses, and industrial properties.
Common Equity Tier 1	A CRD IV regulatory measure of financial (capital) strength. Common Equity Tier 1 capital is the highest quality of capital and comprises share capital and associated share premium, and general reserves from retained profits. The book values of goodwill and intangible assets as well as other regulatory adjustments, including the full amount of expected loss over provisions, are deducted from Common Equity Tier 1 capital for the purposes of capital adequacy.
Conduct risk	The risk that the Bank'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.
Co-operative Asset Management (CoAM)	The segment that comprises Non-core assets managed for run down or exit.
Co-operative Banking Group Limited (CBGL)	The Co-operative Banking Group Ltd and its subsidiaries, which included the Bank until legal separation occurred on 20 December 2013.
Core business	Lines of business that are consistent with the Bank's strategy and risk appetite.
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 Factor (CCF)	The CCF is an estimate of the proportion of undrawn commitments expected to have been drawn down at the point of default, and is used within the calculation of EAD.
Credit default swap	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.
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 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 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 securities in issue	Transferable certificates of indebtedness of the Bank to the bearer of the certificates. These are liabilities of the Bank 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.
Delinquency	A customer in arrears is also said to be in a state of delinquency. When a customer is in arrears, their 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.

Glossary continued
For the year ended 31 December 2015

Terminology	Definition
Encumbrance	Encumbrance is an impediment to use of assets, for example a claim against a property by another party. Encumbrance usually impacts the transferability of the asset and restrict its free use until the encumbrance is removed.
Ethical Policy	A method developed since 1992 by which the Bank engages with its customers in relation to ethics.
Eurozone	The geographical area containing countries whose economies function using the European single currency.
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 Pillar 1 parameter the amount estimated to be outstanding at the time of default – EAD calculated under the standardised approach is always reported post credit conversion factors and provisions. Under the IRB approach the EAD includes undrawn commitments after credit conversion factors.
External audit	An independent opinion, by an external firm, on the Bank and Company's financial statements.
External credit rating	A financial indicator of risk, assigned by credit rating agencies, to potential investors in the Bank.
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 Conduct Authority (FCA)	The FSA was replaced as the UK's financial regulator on 1 April 2013 by two new regulatory bodies: the PRA and the FCA. The FCA is responsible for the regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets.
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 regulated the financial services industry. It was replaced as the UK's financial regulator on 1 April 2013 by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).
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 PRA 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 three to 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 were 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).

Terminology	Definition
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.
Individual Capital Guidance (ICG)	The PRA's statement as to the regulatory capital it expects the Bank to hold. ICG is Pillar 1 plus Pillar 2a.
Individually assessed for impairment	Impairment is measured individually for assets that are individually significant.
Individually significant	Large value loans that exceed a balance threshold established by the Bank, above which it is deemed appropriate to impair accounts on an individual basis.
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	Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.
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 (IRB)	Internal Ratings Based is the approach used for measuring exposure to credit risks. IRB approaches are more sophisticated and risk sensitive than the Standardised Approach and may be Foundation or Advanced. IRB approaches may only be used with PRA permission.
Investment grade	A debt security, treasury bill or similar instrument with a credit rating measured by external agencies of AAA to BBB.
Legal separation	The process by which the Bank was legally separated from The Co-operative Group.
Leverage ratio	A CRD IV measure, calculated as the ratio of Tier 1 capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives. The leverage ratio is a supplementary measure to the risk based capital requirements and is intended to constrain the build-up of excess leverage in the banking sector.
Liability Management Exercise (LME)	The process by which the Bank successfully raised c.£1.2bn of capital in 2013. This was effected by the transfer of preference shares and extinguishment of multiple subordinated liabilities, followed by the recognition of a single tranche of subordinated debt.
LIBOR (London Interbank Offered Rate)	The interest rate participating banks offer to other banks for loans on the London market.
Limited Liability Partnership (LLP)	An LLP provides each of its individual partners protection against personal liability for certain partnership liabilities.
Liquid Asset Buffer (LAB)	A range of assets from which the Bank can manage its liquidity risk. These assets have relatively short maturity dates.
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 Coverage Ratio (LCR)	A liquidity metric that aims to ensure that a bank has an adequate stock of unencumbered high quality liquid assets to meet its liquity needs for a 30 calendar day liquidity stress scenario.
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 emergence period	The time taken, expressed in months, for a loss event on a loan to become observed by the Bank.
Loss Given Default	Loss Given Default is a Pillar 1 parameter and represents an estimate of the actual loss that would occur in the event of default expressed as a percentage of the EAD.
Loss provisions	Provisions held against assets on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. The allowance represents management's best estimate of losses incurred in the loan portfolio at the balance sheet date.
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)).

Terminology	**Definition**
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.
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.
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.
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).
Mortgage backed securities (MBS)	Securities that represent interests in a group of mortgages. Investors in these securities have the right to cash received from future interest and/or principal mortgage payments.
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 up to September 2009, and those acquired by Britannia Treasury Services, which did not conform to regular credit standards and all Almost Prime lending (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.
Optimum	A sub-segment within CoAM 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.
Past due	When a counterparty has failed to make a payment when contractually due.
Pension risk	The risk to Bank 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, non-cumulative and irredeemable.
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. Bonds with no maturity date that do not require the issuer to redeem.
Project Verde	The bid to purchase the Verde business from the Lloyds Banking Group. Also referred to as Project Mars.
Prudential Regulation Authority (PRA)	The FSA was replaced as the UK's financial regulator on 1 April 2013 with two new regulatory bodies: the PRA and the FCA. The PRA, a subsidiary of the Bank of England, is responsible for promoting the stable and prudent operation of the financial system through regulation of all deposit-taking institutions, insurers and investment banks.
Recapitalisation Plan	The process by which the Bank is improving its capital position in line with regulatory guidance.
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.

Terminology	Definition
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 Bank either through its strategic decisions, business performance, an operational failure or external perception.
Residential Mortgage Backed Securities (RMBS)	Securities that represent an interest in an underlying pool of residential mortgages.
Return on Equity	The ratio of profit for the year (after tax) to shareholders equity, expressed as a percentage.
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 Bank is willing to accept (or not accept) in order to safeguard the interests of the members whilst achieving its business objectives.
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 (RWA)	Risk Weighted Asset or Risk Weighted Assets, amount of exposure deemed 'at risk' according to PRA prescribed calculation for Pillar 1 capital requirement.
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 Bank 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.
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).
Small and Medium Enterprises (SME) customers	Small and medium sized businesses engaging with the Bank as customers.
SONIA	Sterling OverNight Index Average (SONIA). Yield curves used by the Bank for swap arrangements. These are based on overnight indexed rates.
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.

Glossary continued
For the year ended 31 December 2015

Terminology	Definition
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.
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 Asset Review	The process by which the Bank centrally monitors risk on its corporate loan assets in line with agreed strategy and governance parameters.
Strategic and business 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.
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.
Term deposit	A deposit balance that cannot be withdrawn before a date specified at the time of deposit.
The Bank	The Co-operative Bank and its subsidiaries.
The Banking Group	See 'The Co-operative Banking Group'.
The Board	The Board of Directors. They manage the Bank's business performance in line with its purpose, givens, vision and values.
The Company	The Co-operative Bank as a standalone entity.
The Co-operative Banking Group	The Co-operative Banking Group Ltd and its subsidiaries, which included the Bank until legal separation occurred on 20 December 2013.
The Co-operative Group	The former ultimate parent company of the Bank, pre legal separation.
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 share capital and associated share premium, and general reserves from retained profits. The book values of goodwill and intangible assets are deducted from Core Tier 1 capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as perpetual subordinated bonds are included in other Tier 1 capital.
Tier 1 ratio	Tier 1 capital divided by RWAs.
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.
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 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 Bank's external auditor.
Unfunded pension scheme	Pension scheme which has liabilities and no assets. The Bank will pay the liabilities of the scheme as they fall due.
Unsecured lending	Lending for which there is no collateral for the loan.
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.

Terminology	Definition
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).

Forward-looking statements

Certain terms

The term the 'Bank' means The Co-operative Bank plc together with its consolidated subsidiaries. The term 'Company', refers to The Co-operative Bank plc.

In this report the abbreviations '£m' represent millions of pounds sterling.

Unless otherwise stated, the income statement analyses and compares the 12 months to 31 December 2015 to the corresponding 12 months of 2014 and balance sheet comparisons, related to the corresponding position as at 31 December 2014. Unless otherwise stated, all disclosed figures relate to continuing operations. Relevant terms that are used in this document but are not defined under applicable regulatory guidance or International Financial Reporting Standards (IFRS) are explained in non-IFRS measures below.

Non-IFRS measures

Certain non-IFRS measures are provided within the Annual Report and Accounts. These can be found mainly (but not exclusively) on the detailed financial review and the detailed Key Performance Indicators pages.

Forward-looking statements

This document contains certain forward-looking statements with respect to certain of the Bank's strategy, plans and its current goals and expectations relating to its future financial condition and operating performance. The Bank cautions readers that no forward-looking statement is a guarantee of future performance and that actual results could differ materially from those contained in the forward-looking statements. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. Forward-looking statements sometimes use words such as 'may', 'will', 'seek', 'continue', 'aim', 'anticipate', 'target', 'projected', 'expect', 'estimate', 'intend', 'plan', 'goal', 'believe', 'achieve', 'predict', 'should' or in each case, their negative or other variations or comparable terminology, or by discussion of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. Examples of forward-looking statements include, among others, statements regarding the Bank's future financial position, income growth, assets, impairment charges, business strategy, capital ratios, leverage, payment of dividends, the industry in which the Bank operates, projected costs, commitments in connection with the 2016-2020 Updated Plan, estimates of capital expenditures and plans and objectives for future operations and other statements that are not historical fact.

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

Readers are advised to read, in particular, the Principal risks and uncertainties section in the Strategic report starting on page 5 for a summary of factors that could affect the Bank's future performance. In light of these risks, uncertainties and assumptions, the events and targets described in the forward-looking statements in this document may not occur.

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

Appendix 1
EDTF recommendations
For the year ended 31 December 2015

The table below provides an index to the Bank's disclosures in accordance with the EDTF's recommendations either within its Annual Report and Accounts or Pillar 3 disclosures.

Type of risk	Recommendation	Disclosure	Section in Pillar 3	Section in Risk Management ARA	Other sections of the accounts
General	1	Risks to which the business is exposed	5	Risk Management objectives and policies	Strategic review
	2	Definition of risk terminology, principles and appetite	5		
	3	Top and emerging risks and the changes during the reporting period	5		
	4	Analysis of future regulatory developments affecting our business model and the Bank's profitability	5		
Risk governance and risk management	5	The Bank's risk management organisation, process and key functions	4	Risk Management objectives and policies Capital Management	Strategic review
	6	Risk culture and risk governance and ownership	4		
	7	Key risks, risk appetite and risk management	4, 5		
	8	Stress testing and the underlying assumptions	3		
Capital adequacy	9	Minimum Pillar 3 disclosure requirements	3	Capital Management	
	10	Reconciliation of accounting balance sheet to regulatory balance sheet	3		
	11	Flow statement of movements in regulatory capital since the previous reporting period including changes in Common Equity Tier 1, Tier 1 and Tier 2 Capital	3		
	12	Discussion of targeted level of capital and how this will be established	1,3,5		
	13	Analysis of Risk Weighted Assets	3		
	14	Analysis of capital requirements for each Basel asset class	3		
	15	Analysis of credit risk for each Basel asset class	3		
	16	Flow statements reconciling the movements in Risk Weighted Assets for each Risk Weighted Asset type	3		
	17	Discussion of Basel credit risk model performance	5		
Liquidity and funding	18	Analysis of the Bank's liquid asset buffer	5	Liquidity 2.4	
	19	Encumbered and unencumbered assets analysed by balance sheet category	5	Liquidity 2.6	
	20	Consolidated total assets, liabilities and off-balance sheet commitments analysed by remaining contract maturity at the balance sheet date	5	Liquidity 2.5	
	21	Analysis of the Bank's sources of funding	5	Liquidity 2.4	
Market risk	22	Relationship between the market risk measures for trading and non-trading portfolios and the balance sheet	5	Market risk 3.1	
	23	Discussion of trading significant trading and non-trading market risk factors	5	Market risk 3.4	
	24	VaR assumptions, limitations and validation	5	Market risk 3.1	
	25	Description of the primary risk management techniques employed by the Bank	5	Market risk 3.4	

Appendix 1
EDTF recommendations continued
For the year ended 31 December 2015

Type of risk	Recommendation	Disclosure	Section in Pillar 3	Section in Risk Management ARA	Other sections of the accounts
Credit risk	26	Analysis of the aggregate credit risk exposures	5	Credit risk 1.1, 1.2, 1.3	Note 16: loans and advances to banks
	27	Describe the policies for identifying impaired and non-performing loans	5	Credit risk 1.1	Note 17: loans and advances to customers
	28	Reconciliation of the opening and closing balances of non-performing or impaired loans in the period	5	Credit risk 1.1	Note 18: investment securities
	29	Analysis of counterparty credit risk that arises from derivative transactions	5	Credit risk 1.2	Note 19: derivative financial instruments
	30	Discussion of credit risk mitigation, including collateral held for all sources of risk	5	Credit risk 1.1, 1.2, 1.3	
Other risks	31	Description of other risks	5	4-11	Note 32: Provisions for liabilities and charges
	32	Discussion of publicly known risk events	5	4-11	Note 34: Pensions Note 35: Contingent liabilities and commitments

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