

The **co-operative** bank  
good with money

The Co-operative Bank plc  
Interim financial report 2010



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## Highlights

- Co-operative Bank profit before tax, distributions and fair value amortisation was £58.2m (2009: £24.9m)
- Profit before distributions and tax was £35.6m (2009: £24.9m)
- Balance sheet assets of £45.7bn (December 2009: £46.1bn), with customer lending maintained and asset quality improved
- New lending to consumers £1.1bn and businesses £0.4bn
- Bank capital ratio of 13.2% and core tier 1 ratio 8.7% (December 2009: 13.5% and 8.7% respectively)
- Strong growth in customer deposits of £1.4bn (4.2%) in the first half of 2010
- Increased customer funding ratio of 110% (December 2009: 104%)
- Recognised as the World's Most Sustainable Bank by the Financial Times
- Successful integration of two complementary businesses over the last twelve months
- Full-year synergy target (following the merger last year) is on track to be exceeded
- Successful implementation of market-leading business banking suite, the first release of a programme to transform CFS's banking capability

Our strategy is made up of our purpose, givens, values, vision and our business plans. Together they help define us as a business, set the direction and inform the decisions we make and how we behave.

### Our **purpose**

Our purpose is to be a pioneering business delivering sustainable financial services for members and society.

### Our **givens**

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

### Our **values**

Our values describe what is important to our organisation and guide our behaviours by determining how we interact with each other and our customers. By living our values, we will deliver a consistent and positive customer experience every time.

### **As a co-operative business:**

- we put our members and customers first in all we do;
- we take personal and social responsibility;
- together we will create a great place to work, grow and develop;
- we strive relentlessly to be faster, better, more successful; and
- we are open and fair and are committed to excellent communication.

### Our **vision**

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

## Business and financial review

In a world where the traditional financial services model has been tested and found wanting, the Co-operative Bank and its parent, the Co-operative Financial Services (CFS) are proud to be different. As a member-owned, customer-led and ethically-guided business, the Co-operative Bank has increasingly differentiated itself by its prudent financial stewardship, its consistent approach to customer service and its concern for its impact, not just on customers but on communities and the environment as a whole. This 'co-operative difference' was recently recognised by the Financial Times in naming CFS the World's Most Sustainable Bank.

As a sustainable alternative to the traditional financial services model, the Co-operative Bank has shown itself well placed to capitalise on current market conditions. Despite macro-economic concerns around growth and unemployment and the challenges of a low interest rate environment, the Co-operative Bank has benefited from the diversity of its businesses, its strong brands together with the stability of its customer relationships and comprehensive product range, supported by a flexible distribution model.

Over the last twelve months, following the merger with Britannia Building Society, the Co-operative Bank has successfully integrated two complementary businesses. The early establishment of a single executive, strategy and senior management structure allowed the business to move quickly beyond stabilisation into transformation.

This far-reaching process encompasses people, processes and systems and is already delivering an enhanced customer experience. An active integration programme, launched in the wake of last year's merger, has already delivered significant cost synergies – indeed the Co-operative Bank is on track to exceed its full-year target. The programme benefits from a strong track record in both heritage businesses and good progress is being made in moving towards an integrated customer proposition.

Looking to the longer term, a fundamental organisation design process has been successfully implemented, while the transformation of the Co-operative Bank's banking systems infrastructure has commenced with the implementation of a market-leading business banking suite. Significant further investment is planned to ensure that the Co-operative Bank's infrastructure matches the CFS ambition to be the UK's most admired financial services business.

### Highlights

Profit before tax, distributions and fair value amortisation to the half year of £58.2m is £33.3m higher than the first half of 2009.

These results reflect the merger with Britannia, business success in strengthening underlying profitability despite the challenges of the current economic environment and the ongoing weakness in the financial services sector in particular. In addition, underlying capital and liquidity positions remain strong, laying the foundations for stable growth.

The Co-operative Bank's capital ratio was 13.2%, with a tier 1 ratio of 9.0% and a core tier 1 ratio of 8.7%. This is substantially unchanged from December 2009, illustrating a robust ongoing capital position. Customer deposits have seen excellent growth of £1.4bn (4.2%) in the first half of 2010 reflecting 97% retention of fixed-rate ISA balances and the attraction of significant new funds, whilst a customer-funding ratio of 110% shows a substantial increase (104% at December 2009).

Profit before tax was £28.9m, 16.1% ahead of the first half of 2009. First half profits reflect a charge of £22.6m for the amortisation of fair values which were created at the time of the merger.

In the first half of 2010 a profit distribution of £6.7m has been made to the Co-operative Group for payment to individual members based on their transactions with CFS for the period to 31 December 2009. In 2009, the dividend was recognised in the second half of the year. This does not include a distribution to ex-Britannia members, who received a payment of £19.0m in March 2010 in relation to the year ended 31 December 2009; this was provided for in the Britannia Building Society cessation accounts for the period to 31 July 2009.

**The Co-operative Bank operating result and profit before taxation**

	<b>2010</b>	2009	Change	Change
	<b>£m</b>	£m	£m	%
Income	<b>403.2</b>	295.7	107.5	36.4%
Operating costs – steady state	<b>(265.6)</b>	(175.6)	(90.0)	-51.3%
Operating costs – strategic initiatives	<b>(15.2)</b>	(5.4)	(9.8)	-181.5%
Impairment losses	<b>(43.0)</b>	(73.0)	30.0	41.1%
<b>Operating result</b>	<b>79.4</b>	41.7	37.7	90.4%
Significant items	<b>(18.3)</b>	(14.6)	(3.7)	-25.3%
Share of post-tax profits from joint ventures	<b>0.4</b>	–	0.4	–
Financial services compensation scheme levies	<b>(3.3)</b>	(2.2)	(1.1)	-50.0%
<b>Profit before tax, distributions and fair-value amortisation</b>	<b>58.2</b>	24.9	33.3	133.7%
Fair-value amortisation	<b>(22.6)</b>	–	(22.6)	–
<b>Profit before taxation and distributions</b>	<b>35.6</b>	24.9	10.7	43.0%
Membership dividend	<b>(6.7)</b>	–	(6.7)	–
<b>Profit before taxation</b>	<b>28.9</b>	24.9	4.0	16.1%

Total operating result was £79.4m compared with £41.7m in the first half of 2009.

Income and operating results show growth of 36.4% and 90.4% respectively. The 2010 figures include the Britannia business for the half year, with 2009 figures reflecting the heritage CFS business (pre-merger) only. In addition, the 2010 half year covers a period of 26 weeks, while 2009 figures reflect a 28-week period.

The growth in both income and costs reflects the increase in scale of the business post merger, although it is noteworthy that impairment has fallen by 41.1% in 2010. This reflects a combination of improved arrears collection processes and tightening of credit-risk scorecards in the unsecured lending business, together with continued focus on credit quality within corporate banking. These figures represent a favourable result in the current economic climate.

On a like-for-like basis (comparing 26 weeks of the first half of 2009 and including Britannia), the Co-operative Bank generated growth in both income (1.9%) and operating results (38.0%), reflecting a robust performance. Banking margins have remained broadly unchanged, with improved mortgage margins offset by the higher costs of term deposit funding.

Like-for-like costs were 1.6% lower than 2009, reflecting rigorous cost management across the business and cost reductions through merger synergy benefits offsetting inflationary pressures. Impairment charges on a like-for-like basis (even before fair-value credit protection) were 7.7% lower than 2009.

Profit before tax, distributions and fair-value amortisation includes £18.3m of significant costs which have been incurred on a major programme of investment and integration and compares with £14.6m for 2009. A cost of £3.3m has been attributed to the Financial Services Compensation Scheme, £1.1m higher than in 2009.

Total balance sheet assets of £45.7bn were £0.4bn lower than the position at 31 December 2009. Customer lending balances have increased, reflecting CFS's continued support to families and small businesses during these difficult times, advancing £1.1bn to mortgage customers and £0.4bn to businesses. The increase in customer deposits of £1.4bn (4.2%) has enabled CFS to reduce its dependency on funding from the wholesale markets. In addition, the issuance of a £2.5bn securitisation in early 2010 has provided an additional source of term-funding.

**Our businesses**

CFS consists of two main segments – **Retail** and **Corporate and Markets**.

The Retail business offers a range of financial products and services to individuals, households and small businesses throughout the UK, trading as The Co-operative Bank, Britannia and **smile**.

Corporate and Markets (CAM) is the business-to-business part of CFS and includes corporate banking, Platform, Optimum, treasury and business services.

Other includes the results of Unity Trust Bank and central costs.

## Business and financial review

### Operating result by business segment

	<b>2010</b>	2009	Change	Change
	<b>£m</b>	£m	£m	%
Retail	–	0.7	(0.7)	-100.0%
CAM	<b>80.4</b>	37.3	43.1	115.5%
Other	<b>(1.0)</b>	3.7	(4.7)	-127.0%
<b>Operating result</b>	<b>79.4</b>	41.7	37.7	90.4%

### Retail

#### Operating result

	<b>2010</b>	2009	Change	Change
	<b>£m</b>	£m	£m	%
Net interest income	<b>167.3</b>	120.1	47.2	39.3%
Non-interest income	<b>77.2</b>	70.4	6.8	9.7%
<b>Net income</b>	<b>244.5</b>	190.5	54.0	28.3%
Operating costs – steady state	<b>(201.3)</b>	(136.0)	(65.3)	-48.0%
Operating costs – strategic initiatives	<b>(12.2)</b>	(4.6)	(7.6)	-165.2%
Impairment losses	<b>(31.0)</b>	(49.2)	18.2	37.0%
<b>Operating result</b>	<b>–</b>	0.7	(0.7)	-100%

Total Retail operating result reflected a break even position in difficult markets, only £0.7m lower than 2009 despite the low interest-rate environment and the consequent shift in customer behaviour, which has been reflected in lower current account commissions and lower credit card spend and balances. This, however, includes the increased costs of project expenditure which are expected to generate future benefits; excluding these costs, operating profit was £6.9m higher than 2009.

The improvement in net interest income largely reflects the inclusion of Britannia. On a like-for-like basis, net interest income has fallen reflecting changes in the interest-rate environment and the impact of floors on savings balances. Mortgage balances remain strong, with June 2010 applications surpassing the record for either heritage business in a single month. Average loan to value ratios remain below 50% across the retail business.

Mortgage margins have improved, but this has been offset by the cost of maintaining higher, mainly term, liability balances to ensure a strong liquidity position and by a decline in credit card balances and yields reflecting the change in customer behaviour due to the recession.

Non-interest income has improved due to the inclusion of Britannia, partially offset by lower income from the independent financial advisor subsidiary, reflecting difficult market conditions and lower merchant interchange fees as customers' credit card spend declines.

Impairment losses have significantly improved compared with 2009 reflecting improved arrears collection processes and a tightening of credit-risk scorecards in the unsecured book. Mortgage quality has been maintained with continued low rates of impairment.

The strength of the retail customer proposition has once again been recognised by a number of awards. CFS was named a 'recommended provider' by Which? Magazine, and won multiple categories at the Moneywise Customer Service awards. The Co-operative Bank received the highest rating from the Forrester UK bank website benchmarking survey (beating NatWest, Santander, Barclays, Lloyds TSB and Halifax).

**Corporate and Markets (CAM)****Operating result**

	<b>2010</b>	2009	Change	Change
	<b>£m</b>	£m	£m	%
Net interest income	<b>135.6</b>	75.0	60.6	80.8%
Non-interest income	<b>17.4</b>	22.5	(5.1)	-22.7%
<b>Net income</b>	<b>153.0</b>	97.5	55.5	56.9%
Operating costs – steady state	<b>(59.2)</b>	(35.9)	(23.3)	-64.9%
Operating costs – strategic initiatives	<b>(3.0)</b>	(0.8)	(2.2)	-275.0%
Impairment losses	<b>(10.4)</b>	(23.5)	13.1	55.7%
<b>Operating result</b>	<b>80.4</b>	37.3	43.1	115.5%

CAM business profitability has more than doubled to £80.4m, an increase of £43.1m compared with 2009, driven by a significant improvement in underlying performance and the merger with Britannia. During 2010, CAM continued its focus on a balanced approach to lending and deposit growth resulting in £0.7bn of new customer lending and a £0.8bn increase in customer deposits.

**Corporate banking**

The continued focus on credit quality has resulted in lower impairment charges. The economic recovery remains fragile and corporate colleagues continue to support customers wherever possible in difficult times. Corporate banking has been successful in controlling its cost base whilst growing the business. These benefits have been partially offset by slightly reduced like-for-like net income in the period, reflecting the higher cost of term funding. The results also reflect continued robust lending margins and significant customer deposits growth in the period.

**Optimum and Platform**

In the period since merger, the Platform intermediary business has demonstrated success as a prime and selective specialist lender. Controlled growth has allowed Platform to write good quality prime business and be selective with prudent loan-to-value criteria.

During the first half of 2010, overall arrears in the Optimum portfolio (a closed book of pre-merger intermediary and acquired loan book assets) have continued to improve. The number of new arrears cases has fallen as the business experiences success with continuing investment and focus on existing cases. This enables customers to repair their arrears position and credit record.

**Treasury**

Treasury has successfully maintained high levels of liquidity from diversified funding sources. Like-for-like treasury performance is broadly in line with 2009. Higher term-funding costs for new debt issues have been offset by active management of the costs of the back book of secured funding. Treasury was successful in issuing a £2.5bn securitisation in early 2010 providing an additional source of term-funding for the business as a whole.

**Business services**

Business services was formed on 1 January 2010, bringing together the provision of fee income generating services such as agency banking, business Visa and purchasing card processing schemes, third-party mortgage processing and overseas payments.

In the first half of 2010 it has grown the customer base for Visa/government purchasing card schemes and established a major new third-party mortgage master-servicing contract.

**Summary and outlook**

Despite the continuing pressures on the UK economy and financial services industry, the Co-operative Bank has delivered a strong half-year performance. Profits have strengthened across the business, supported by a strong brand and a business model which reflects complementary business divisions. Operating results are up 90% to £79.4m.

Our reputation for prudence and financial stability is strongly underpinned by a capital position that sets the platform for future growth without compromising customer interests. Like-for-like costs have reduced year on year and impairment is significantly improved. Strong liquidity and capital reserves mean that the Co-operative Bank is in a position to pursue a strategy of growth and investment over the coming years.

The Co-operative Bank is now well on with its business integration programme, which will be rolled out over the next three years and will deliver the infrastructure to take an increasingly proactive role in tomorrow's markets. As the UK's most diversified mutual financial service provider the Co-operative Bank will continue to integrate the range of customer access points in order to offer a single, seamless customer proposition. As UK consumers increasingly question the financial services 'status quo', our member-owned, customer-led and ethically-guided business model is well placed to establish itself as the UK's most admired financial services provider.

# Principal risks

All amounts are stated in £m unless otherwise indicated

The Disclosure and Transparency Rules (DTR 4.2.7) require that a description of the principal risks and uncertainties are given in the interim financial report in respect of the remaining six months of the financial year. These risks are consistent with those described in the Bank's risk management section of the 2009 financial statements on pages 53 to 88. The principal risks that the Bank faces for the second half of 2010 are:

## Credit risk

Credit risk is the current or prospective risk to earnings and capital arising from an obligor's failure to meet the terms of any contract with the Bank or its failure to perform as agreed.

The Bank's credit risk management policies are approved by the risk management committee (RMC) (delegated authority from the Board) annually and are the responsibility of the banking risk officer. The policies determine the criteria for the management of retail, corporate and wholesale risk, including securitisation, market exposures and credit management standards, including country, sector and counterparty limits, along with risk appetites and delegated authorities.

All authority to take credit risk derives from the Board. This is delegated to individuals via the chief executive. The level of credit risk authority delegated depends on seniority and experience, varying according to the quality of the counterparty or any associated security or collateral held.

The Bank's personal lending policy is to establish credit criteria which determine the balance between volume growth (generating higher income) and higher bad debts, so as to optimise overall profitability relative to the Board's risk appetite and the Bank's co-operative values and principles. The quality of the overall portfolio and individual customers are monitored using risk rating systems and scorecards calibrated to risk of default and expected loss, and the Board receives an update on bad debt monthly. The RMC receives regular detailed reports on the performance of the portfolio.

The Bank's corporate sector policy is to maintain a broad sectoral spread of exposures which reflect the Bank's areas of expertise. Credit exposures to corporate and business banking customers are assessed individually. The quality of the overall portfolio is monitored using a credit grading system calibrated to expected loss. All aspects of credit management are controlled centrally. The RMC receives regular detailed reports on the performance of the portfolio. The exposures committee receives regular reports on new facilities, bad debt provisions and the management of problem loans. The Board receives an update on portfolio performance and bad debt monthly.

The Bank's wholesale-market credit-risk framework takes an holistic approach to risk management with, at its centre, a credit-risk policy which governs the types of exposure the business can take and sets concentration parameters. To complement this, individual authority is delegated in terms of internal rating grade (IRG) and associated probability of default (PD) to approve limits to individual counterparties within the parameters established by the credit risk policy. The RMC receives regular detailed reports on the performance of the portfolio. The exposures committee receives regular reports on changes in exposure limits, watchlist and problem counterparty information. The Board receives an update on portfolio performance and bad debt monthly.

Cash and balances at central banks are considered to be risk-free and have been excluded from the following analysis of credit exposure.

	Notes	Gross balance	Credit commitments	Credit-risk exposure
<b>30 June 2010</b>				
Loans and receivables				
Loans and advances to banks		<b>2,318.8</b>	<b>71.7</b>	<b>2,390.5</b>
Loans and advances to customers	5	<b>34,272.9</b>	<b>5,095.8</b>	<b>39,368.7</b>
Investment securities	6	<b>2,197.8</b>	–	<b>2,197.8</b>
Available-for-sale financial assets				
Investment securities	6	<b>3,953.7</b>	–	<b>3,953.7</b>
Derivative financial instruments		<b>953.9</b>	–	<b>953.9</b>
		<b>43,697.1</b>	<b>5,167.5</b>	<b>48,864.6</b>
Allowance for impairment on loans and advances				<b>(203.1)</b>
Impairment losses on investments				<b>(87.7)</b>
<b>Total</b>				<b>48,573.8</b>

## Principal risks

All amounts are stated in £m unless otherwise indicated

### Credit risk (continued)

	Notes	Gross balance	Credit commitments	Credit-risk exposure
<b>31 December 2009</b>				
Loans and receivables				
Loans and advances to banks		1,781.5	113.8	1,895.3
Loans and advances to customers	5	34,267.7	5,021.3	39,289.0
Investment securities	6	2,500.7	–	2,500.7
Available-for-sale financial assets				
Investment securities	6	4,529.2	–	4,529.2
Derivative financial instruments		1,023.0	–	1,023.0
		44,102.1	5,135.1	49,237.2
Allowance for impairment on loans and advances				(194.0)
Impairment losses on investments				(86.4)
<b>Total</b>				<b>48,956.8</b>

Notes 5 and 6 provide further analysis on concentrations of credit risk.

The following table analyses the above exposures by impairment classification and either arrears or risk banding as appropriate.

	Loans and advances to banks	Loans and advances to customers	Investment securities loans and receivables	Investment securities available- for-sale	Derivative financial instruments	Total
<b>30 June 2010</b>						
<b>Individually impaired</b>						
90 days past due or evidence of impairment	–	1,966.5	25.0	73.2	–	2,064.7
Impairment recognised	–	(55.8)	(8.5)	(73.2)	–	(137.5)
	–	1,910.7	16.5	–	–	1,927.2
<b>Collectively impaired</b>						
Less than 90 days past due	–	228.3	110.0	–	–	338.3
90-179 days past due	–	21.4	–	–	–	21.4
180 days plus past due	4.6	143.2	–	–	–	147.8
Impairment recognised	–	(147.3)	(6.0)	–	–	(153.3)
	4.6	245.6	104.0	–	–	354.2
<b>Past due but not impaired</b>						
0-29 days past due	–	314.8	–	–	–	314.8
30-59 days past due	–	111.7	–	–	–	111.7
60-89 days past due	–	92.0	–	–	–	92.0
	–	518.5	–	–	–	518.5
<b>Neither past due nor impaired</b>						
Low to medium risk	2,385.9	29,031.4	2,062.8	3,880.5	953.9	38,314.5
Medium to high risk	–	7,459.4	–	–	–	7,459.4
	2,385.9	36,490.8	2,062.8	3,880.5	953.9	45,773.9
<b>Total</b>	<b>2,390.5</b>	<b>39,165.6</b>	<b>2,183.3</b>	<b>3,880.5</b>	<b>953.9</b>	<b>48,573.8</b>

## Principal risks

All amounts are stated in £m unless otherwise indicated

### Credit risk (continued)

<b>31 December 2009</b>	<b>Loans and advances to banks</b>	<b>Loans and advances to customers</b>	<b>Investment securities loans and receivables</b>	<b>Investment securities available- for-sale</b>	<b>Derivative financial instruments</b>	<b>Total</b>
<b>Individually impaired</b>						
90 days past due or evidence of impairment	–	2,100.3	25.0	71.9	–	2,197.2
Impairment recognised	–	(53.6)	(8.5)	(71.9)	–	(134.0)
	–	2,046.7	16.5	–	–	2,063.2
<b>Collectively impaired</b>						
Less than 90 days past due	–	212.1	124.3	–	–	336.4
90-179 days past due	–	22.6	–	–	–	22.6
180 days plus past due	4.6	143.0	–	–	–	147.6
Impairment recognised	–	(140.4)	(6.0)	–	–	(146.4)
	4.6	237.3	118.3	–	–	360.2
<b>Past due but not impaired</b>						
0-29 days past due	–	281.0	–	–	–	281.0
30-59 days past due	–	125.0	–	–	–	125.0
60-89 days past due	–	52.1	–	–	–	52.1
	–	458.1	–	–	–	458.1
<b>Neither past due nor impaired</b>						
Low to medium risk	1,890.7	28,723.1	2,351.4	4,457.3	1,023.0	38,445.5
Medium to high risk	–	7,629.8	–	–	–	7,629.8
	1,890.7	36,352.9	2,351.4	4,457.3	1,023.0	46,075.3
<b>Total</b>	1,895.3	39,095.0	2,486.2	4,457.3	1,023.0	48,956.8

### Analysis of impaired assets and associated collateral

#### Impaired assets

Loans and securities are considered impaired where it is determined that the Bank will be unable to collect all principal and interest outstanding, according to the contractual terms of the agreements.

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

Corporate loans and retail mortgage lending with evidence of impairment including 90 days past due are individually assessed for impairment. Collectively-impaired assets include unsecured retail lending balances. Provisions are applied to credit-card balances at 30 days past due and at 45 days past due on all other unsecured retail-lending balances.

At the balance sheet date, the Bank assesses its debt securities for objective evidence that an impairment loss event has occurred. For a debt security this may be the disappearance of an active market. For available-for-sale debt securities particular consideration is given to evidence of any significant financial difficulty of the issuer or measurable decrease in the estimated cash flows from the investments.

During the first half of 2010, 194 customer loans with a balance of £21.7m (during the whole of 2009: 534 loans with a balance of £95.2m) in the Bank were renegotiated. These loans are classified as loans neither past due nor impaired, for so long as the mortgagees comply with the terms of their renegotiated contracts.

#### Past due but not impaired

Loans and securities are considered past due but not impaired when the contractual interest or principal payment are in arrears, but the Bank believes that impairment is not appropriate as a trigger point for impairment has not been reached.

Included within past due but not impaired are credit-card exposures of less than 30 days and 45 days for other retail unsecured lending. For mortgages, accounts up to 90 days in arrears but with no provision are classed as past due but not impaired.

**Credit risk (continued)****Neither past due nor impaired**

Within the credit-exposure analysis table above low to medium risk has been defined as exposures where the PD is 1% or below over a one-year time horizon for exposures on an internal-ratings-based (IRB) approach under Basel II and slotting category strong/good/satisfactory for specialised lending exposures under the slotting approach. Medium to high risk has been defined as a PD of greater than 1% over a one-year time horizon for exposure on an IRB approach under Basel II and slotting category weak for specialised lending exposures under the slotting approach.

Within the treasury debt-security portfolio 83% (2009: 82%) of exposures have an external credit rating equivalent to Fitch A or above.

The factors considered in determining if financial assets are individually impaired are stated above and in the critical judgments and estimates section of the Bank's 2009 financial statements on pages 90 to 92.

**Fair-value adjustments and provisions held against impaired exposures**

When Britannia Building Society merged with The Co-operative Bank, the heritage-Britannia lending portfolios were carried into the newly merged entity at their fair value, taking account of future lifetime expected loss on the lending portfolios at 1 August 2009. The lifetime-expected-loss adjustment is offset against the heritage-Britannia gross lending balances in the combined entity's accounts.

**Market risk**

Market risk arises from the effect of changes in market prices of financial instruments, on income derived from the structure of the balance sheet, execution of customer and inter-bank business and proprietary trading. The majority of the risk arises from changes in interest rates.

The Board receives reports on the management of balance-sheet risk and, each month, the CFS asset and liability committee (ALCO) reviews the balance-sheet risk position and the utilisation of wholesale-market risk limits.

Market risk is controlled within strict limits which are approved by the Board. The levels of these risk limits have been reviewed and remain appropriate. The risk limits reflect the low risk nature of the market risk activity which is undertaken by the Bank.

The table below illustrates the sensitivity analysis relating to the 'core' Bank, a primary measure in the approach to managing interest-rate risk. It shows the estimated change in net income over the period resulting from a 1% shock in interest rates at the beginning of the period (subject to a 0% floor). The results are driven by product and pricing mix, and exclude wholesale treasury and customer currency balances which are managed within the treasury risk framework.

**Change in net interest income for 2010 based on 100bp shock in interest rates at the beginning of the year (£m)**

	<b>100bp increase</b>	<b>100bp decrease</b>
<b>2010</b>		
At 30 June 2010	<b>14.6</b>	<b>(12.5)</b>
Average for the period	<b>(1.0)</b>	<b>4.5</b>
Maximum for the period	<b>14.6</b>	<b>16.0</b>
Minimum for the period	<b>(11.7)</b>	<b>(12.5)</b>
<b>2009</b>		
At the year end	(0.2)	1.9
Average for the period	(4.4)	5.7
Maximum for the period	3.4	25.6
Minimum for the period	(23.3)	(3.7)

**Currency risk**

The Bank's treasury foreign exchange activities are primarily:

- providing a service in meeting the foreign-exchange requirements of customers; and
- maintaining liquidity in euros and US dollars by raising funds and investing these to generate a return; and
- performing limited intra-day trading and overnight positioning in major currencies to generate incremental income.

## Principal risks

All amounts are stated in £m unless otherwise indicated

### Currency risk (continued)

The table below provides an analysis of the Bank's assets and liabilities by currency. All numbers are stated in sterling equivalents.

	£	\$	€	Other	Total 2010	£	\$	€	Other	Total 2009
<b>Assets</b>										
Cash and balances at central banks	1,591.7	–	–	–	1,591.7	1,706.8	–	–	–	1,706.8
Loans and advances to banks	2,067.1	11.4	221.7	18.6	2,318.8	1,377.9	101.5	293.8	8.3	1,781.5
Loans and advances to customers	33,755.9	77.4	221.1	15.4	34,069.8	33,724.9	72.2	261.0	15.6	34,073.7
Fair-value adjustments for hedged risk	212.4	–	–	–	212.4	66.1	–	–	–	66.1
Investment securities – loans and receivables	1,659.4	87.2	380.1	56.6	2,183.3	1,862.7	137.3	426.6	59.6	2,486.2
Investment securities – available-for-sale	2,467.2	519.0	585.5	308.8	3,880.5	2,441.0	613.3	1,042.4	360.6	4,457.3
Derivative financial instruments	953.3	0.1	0.5	–	953.9	1,022.7	–	0.3	–	1,023.0
Equity shares	7.2	–	–	–	7.2	7.2	–	–	–	7.2
Investments in joint ventures	2.2	–	–	–	2.2	1.8	–	–	–	1.8
Goodwill	0.6	–	–	–	0.6	0.6	–	–	–	0.6
Intangible fixed assets	39.9	–	–	–	39.9	46.1	–	–	–	46.1
Investment properties	154.9	–	–	–	154.9	137.7	–	–	–	137.7
Property, plant and equipment	106.5	–	–	–	106.5	121.5	–	–	–	121.5
Amounts owed by other										
Co-operative Group undertakings	18.6	–	–	–	18.6	91.0	–	–	–	91.0
Other assets	71.3	0.4	1.2	0.1	73.0	51.0	0.3	0.8	0.1	52.2
Deferred tax assets	83.7	–	–	–	83.7	86.1	–	–	–	86.1
<b>Total assets</b>	<b>43,191.9</b>	<b>695.5</b>	<b>1,410.1</b>	<b>399.5</b>	<b>45,697.0</b>	42,745.1	924.6	2,024.9	444.2	46,138.8
	£	\$	€	Other	Total 2010	£	\$	€	Other	Total 2009
<b>Liabilities</b>										
Deposits by banks	1,767.5	452.0	788.7	131.5	3,139.7	4,056.5	488.0	1,397.5	140.4	6,082.4
Customer accounts	32,019.3	16.9	29.8	1.5	32,067.5	30,755.6	22.4	46.3	3.9	30,828.2
Customer accounts – capital bonds	1,789.6	–	–	–	1,789.6	1,647.1	–	–	–	1,647.1
Debt securities in issue	4,155.0	–	239.0	–	4,394.0	3,201.0	123.8	9.5	–	3,334.3
Derivative financial instruments	727.8	1.5	7.6	–	736.9	580.3	4.2	6.8	–	591.3
Other borrowed funds	976.1	–	–	–	976.1	946.5	–	–	–	946.5
Amounts owed to other										
Co-operative Group undertakings	330.9	–	–	–	330.9	329.2	–	–	–	329.2
Other liabilities	118.8	0.4	1.4	–	120.6	220.2	0.9	0.8	–	221.9
Accruals and deferred income	128.5	–	0.1	–	128.6	158.0	–	–	–	158.0
Provisions for liabilities and charges	58.4	–	–	–	58.4	52.8	–	–	–	52.8
Current tax liabilities	51.2	–	–	–	51.2	71.0	–	–	–	71.0
<b>Total liabilities</b>	<b>42,123.1</b>	<b>470.8</b>	<b>1,066.6</b>	<b>133.0</b>	<b>43,793.5</b>	42,018.2	639.3	1,460.9	144.3	44,262.7
<b>Net on-balance-sheet position</b>	<b>1,068.8</b>	<b>224.7</b>	<b>343.5</b>	<b>266.5</b>	<b>1,903.5</b>	726.9	285.3	564.0	299.9	1,876.1

### Liquidity risk

Liquidity risk arises from the timing of cash flows generated from the Bank's assets, liabilities and off-balance sheet instruments. The Bank's liquidity-management policies are reviewed and approved annually by the RMC and compliance reviewed monthly by ALCO.

The Bank's liquidity-management framework is designed in line with industry guidelines, including Institute of International Finance and Bank for International Settlements recommendations, and is being developed in response to emerging FSA requirements.

The Bank's liquidity-risk appetite is achieved by embedding the Bank's liquidity philosophy, which is:

- the Bank funds before it lends;
- the Bank funds customer assets with customer deposits to a high degree, balanced with the use of term money from the wholesale markets; and
- the Bank holds liquid assets in case of stress.

**Liquidity risk (continued)**

The liquidity-risk philosophy is supported by strategic liquidity ratios and stress testing. The strategic ratios are:

- wholesale borrowing ratio;
- liquid assets ratio;
- customer loan/deposit ratio; and
- core funding ratio.

These are supplemented by tactical liquidity measures which cover a range of indicators including re-finance risk, concentration risk and credit ratings.

Stress testing is undertaken weekly across a range of five stress tests. The Board has set minimum survival time periods for each of the stresses.

Day-to-day cash flow (tactical liquidity) is managed by treasury within guidelines laid down by ALCO and in accordance with the standards established for all banks by banking regulators.

The Bank has a high proportion of retail assets funded by retail deposits, ensuring there is no over-reliance on wholesale funding. There is a target funding ratio set in line with the Board approved strategic plan, which is being met. The Bank's structural liquidity-risk management is therefore retail-based and is dependent on behavioural analysis of both customer demand and deposit and loan drawdown profiles by product category based on experience over the last 10 years. The behaviour of retail products is reviewed by ALCO on a quarterly basis. In addition the Bank has maturity mismatch limits to control the exposure to longer-term mismatches.

As a result of this strength, the Bank has not been required to enter the markets at disadvantageous terms in the half year. Future asset growth will be undertaken within the liquidity-risk appetite set by the Board.

The following table analyses assets and liabilities into relevant maturity groupings based on the remaining period from the balance-sheet date to the contractual maturity date.

<b>30 June 2010</b>	<b>Repayable on demand</b>	<b>3 months or less but not repayable on demand</b>	<b>1 year or less but over 3 months</b>	<b>5 years or less but over 1 year</b>	<b>Over 5 years</b>	<b>Non-cash items</b>	<b>Total</b>
<b>Assets</b>							
Loans and advances to banks	245.6	1,478.5	61.7	536.0	–	(3.0)	2,318.8
Loans and advances to customers	1,149.9	2,674.6	1,743.6	6,594.4	23,028.1	(908.4)	34,282.2
Investment securities – loans and receivables	–	103.8	724.9	1,155.2	473.6	(274.2)	2,183.3
Investment securities – available-for-sale	–	1,226.0	737.9	1,089.9	826.7	–	3,880.5
Amounts owed by other							
Co-operative Group undertakings	18.6	–	–	–	–	–	18.6
Other assets	2,545.5	–	–	–	–	468.1	3,013.6
	<b>3,959.6</b>	<b>5,482.9</b>	<b>3,268.1</b>	<b>9,375.5</b>	<b>24,328.4</b>	<b>(717.5)</b>	<b>45,697.0</b>
<b>Liabilities</b>							
Deposits by banks	110.7	1,662.2	291.7	1,075.1	–	–	3,139.7
Customer accounts	20,652.7	4,555.4	4,516.0	2,248.8	94.6	–	32,067.5
Customer accounts – capital bonds	–	117.9	271.3	1,320.0	80.4	–	1,789.6
Debt securities in issue	–	881.0	824.8	1,023.9	2,596.7	(932.4)	4,394.0
Other borrowed funds	–	3.2	–	150.0	1,105.1	(282.2)	976.1
Amounts owed to other							
Co-operative Group undertakings	79.5	251.4	–	–	–	–	330.9
Other liabilities	736.9	82.0	8.9	9.0	–	258.9	1,095.7
	<b>21,579.8</b>	<b>7,553.1</b>	<b>5,912.7</b>	<b>5,826.8</b>	<b>3,876.8</b>	<b>(955.7)</b>	<b>43,793.5</b>
<b>Net liquidity gap – contractual basis</b>	<b>(17,620.2)</b>	<b>(2,070.2)</b>	<b>(2,644.6)</b>	<b>3,548.7</b>	<b>20,451.6</b>	<b>238.2</b>	<b>1,903.5</b>
<b>Behavioural adjustments:</b>							
Loans and advances to customers	–	(301.5)	(600.1)	(3,701.9)	4,603.5	–	–
Customer accounts	20,033.5	1,110.2	(807.0)	(20,336.7)	–	–	–
<b>Net liquidity gap – behavioural basis</b>	<b>2,413.3</b>	<b>(1,261.5)</b>	<b>(4,051.7)</b>	<b>(20,489.9)</b>	<b>25,055.1</b>	<b>238.2</b>	<b>1,903.5</b>

## Principal risks

All amounts are stated in £m unless otherwise indicated

### Liquidity risk (continued)

<b>31 December 2009</b>	<b>Repayable on demand</b>	<b>3 months or less but not repayable on demand</b>	<b>1 year or less but over 3 months</b>	<b>5 years or less but over 1 year</b>	<b>Over 5 years</b>	<b>Non-cash items</b>	<b>Total</b>
<b>Assets</b>							
Loans and advances to banks	272.9	1,492.6	–	32.4	–	(16.4)	1,781.5
Loans and advances to customers	1,024.6	2,667.2	1,584.6	7,048.6	22,553.0	(738.2)	34,139.8
Investment securities – loans and receivables	–	105.7	391.3	1,808.5	524.7	(344.0)	2,486.2
Investment securities – available-for-sale	–	1,076.4	874.7	1,705.0	801.6	(0.4)	4,457.3
Amounts owed by other							
Co-operative Group undertakings	1.5	89.5	–	–	–	–	91.0
Other assets	1,881.0	135.1	149.3	490.3	74.2	453.1	3,183.0
	<b>3,180.0</b>	<b>5,566.5</b>	<b>2,999.9</b>	<b>11,084.8</b>	<b>23,953.5</b>	<b>(645.9)</b>	<b>46,138.8</b>
<b>Liabilities</b>							
Deposits by banks	420.8	4,421.1	701.3	537.9	1.3	–	6,082.4
Customer accounts	19,137.6	3,216.5	6,246.8	2,213.7	–	13.6	30,828.2
Customer accounts – capital bonds	–	57.5	356.7	1,173.6	59.3	–	1,647.1
Debt securities in issue	–	944.4	436.5	2,590.6	551.6	(1,188.8)	3,334.3
Other borrowed funds	–	7.6	–	–	1,232.0	(293.1)	946.5
Amounts owed to other							
Co-operative Group undertakings	58.2	271.0	–	–	–	–	329.2
Other liabilities	95.8	17.8	62.7	345.9	99.0	473.8	1,095.0
	<b>19,712.4</b>	<b>8,935.9</b>	<b>7,804.0</b>	<b>6,861.7</b>	<b>1,943.2</b>	<b>(994.5)</b>	<b>44,262.7</b>
<b>Net liquidity gap – contractual basis</b>	<b>(16,532.4)</b>	<b>(3,369.4)</b>	<b>(4,804.1)</b>	<b>4,223.1</b>	<b>22,010.3</b>	<b>348.6</b>	<b>1,876.1</b>
<b>Behavioural adjustments:</b>							
Loans and advances to customers	–	(235.3)	(598.9)	(2,137.8)	2,972.0	–	–
Customer accounts	17,556.9	(44.3)	2,328.8	(19,841.4)	–	–	–
<b>Net liquidity gap – behavioural basis</b>	<b>1,024.5</b>	<b>(3,649.0)</b>	<b>(3,074.2)</b>	<b>(17,756.1)</b>	<b>24,982.3</b>	<b>348.6</b>	<b>1,876.1</b>

### Fair values of financial assets and liabilities

The table below sets out a summary of the carrying and fair values of those financial assets and liabilities not presented on the Bank balance sheet at fair value, unless there is no significant difference between carrying and fair values.

<b>Category (as defined by IAS 39)</b>	<b>Class (as determined by the Bank)</b>	<b>Carrying value (including fair-value adjustments for hedged risk)</b>	<b>Fair value</b>
<b>30 June 2010</b>			
<b>Financial assets</b>			
Loans and receivables			
	Loans and advances to banks	<b>2,318.8</b>	<b>2,319.1</b>
	Loans and advances to customers	<b>34,282.2</b>	<b>34,974.9</b>
	Investment securities	<b>2,183.3</b>	<b>2,295.3</b>
<b>Financial liabilities</b>			
Financial liabilities at amortised cost			
	Deposits by banks	<b>3,139.7</b>	<b>3,141.4</b>
	Customer accounts	<b>32,067.5</b>	<b>32,238.8</b>
	Debt securities in issue	<b>4,394.0</b>	<b>4,181.2</b>
	Other borrowed funds	<b>976.1</b>	<b>923.2</b>

**Fair values of financial assets and liabilities (continued)**

<b>Category (as defined by IAS 39)</b>	<b>Class (as determined by the Bank)</b>	<b>Carrying value (including fair-value adjustments for hedged risk)</b>	<b>Fair value</b>
<b>31 December 2009</b>			
<b>Financial assets</b>			
Loans and receivables			
	Loans and advances to banks	1,781.5	1,780.5
	Loans and advances to customers	34,139.8	34,758.0
	Investment securities	2,486.2	2,489.4
<b>Financial liabilities</b>			
Financial liabilities at amortised cost			
	Deposits by banks	6,082.4	6,084.7
	Customer accounts	30,828.2	30,919.6
	Debt securities in issue	3,334.3	2,475.2
	Other borrowed funds	946.5	787.0

Key considerations in the calculation of fair values are as follows:

**(a) Loans and advances to banks/deposits by banks**

Loans and advances to banks include inter-bank placements and items in the course of collection.

The fair value of floating-rate placements and overnight deposits is their carrying amount. The estimated fair value of fixed-interest-bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity. A credit-loss adjustment has been applied based on expected loss amounts derived from the Bank's regulatory capital calculations.

**(b) Loans and advances to customers**

Fixed-rate loans and advances to customers are revalued to fair value based on future interest cash flows (at funding rates) and principal cash flows discounted using the zero-coupon rate. Forecast principal repayments are based on redemption at the earlier of maturity or repricing date with some overlay for historic behavioural experience where relevant. The eventual timing of future cash flows may be different from the forecast due to unpredictable customer behaviour. It is assumed there is no fair-value adjustment required in respect of interest-rate movement on variable-rate assets. A credit-loss adjustment has been applied based on expected loss amounts derived from the Bank's regulatory capital calculations.

**(c) Customer accounts**

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings without quoted market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

**(d) Customer accounts – capital bonds**

The estimated fair value of customer accounts – capital bonds is based on independent third-party valuations using forecast future movements in the appropriate indices.

**(e) Debt securities in issue and other borrowed funds**

The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

**(f) Investment securities**

Fair value is based on market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

Additionally, derivatives are measured at fair value.

## Principal risks

All amounts are stated in £m unless otherwise indicated

### **Fair values of financial assets and liabilities (continued)**

#### **(g) Derivatives**

Futures and options are marked to market using listed market prices. For interest-rate swaps, the estimated fair value is based on discounted cash flows using prevailing money-market interest rates for instruments with similar remaining maturity.

#### **Operational and other risks**

The Bank set out details of the other risks and uncertainties that could impact its performance in its 2009 financial statements. These remain unchanged at the reporting date.

## Capital resources

The Bank's policy is to maintain a strong base so as to maintain investor, creditor and market confidence and to sustain future development of the business. However, the Bank still recognises the need to maintain a balance between the potential higher returns that might be achieved with greater gearing, and the advantages and security afforded by a sound capital position.

Our submissions to the FSA in the period have shown that the Bank and its individually-regulated operations have complied with all externally-imposed capital requirements throughout the period.

There have been no material changes in the Bank's management of capital during the period.

	<b>30 June 2010</b>	<b>31 December 2009</b>
<b>Core tier one capital</b>		
Permanent share capital	<b>230.0</b>	230.0
Retained earnings	<b>1,562.8</b>	1,454.2
Minority interest	<b>31.6</b>	29.5
Interim profits	<b>–</b>	15.9
Share premium account	<b>8.8</b>	8.8
Total core tier one capital	<b>1,833.2</b>	1,738.4
Perpetual non-cumulative preference shares	<b>60.0</b>	60.0
Total tier one capital before regulatory deductions	<b>1,893.2</b>	1,798.4
<b>Tier two capital</b>		
Revaluation reserves	<b>2.9</b>	2.9
Long term subordinated debt	<b>876.6</b>	870.5
Total tier two capital before deductions	<b>879.5</b>	873.4

The Bank's regulatory capital is analysed into two tiers:

### *Tier one capital*

Tier one capital includes share capital, retained earnings, and perpetual non-cumulative preference shares. The preference shares carry the right to fixed non-cumulative preferential dividend at a rate of 9.25%, payable 31 May and 30 November. Retained earnings exclude gains or losses on cashflow hedges and available-for-sale assets.

### *Tier two capital*

Revaluation reserves relating to net gains on equity held in the available-for-sale financial assets category are included in tier two capital.

The tier two capital includes six subordinated-debt issues. The rights of payment to the holders of this debt are subordinated to the claims of depositors and other creditors of the Bank. More information on these can be found in the 2009 financial statements.

The capital ratios reported in the business and financial review are based on the Pillar I capital requirement.

## Capital allocation

The allocation of capital between specific operations and activities is driven by optimisation of the return achieved on the capital allocated, and is based upon the regulatory capital. Capital allocation is undertaken independently of those responsible for capital management, and is reviewed by ALCO. Each new product must earn at least the Bank's minimum target return on equity.

# Independent review report

For the period ended 30 June 2010

## Introduction

We have been engaged by the company to review the condensed set of financial statements in the interim financial report for the six months ended 30 June 2010 which comprises the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of cash flows, consolidated statement of changes in equity and the related explanatory notes. We have read the other information contained in the interim financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the company in accordance with the terms of our engagement to assist the company in meeting the requirements of the Disclosure and Transparency Rules ("the DTR") of the UK's Financial Services Authority ("the UK FSA"). Our review has been undertaken so that we might state to the company those matters we are required to state to it in this 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 for our review work, for this report, or for the conclusions we have reached.

## Directors' responsibilities

The interim financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim financial report in accordance with the DTR of the UK FSA.

As disclosed in the basis of preparation the annual financial statements of the group are prepared in accordance with IFRSs as adopted by the EU. The condensed set of financial statements included in this interim financial report has been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU.

## Our responsibility

Our responsibility is to express to the company a conclusion on the condensed set of financial statements in the interim financial report based on our review.

## Scope of review

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

## Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the interim financial report for the six months ended 30 June 2010 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the UK FSA.

## Andrew Walker

### for and on behalf of KPMG Audit Plc

Chartered Accountants  
St James' Square  
Manchester  
M2 6DS

25 August 2010

# Consolidated income statement

For the period ended 30 June 2010 (unaudited)  
All amounts are stated in £m unless otherwise indicated

	Notes	Period to 30 June 2010			Period to 25 July 2009		
		Before significant items	Significant items	After significant items	Before significant items	Significant items	After significant items
Interest receivable and similar income		<b>863.2</b>	–	<b>863.2</b>	298.3	–	298.3
Interest expense and similar charges		<b>(570.9)</b>	–	<b>(570.9)</b>	(96.1)	–	(96.1)
<b>Net interest income</b>	2	<b>292.3</b>	–	<b>292.3</b>	202.2	–	202.2
Fee and commission income		<b>121.7</b>	–	<b>121.7</b>	111.7	–	111.7
Fee and commission expense		<b>(28.6)</b>	–	<b>(28.6)</b>	(22.2)	–	(22.2)
<b>Net fee and commission income</b>	3	<b>93.1</b>	–	<b>93.1</b>	89.5	–	89.5
Net trading income		<b>2.1</b>	–	<b>2.1</b>	3.5	–	3.5
Other operating income		<b>0.2</b>	–	<b>0.2</b>	0.5	–	0.5
<b>Operating income</b>		<b>387.7</b>	–	<b>387.7</b>	295.7	–	295.7
Operating expenses	4	<b>(287.9)</b>	<b>(18.3)</b>	<b>(306.2)</b>	(181.0)	(14.6)	(195.6)
Financial services compensation scheme levies		<b>(3.3)</b>	–	<b>(3.3)</b>	(2.2)	–	(2.2)
Impairment losses on loans and advances		<b>(43.0)</b>	–	<b>(43.0)</b>	(73.0)	–	(73.0)
<b>Operating profit</b>		<b>53.5</b>	<b>(18.3)</b>	<b>35.2</b>	39.5	(14.6)	24.9
Share of post-tax profits from joint ventures		<b>0.4</b>	–	<b>0.4</b>	–	–	–
<b>Profit before taxation and profit-based payments</b>		<b>53.9</b>	<b>(18.3)</b>	<b>35.6</b>	39.5	(14.6)	24.9
Profit-based payments to members of The Co-operative Group		<b>(6.7)</b>	–	<b>(6.7)</b>	–	–	–
<b>Profit before taxation</b>		<b>47.2</b>	<b>(18.3)</b>	<b>28.9</b>	39.5	(14.6)	24.9
Income tax		<b>(17.1)</b>	<b>5.0</b>	<b>(12.1)</b>	(12.3)	4.1	(8.2)
<b>Profit for the period</b>		<b>30.1</b>	<b>(13.3)</b>	<b>16.8</b>	27.2	(10.5)	16.7
Attributable to:							
Equity shareholders		<b>30.1</b>	<b>(13.3)</b>	<b>16.8</b>	25.2	(10.5)	14.7
Minority interests		–	–	–	2.0	–	2.0
<b>Earnings per share</b>		<b>0.66p</b>	<b>(0.29)p</b>	<b>0.37p</b>	0.76p	(0.32)p	0.44p

The significant items relate to non-recurring restructuring costs.

# Consolidated statement of comprehensive income

For the period ended 30 June 2010 (unaudited)

All amounts are stated in £m unless otherwise indicated

	<b>Period to 30 June 2010</b>	<b>Period to 25 July 2009</b>
Profit for the period – equity shareholders	<b>16.8</b>	14.7
Profit for the period – minority interests	–	2.0
<b>Profit for the period</b>	<b>16.8</b>	16.7
<b>Other comprehensive income:</b>		
Changes in cashflow hedges		
Net changes in fair value recognised directly in equity	<b>35.6</b>	(21.8)
Income tax	<b>(9.9)</b>	6.1
Changes in available-for-sale assets		
Net changes in fair value recognised directly in equity	<b>(19.8)</b>	6.8
Income tax	<b>5.5</b>	(1.9)
Transfer to other operating income on disposal of equity shares	–	(0.7)
Income tax	–	0.2
Other comprehensive income for the period, net of income tax	<b>11.4</b>	(11.3)
<b>Total comprehensive income for the period</b>	<b>28.2</b>	5.4
Attributable to:		
Equity shareholders	<b>28.2</b>	4.3
Minority interests	–	1.1
<b>Total comprehensive income for the period</b>	<b>28.2</b>	5.4

# Consolidated balance sheet

At 30 June 2010 (unaudited)

All amounts are stated in £m unless otherwise indicated

	Notes	30 June 2010	31 December 2009 restated
<b>Assets</b>			
Cash and balances at central banks		<b>1,591.7</b>	1,706.8
Loans and advances to banks		<b>2,318.8</b>	1,781.5
Loans and advances to customers	5	<b>34,069.8</b>	34,073.7
Fair-value adjustments for hedged risk		<b>212.4</b>	66.1
Investment securities – loans and receivables	6	<b>2,183.3</b>	2,486.2
Investment securities – available-for-sale	6	<b>3,880.5</b>	4,457.3
Derivative financial instruments		<b>953.9</b>	1,023.0
Equity shares		<b>7.2</b>	7.2
Investments in joint ventures		<b>2.2</b>	1.8
Goodwill		<b>0.6</b>	0.6
Intangible fixed assets		<b>39.9</b>	46.1
Investment properties		<b>154.9</b>	137.7
Property, plant and equipment		<b>106.5</b>	121.5
Amounts owed by other Co-operative Group undertakings		<b>18.6</b>	91.0
Other assets		<b>50.0</b>	22.1
Prepayments and accrued income		<b>23.0</b>	30.1
Deferred tax assets		<b>83.7</b>	86.1
<b>Total assets</b>		<b>45,697.0</b>	46,138.8
<b>Liabilities</b>			
Deposits by banks		<b>3,139.7</b>	6,082.4
Customer accounts	7	<b>32,067.5</b>	30,828.2
Customer accounts – capital bonds	8	<b>1,789.6</b>	1,647.1
Debt securities in issue		<b>4,394.0</b>	3,334.3
Derivative financial instruments		<b>736.9</b>	591.3
Other borrowed funds		<b>976.1</b>	946.5
Amounts owed to other Co-operative Group undertakings		<b>330.9</b>	329.2
Other liabilities		<b>120.6</b>	221.9
Accruals and deferred income		<b>128.6</b>	158.0
Provisions for liabilities and charges		<b>58.4</b>	52.8
Current tax liabilities		<b>51.2</b>	71.0
<b>Total liabilities</b>		<b>43,793.5</b>	44,262.7
<b>Capital and reserves attributable to the Bank's equity holders</b>			
Ordinary share capital		<b>230.0</b>	230.0
Share premium account		<b>8.8</b>	8.8
Retained earnings		<b>1,579.6</b>	1,562.8
Available-for-sale reserve		<b>(11.8)</b>	2.5
Cashflow hedging reserve		<b>64.1</b>	38.4
		<b>1,870.7</b>	1,842.5
Minority interests		<b>32.8</b>	33.6
<b>Total equity</b>		<b>1,903.5</b>	1,876.1
<b>Total liabilities and equity</b>		<b>45,697.0</b>	46,138.8

# Consolidated statement of cash flows

For the period ended 30 June 2010 (unaudited)

All amounts are stated in £m unless otherwise indicated

	Period to 30 June 2010	Period to 25 July 2009
<b>Cash flows from operating activities</b>		
Profit before taxation	28.9	24.9
Adjustments for:		
Decrease in prepayments and accrued income	7.1	7.1
(Decrease)/increase in accruals and deferred income	(99.5)	17.3
Interest payable in respect of subordinated liabilities	22.3	9.4
Effect of exchange rate movements	46.0	(3.7)
Effect of non-cash pension costs	0.1	0.1
Impairment losses on loans and advances	43.0	73.0
Depreciation and amortisation	13.1	9.6
Interest amortisation	–	(6.2)
Amortisation of investments	(36.5)	0.3
Loss on disposal of fixed assets	0.6	0.5
Unwind of fair-value adjustments arising on transfer of engagements	22.6	–
Preference dividend	2.8	3.0
	<b>50.5</b>	135.3
(Decrease)/increase in deposits by banks	<b>(2,942.7)</b>	57.3
Increase in customer accounts	<b>1,381.3</b>	595.3
Increase/(decrease) in debt securities in issue	<b>836.1</b>	(120.2)
Decrease in loans and advances to banks	<b>185.0</b>	304.9
Increase in loans and advances to customers	<b>(44.4)</b>	(378.9)
Decrease/(increase) in amounts owed by other Co-operative Group undertakings	<b>72.4</b>	(43.2)
Increase/(decrease) in amounts owed to other Co-operative Group undertakings	<b>1.7</b>	(127.3)
Net movement of other assets and other liabilities	<b>129.1</b>	9.7
Income tax (paid)/recovered	<b>(33.9)</b>	2.3
<b>Net cash flows from operating activities</b>	<b>(364.9)</b>	435.2
<b>Cash flows from investing activities</b>		
Purchase of property, plant, equipment and software	<b>(16.2)</b>	–
Proceeds from sale of property, plant and equipment	<b>2.1</b>	–
Purchase of investment securities	<b>(750.1)</b>	(9,973.3)
Proceeds from sale and maturity of investment securities	<b>2,043.8</b>	9,542.3
<b>Net cash flows from investing activities</b>	<b>1,279.6</b>	(431.0)
<b>Cash flows from financing activities</b>		
Interest paid on subordinated loanstock	<b>(20.8)</b>	(13.0)
Proceeds of issued shares	–	120.0
Preference share dividends paid	<b>(2.8)</b>	(2.8)
Dividends paid to minority shareholders in subsidiary undertaking	<b>(0.8)</b>	(0.8)
<b>Net cash flows from financing activities</b>	<b>(24.4)</b>	103.4
<b>Increase in cash and cash equivalents</b>	<b>890.3</b>	107.6
<b>Cash and cash equivalents at beginning of the period</b>	<b>2,387.3</b>	2,324.0
<b>Cash and cash equivalents at end of the period</b>	<b>3,277.6</b>	2,431.6
Cash and balances with central banks	<b>1,556.1</b>	407.6
Loans and advances to banks	<b>1,186.4</b>	1,131.3
Short-term investments	<b>535.1</b>	892.7
	<b>3,277.6</b>	2,431.6

# Consolidated statement of changes in equity

For the period ended 30 June 2010 (unaudited)  
All amounts are stated in £m unless otherwise indicated

## Attributable to equity holders of the company

	Share capital	Share premium	Available-for-sale reserve	Cashflow hedging reserve	Retained earnings	Total	Minority interest	Total equity
<b>Period from 1 January 2010 to 30 June 2010</b>								
At the beginning of the period	230.0	8.8	2.5	38.4	1,562.8	1,842.5	33.6	1,876.1
Total comprehensive income for the period	–	–	(14.3)	25.7	16.8	28.2	–	28.2
Transactions with owners recorded directly in equity:								
Dividend	–	–	–	–	–	–	(0.8)	(0.8)
<b>Total equity</b>	<b>230.0</b>	<b>8.8</b>	<b>(11.8)</b>	<b>64.1</b>	<b>1,579.6</b>	<b>1,870.7</b>	<b>32.8</b>	<b>1,903.5</b>
<b>Period from 26 July 2009 to 31 December 2009</b>								
At the beginning of the period	175.0	8.8	(11.8)	43.9	656.2	872.1	33.2	905.3
Amounts arising on transfer of engagements	–	–	–	–	811.2	811.2	–	811.2
Total comprehensive income for the period	–	–	14.3	(5.5)	95.4	104.2	0.5	104.7
Transactions with owners recorded directly in equity:								
Increase in share capital	55.0	–	–	–	–	55.0	–	55.0
Dividend	–	–	–	–	–	–	(0.1)	(0.1)
<b>Total equity</b>	<b>230.0</b>	<b>8.8</b>	<b>2.5</b>	<b>38.4</b>	<b>1,562.8</b>	<b>1,842.5</b>	<b>33.6</b>	<b>1,876.1</b>
<b>Period from 11 January 2009 to 25 July 2009</b>								
At the beginning of the period	55.0	8.8	(16.6)	59.1	641.5	747.8	32.9	780.7
Total comprehensive income for the period	–	–	4.8	(15.2)	14.7	4.3	1.1	5.4
Transactions with owners recorded directly in equity:								
Increase in share capital	120.0	–	–	–	–	120.0	–	120.0
Dividend	–	–	–	–	–	–	(0.8)	(0.8)
<b>Total equity</b>	<b>175.0</b>	<b>8.8</b>	<b>(11.8)</b>	<b>43.9</b>	<b>656.2</b>	<b>872.1</b>	<b>33.2</b>	<b>905.3</b>

# Basis of preparation and accounting policies

For the period ended 30 June 2010 (unaudited)

All amounts are stated in £m unless otherwise indicated

## **Basis of preparation**

EU law (IAS Regulation EC1606/2002) requires that the annual consolidated financial statements for the year ended 31 December 2010 are prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and International Financial Reporting Interpretations Committee guidance as issued by the European Union.

The information in this interim financial report 2010 is unaudited and does not constitute statutory accounts within the meaning of section 435 of the Companies Act 2006. The comparative figures for the financial year ended 31 December 2009 are not the company's statutory accounts for that financial year. Those accounts have been reported on by the company's auditors and delivered to the registrar of companies. The report of the auditors was unqualified, did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

The interim financial report 2010 was approved by the Board of Directors on 25 August 2010.

This condensed consolidated interim financial report for the half-year ended 30 June 2010 has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Services Authority and with IAS 34 (Interim Financial Reporting) as adopted by the European Union. The interim financial report should be read in conjunction with the 2009 financial statements, which have been prepared in accordance with IFRS as adopted by the European Union.

The accounting policies, methods of computation and presentation adopted by the Bank in the preparation of its interim financial report 2010 are those which the Bank currently expects to adopt in its 2010 financial statements and are consistent with those disclosed in the 2009 financial statements.

### *Going concern*

The Bank's business activities together with its financial position, and the factors likely to affect its future development and performance are set out in the business and financial review. Further risk information is provided in the principal risks section. In addition, the risk management section of the 2009 financial statements, includes the Bank's objectives, policies and processes for managing its liquidity risk and details of financial instruments and hedging activities. The capital management section provides information on the Bank's capital policies.

In common with many financial institutions, the Bank meets its day-to-day liquidity requirements through managing both its retail and wholesale funding sources, and is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business. The Bank's forecasts and objectives, taking into account a number of potential changes in trading performance and funding retention, show that the Bank should be able to operate at adequate levels of both liquidity and capital, for the foreseeable future. The Bank has also considered a number of stress tests on capital and liquidity and these provide assurance that the Bank is sufficiently capitalised and is comfortably in excess of liquidity stress tests.

Consequently, after making enquiries, the directors are satisfied that the Bank has sufficient resources to continue in business for the foreseeable future and have therefore continued to adopt the going-concern basis in preparing the financial statements.

### *Prior-year restatements*

In accordance with IFRS 3, the Bank has twelve months from the date of the merger with Britannia in which to complete the initial accounting based on facts and circumstances that existed at merger date. The Bank has reassessed the carrying values of the Britannia assets and liabilities acquired and made the following adjustments.

The carrying value of loans and advances to customers has been increased following a review of the probabilities of default of assets that were neither past due nor impaired at the merger date. Based on further information that has become available, the Bank has reassessed the fair value of provisions for liabilities and charges.

The impact of these adjustments is not material to the overall level of adjustments to the carrying values of Britannia assets and liabilities that were made on merger and there is no change to the amount of goodwill arising.

### *Use of estimates and judgments*

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

Estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Management believes that the Bank's critical accounting policies where judgment is necessarily applied are consistent with those outlined in the 2009 financial statements.

## **Accounting date**

In 2009 the Bank elected to change its accounting-year-end date to 31 December to align with Britannia Building Society following the merger on 1 August 2009. Therefore this interim financial report relates to the six month period to 30 June 2010. The comparative period given is that disclosed in the interim financial report 2009 which covers the 28-week period to 25 July 2009.

# Notes to the interim financial report

For the period ended 30 June 2010 (unaudited)  
All amounts are stated in £m unless otherwise indicated

## 1. Segmental information

In its interim financial report for the period ended 25 July 2009, the Bank reported its operating segments as Retail, Corporate and Wholesale, which was in line with the information presented to the Co-operative Financial Services Board, the chief operating decision-making body of the Bank. At the highest level, the Bank's internal reporting structure has been revised following the transfer of engagements of Britannia Building Society and is split between Retail and Corporate and Markets (CAM), based on differences in products and services. CAM has been split further into Corporate, Wholesale, Optimum and Platform, and Business Services. This level of information is regularly presented to the Board. Revenues are attributed to the segment in which they are generated. Transactions between the reportable segments are on normal commercial terms. Internal charges and transfer-pricing adjustments have been reflected in each segment. The comparative information as at 25 July 2009 has been restated as appropriate to reflect the new segments.

The Bank is comprised of the following main reportable segments:

### Retail

- Customer-focused products and services for individuals, sole traders and small businesses. This includes mortgages, credit cards, consumer loans, current accounts and savings products;

### CAM

- **Corporate** – customer-focused products and services for businesses. This includes large corporate and commercial entities. It includes loans, asset finance, current accounts and savings products;
- **Wholesale** – this is the asset and liability management across the Bank's balance sheet, including trading activities;
- **Optimum and Platform** – this is the intermediary mortgage lender dealing with specialist and mainstream lending;
- **Business Services** – the business-services part of the CAM segment;

### Other

- Includes other central costs and Unity Trust. Unity Trust is a subsidiary bank operating in the corporate banking and social economy sectors on behalf of trade unions.

	Retail		Corporate and Markets			Other	Total	
	Corporate	Wholesale	Optimum and Platform	Business Services	Total CAM			
<b>Period to 30 June 2010</b>								
Interest margin	167.3	61.4	20.9	52.3	1.0	135.6	4.9	307.8
Non-interest income	77.2	18.9	(15.0)	5.3	8.2	17.4	0.8	95.4
<b>Segment operating income</b>	<b>244.5</b>	<b>80.3</b>	<b>5.9</b>	<b>57.6</b>	<b>9.2</b>	<b>153.0</b>	<b>5.7</b>	<b>403.2</b>
Operating expenses	(213.5)	(28.4)	(7.8)	(20.4)	(5.6)	(62.2)	(5.1)	(280.8)
Impairment losses on loans and advances	(31.0)	(10.4)	–	(0.1)	0.1	(10.4)	(1.6)	(43.0)
<b>Segment operating profit</b>	<b>–</b>	<b>41.5</b>	<b>(1.9)</b>	<b>37.1</b>	<b>3.7</b>	<b>80.4</b>	<b>(1.0)</b>	<b>79.4</b>
Fair-value amortisation								(22.6)
Financial services compensation scheme levies								(3.3)
Share of post-tax profits from joint ventures								0.4
Profit-based payments to members of The Co-operative Group								(6.7)
Significant items								(18.3)
<b>Profit before taxation</b>								<b>28.9</b>
Income tax								(12.1)
<b>Profit for the period</b>								<b>16.8</b>

The Board relies primarily on net interest revenue to assess the performance of each segment. As a result interest margin is reported on a net basis to the Board.

# Notes to the interim financial report

For the period ended 30 June 2010 (unaudited)

All amounts are stated in £m unless otherwise indicated

## 1. Segmental information (continued)

### Reconciliation to statutory income statement

#### Interest margin

Total interest margin for reportable segments

Fair-value amortisation

Net interest income

Period to  
30 June  
2010

307.8

(15.5)

292.3

#### Operating expenses

Total operating expenses for reportable segments

Fair-value amortisation

Operating expenses

(280.8)

(7.1)

(287.9)

#### Fair-value amortisation

Total interest unwind for reportable segments

Interest margin unwind

Operating expenses unwind

Fair-value amortisation

(22.6)

15.5

7.1

–

	Retail	Corporate and Markets				Other	Total	
			Optimum and Platform	Business Services	Total CAM			
<b>Period to 25 July 2009</b>								
Interest margin	120.1	55.7	19.1	–	0.2	75.0	7.1	202.2
Non-interest income	70.4	22.0	(3.5)	–	4.0	22.5	0.6	93.5
<b>Segment operating income</b>	190.5	77.7	15.6	–	4.2	97.5	7.7	295.7
Operating expenses	(140.6)	(30.4)	(4.6)	–	(1.7)	(36.7)	(3.7)	(181.0)
Impairment losses on loans and advances	(49.2)	(23.5)	–	–	–	(23.5)	(0.3)	(73.0)
<b>Segment operating profit</b>	0.7	23.8	11.0	–	2.5	37.3	3.7	41.7
Financial services compensation scheme levies								(2.2)
Significant items								(14.6)
<b>Profit before taxation</b>								24.9
Income tax								(8.2)
<b>Profit for the period</b>								16.7

# Notes to the interim financial report

For the period ended 30 June 2010 (unaudited)  
All amounts are stated in £m unless otherwise indicated

## 1. Segmental information (continued)

	Retail	Corporate and Markets				Total CAM	Other	Total
	Corporate	Wholesale	Optimum and Platform	Business Services				
<b>Period to 25 July 2009</b>								
<b>Total segment assets</b>								
<b>30 June 2010</b>	<b>16,551.9</b>	<b>7,959.0</b>	<b>9,225.3</b>	<b>9,223.6</b>	<b>1.2</b>	<b>26,409.1</b>	<b>–</b>	<b>42,961.0</b>
<b>Unallocated assets</b>								<b>1,610.1</b>
<b>Total assets for reportable segments</b>	<b>16,551.9</b>	<b>7,959.0</b>	<b>9,225.3</b>	<b>9,223.6</b>	<b>1.2</b>	<b>26,409.1</b>	<b>–</b>	<b>44,571.1</b>
<b>Statutory reclassifications</b>								<b>1,125.9</b>
<b>Consolidated total assets</b>								<b>45,697.0</b>
31 December 2009	16,722.6	7,900.5	9,531.1	9,249.4	–	26,681.0	–	43,403.6
Unallocated assets								1,710.6
Total assets for reportable segments	16,722.6	7,900.5	9,531.1	9,249.4	–	26,681.0	–	45,114.2
Statutory reclassifications								1,024.6
Consolidated total assets								46,138.8

## 2. Net interest income

### Interest receivable and similar income

On financial assets not at fair value through income or expense:

	Period to 30 June 2010	Period to 25 July 2009
On loans and advances to customers	<b>816.8</b>	240.7
On loans and advances to banks	<b>0.9</b>	9.0
On investment securities	<b>193.3</b>	29.2
	<b>1,011.0</b>	278.9

On financial assets at fair value through income or expense:

Net expense on financial instruments hedging assets	<b>(142.8)</b>	14.6
Net interest income on financial instruments not in a hedging relationship	<b>(5.0)</b>	4.8
	<b>863.2</b>	298.3

### Interest expense and similar charges

On financial liabilities not at fair value through income or expense:

On customer accounts	<b>241.2</b>	69.8
On bank and other deposits	<b>275.0</b>	14.1
On subordinated liabilities	<b>21.8</b>	12.2
On perpetual secured debt	<b>13.9</b>	–
	<b>551.9</b>	96.1

On financial liabilities at fair value through income or expense:

Net expense on financial instruments hedging liabilities	<b>19.0</b>	–
	<b>570.9</b>	96.1

# Notes to the interim financial report

For the period ended 30 June 2010 (unaudited)

All amounts are stated in £m unless otherwise indicated

## 3. Net fee and commission income

### Fee and commission income

On items not at fair value through income or expense

On trust or fiduciary activities that result from holding or investing in assets on behalf of others

	Period to 30 June 2010	Period to 25 July 2009
	<b>121.0</b>	110.3
	<b>0.7</b>	1.4
	<b>121.7</b>	111.7

### Fee and commission expense

On items not at fair value through income or expense

On items at fair value through income or expense

	<b>24.7</b>	20.7
	<b>3.9</b>	1.5
	<b>28.6</b>	22.2

## 4. Operating expenses

### Period to 30 June 2010

Staff costs:

Wages and salaries

Social security costs

Pension costs – defined-benefit plans

Pension costs – defined-contribution plans

Other staff costs

	Before significant items	Significant items	After significant items
	<b>111.5</b>	<b>5.2</b>	<b>116.7</b>
	<b>9.9</b>	<b>0.4</b>	<b>10.3</b>
	<b>0.2</b>	–	<b>0.2</b>
	<b>14.3</b>	<b>0.5</b>	<b>14.8</b>
	<b>11.2</b>	<b>1.2</b>	<b>12.4</b>
	<b>147.1</b>	<b>7.3</b>	<b>154.4</b>
Administrative expenses	<b>101.9</b>	<b>11.0</b>	<b>112.9</b>
Depreciation of property, plant and equipment	<b>12.4</b>	–	<b>12.4</b>
Amortisation of intangible fixed assets	<b>7.9</b>	–	<b>7.9</b>
Loss on sale of property, plant and equipment	<b>0.6</b>	–	<b>0.6</b>
Operating lease rentals	<b>16.8</b>	–	<b>16.8</b>
Direct expenses from investment properties that generated rental income in the period	<b>1.1</b>	–	<b>1.1</b>
Direct expenses from investment properties that did not generate rental income in the period	<b>0.1</b>	–	<b>0.1</b>
	<b>287.9</b>	<b>18.3</b>	<b>306.2</b>

### Period to 25 July 2009

Staff costs:

Wages and salaries

Social security costs

Pension costs – defined-benefit plans

Pension costs – defined-contribution plans

Other staff costs

Administrative expenses

Depreciation of property, plant and equipment

Amortisation of intangible fixed assets

Loss on sale of property, plant and equipment

Operating lease rentals

	58.5	3.3	61.8
	4.9	0.3	5.2
	0.1	–	0.1
	6.0	0.5	6.5
	10.8	3.3	14.1
	80.3	7.4	87.7
	82.3	7.2	89.5
	8.8	–	8.8
	0.8	–	0.8
	0.5	–	0.5
	8.3	–	8.3
	181.0	14.6	195.6

The significant items relate to non-recurring restructuring costs.

# Notes to the interim financial report

For the period ended 30 June 2010 (unaudited)  
All amounts are stated in £m unless otherwise indicated

## 5. Loans and advances to customers

	<b>30 June 2010</b>	<b>31 December 2009 restated</b>
Gross loans and advances	<b>34,272.9</b>	34,267.7
Less: allowance for losses on loans and advances to customers	<b>(203.1)</b>	(194.0)
	<b>34,069.8</b>	34,073.7

Loans and advances to customers includes £8,977.5m (31 December 2009: £9,492.7m) 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.

### Concentration of exposure

The Bank's exposure is virtually all within the UK. The following industry concentrations of gross advances are considered significant:

	<b>30 June 2010</b>	<b>31 December 2009</b>
Property and construction	<b>4,366.9</b>	4,498.1
Retail distribution	<b>475.2</b>	446.9
Business and other services	<b>3,814.9</b>	3,658.2
Personal – unsecured	<b>1,620.6</b>	1,625.6
Personal – secured	<b>23,995.3</b>	24,038.9
	<b>34,272.9</b>	34,267.7

### Allowance for losses on loans and advances

<b>Period to 30 June 2010</b>	<b>Individual mortgage</b>	<b>Individual corporate</b>	<b>Collective</b>	<b>Total</b>
At the beginning of the period	<b>2.3</b>	<b>51.3</b>	<b>140.4</b>	<b>194.0</b>
Charge against profits	<b>0.7</b>	<b>12.0</b>	<b>30.3</b>	<b>43.0</b>
Amounts written off	<b>(0.2)</b>	<b>(9.8)</b>	<b>(22.7)</b>	<b>(32.7)</b>
Unwind of discount allowance	–	<b>(0.7)</b>	<b>(0.7)</b>	<b>(1.4)</b>
Interest charged on impaired loans	–	<b>0.2</b>	–	<b>0.2</b>
At the end of the period	<b>2.8</b>	<b>53.0</b>	<b>147.3</b>	<b>203.1</b>

<b>Period to 31 December 2009</b>	<b>Individual mortgage</b>	<b>Individual corporate</b>	<b>Collective</b>	<b>Total</b>
At the beginning of the year	1.5	45.6	140.8	187.9
Charge against profits for 28 weeks to 25 July 2009	0.6	18.9	53.5	73.0
Charge against profits for 24 weeks to 31 December 2009	0.9	14.5	27.7	43.1
Amounts written off	(0.7)	(26.5)	(79.2)	(106.4)
Recoveries	–	(0.1)	–	(0.1)
Unwind of discount allowance	–	(1.4)	(2.4)	(3.8)
Interest charged on impaired loans	–	0.3	–	0.3
At the end of the year	2.3	51.3	140.4	194.0

### 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. The changes in fair value of fixed-rate mortgages are disclosed on the balance sheet as fair-value adjustments for hedged risk immediately below the loans and advances to customers.

Fair-value adjustments to loans and advances to customers attributable to portfolio-hedged risk are £212.4m (31 December 2009: £66.1m).

# Notes to the interim financial report

For the period ended 30 June 2010 (unaudited)

All amounts are stated in £m unless otherwise indicated

## 6. Investment securities

### Loans and receivables

	<b>30 June 2010</b>	<b>31 December 2009</b>
Listed	<b>120.1</b>	124.3
Unlisted	<b>2,077.7</b>	2,376.4
	<b>2,197.8</b>	2,500.7
Less: allowance for losses on loans and receivables	<b>(14.5)</b>	(14.5)
	<b>2,183.3</b>	2,486.2
Included in cash and cash equivalents	–	–

### Impairment analysis of investment securities – loans and receivables

	<b>30 June 2010</b>	<b>31 December 2009</b>
At the beginning of the period	<b>14.5</b>	22.5
Allowance for impairment losses to 30 June 2010 (to 25 July 2009)	–	(4.0)
Allowance for impairment losses to 31 December 2009	–	(4.0)
Release for the period	–	(8.0)
At the end of the period	<b>14.5</b>	14.5

### Available-for-sale

	<b>30 June 2010</b>	<b>31 December 2009</b>
Listed	<b>1,382.7</b>	1,470.4
Unlisted	<b>2,571.0</b>	3,058.8
	<b>3,953.7</b>	4,529.2
Less: allowance for losses on available-for-sale investments	<b>(73.2)</b>	(71.9)
	<b>3,880.5</b>	4,457.3
Included in cash and cash equivalents	<b>535.1</b>	252.0

### Impairment analysis of investment securities – available-for-sale

	<b>30 June 2010</b>	<b>31 December 2009</b>
At the beginning of the period	<b>71.9</b>	69.8
Impairment losses recycled through equity reserves to 30 June 2010 (to 25 July 2009)	–	4.0
Impairment losses recycled through equity reserves to 31 December 2009	–	–
Charge for the period	–	4.0
Exchange adjustments	<b>1.3</b>	(1.9)
At the end of the period	<b>73.2</b>	71.9

# Notes to the interim financial report

For the period ended 30 June 2010 (unaudited)  
All amounts are stated in £m unless otherwise indicated

## 6. Investment securities (continued)

### Reclassification of available-for-sale assets

Pursuant to the amendments to IAS 39 and IFRS 7, during 2008 the Bank reclassified specific available-for-sale investment securities to loans and receivables at amortised cost. The Bank identified particular assets that would have met the definition of loans and receivables (if they had not been designated as available for sale) for which at 27 July 2008 it considered it had the intention and ability to hold them for the foreseeable future or until maturity, due to the market in such instruments being considered to be inactive.

As per the amendment to IAS 39, the reclassifications were made with effect from 27 July 2008 at fair value at that date. The table below sets out the carrying value and fair values for the Bank at the balance sheet date:

	<b>30 June 2010</b>	<b>31 December 2009</b>
Available-for-sale financial assets transferred to loans and receivables		
Amounts reclassified in 2008		
Carrying value	<b>130.4</b>	134.8
Fair value	<b>134.0</b>	138.0

At the date of transfer fair value equated to carrying value. At other reporting dates the fair value is based on quoted market prices being the only indicator of fair value that is available.

The table below sets out the amounts that would have been recognised for the Bank in the half year to 2010 and in the period ended 2009, if the reclassification in 2008 had not been made:

	<b>Income or expense</b>	<b>Other comprehensive income</b>	<b>Income or expense</b>	<b>Other comprehensive income</b>
	<b>30 June 2010</b>		<b>31 December 2009</b>	
Available-for-sale investments reclassified to loans and receivables:				
Interest income	<b>0.5</b>	–	3.1	–
Net impairment release/(charge)	–	–	8.0	(4.0)
Net change in fair value	–	<b>2.3</b>	–	25.6
	<b>0.5</b>	<b>2.3</b>	11.1	21.6

At 27 July 2008, the effective interest rates on available-for-sale assets reclassified to loans and receivables at amortised cost ranged from 8% to 12% with expected recoverable cash flows as at 30 June 2010 of £142.8m (31 December 2009: £144.2m).

Gains and losses from investment securities, included within interest income, comprise:

	<b>30 June 2010</b>	<b>31 December 2009</b>
Derecognition of available-for-sale assets	<b>0.2</b>	7.1

# Notes to the interim financial report

For the period ended 30 June 2010 (unaudited)

All amounts are stated in £m unless otherwise indicated

## 6. Investment securities (continued)

### Analysis of investment securities by issuer

	30 June 2010	31 December 2009
<b>Investment securities issued by public bodies:</b>		
Government securities	933.7	942.7
Other public sector securities	9.4	9.1
	<b>943.1</b>	951.8
<b>Investment securities issued by other issuers:</b>		
Bank and building society certificates of deposits	1,056.2	849.2
<b>Other debt securities:</b>		
Credit trading funds	16.5	16.5
Structured investment vehicles	–	–
Other floating-rate notes	1,995.3	2,774.6
Mortgage-backed securities	2,052.7	2,351.4
	<b>4,064.5</b>	5,142.5
	<b>6,063.8</b>	6,943.5

Other floating-rate notes (FRNs) relate to sterling, euro and US dollar denominated FRNs with maturities ranging from two weeks to six years from the balance sheet date.

## 7. Customer accounts

	30 June 2010	31 December 2009
Retail	27,038.0	26,700.1
Corporate and Markets	4,446.6	3,577.1
Other	582.9	551.0
	<b>32,067.5</b>	30,828.2

The Group has entered into interest-rate swaps that protect it from changes in interest rates on the floating-rate assets that are funded by its fixed-rate customer accounts. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed-rate customer accounts. Included within customer accounts are 'fair-value-hedged' fixed-rate accounts with a total nominal value of £547.3m (31 December 2009: £3,359.3m) against which there are fair-value adjustments for hedged risk of £1.5m (31 December 2009: £9.7m), giving a total carrying value of £548.8m (31 December 2009: £3,369.0m).

## 8. Customer accounts – capital bonds

	30 June 2010	31 December 2009
Retail	1,789.6	1,647.1

The capital bonds are fixed-term customer accounts with returns based on the movement in an index (eg FTSE100) over the term of the bond.

The capital bonds have been designated on initial recognition at fair value through income or expense and are carried at their fair value.

The fair values for the capital bonds are obtained on a monthly basis from the third parties that issue these products. These external valuations are reviewed independently using valuation software to ensure the fair values are priced on a consistent basis.

None of the change in the fair value of the capital bonds is attributable to changes in the liability's credit risk.

## 8. Customer accounts – capital bonds (continued)

The maximum amount the Bank would contractually be required to pay at maturity for all the capital bonds is £1,791.3m (31 December 2009: £1,653.2m).

The Bank uses swaps to create economic hedges against all of its capital bonds. The loss on capital bonds in the income statement for the period is £11.7m (25 July 2009: £nil). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the period is a loss of £0.2m (25 July 2009: £nil).

## 9. Provision for Financial Services Compensation Scheme (FSCS) levies

The FSCS has provided compensation to customers of financial institutions following the collapse of deposit takers in 2008. The compensation paid out to consumers is currently funded through loans from HM Treasury. The Bank could 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 Bank has provided £23.7m as at 30 June 2010 (31 December 2009: £20.3m) for its share of the levies that will be raised by the FSCS including the interest on the loan from HM Treasury in respect of the 2008/09, 2009/10, 2010/11 and 2011/12 levy years. The provision includes estimates for the interest FSCS will pay on the loan and of the Bank's market participation in the relevant periods.

However the ultimate FSCS levy to the industry as a result of the 2008 collapses cannot currently be estimated reliably as it is dependent on other factors that may affect amounts payable and the timing of amounts payable, including changes in interest rates, potential recoveries of assets by the FSCS and the level of protected deposits. The current arrangements end in March 2012 and the FSCS has not yet issued any details of arrangements beyond this date. Therefore the Bank has not made any provision for fees beyond this period.

## 10. Contingent liability

### Payment-protection insurance

The Bank operates in regulated markets and is subject to significant legislative and regulatory requirements, with the main regulator of the Bank being the FSA. Regulatory intervention is an ongoing feature of UK financial services and changes could impact the profitability of the Bank. Currently, the most significant regulatory issue with uncertain consequences relates to past sales of payment-protection insurance (PPI). The FSA has considered its requirements to this industry-wide issue and has now set them out in a policy statement published on 10 August 2010. The Bank has until 1 December 2010 to comply with the new requirements.

Relevant sales have been made by the Bank although the Bank ceased selling this product in January 2009. Total complaints received from customers remain low as a proportion of total PPI sales made. The Bank is investigating the impact of the new requirements but at this time it is not practical to evaluate the cases concerned, nor therefore to make a reliable estimate of the amount of any provision that may be required. In the remainder of the year, the Bank will assess what provision is appropriate.

## 11. Related-party transactions

Related-party transactions and transactions with key management personnel in the half year to 30 June 2010 are similar in nature to those for the year ended 31 December 2009. Details of the Bank's related party transactions and transactions with key management personnel for the year ended 31 December 2009 can be found in the 2009 financial statements.

A number of banking transactions are entered into with related parties in the normal course of business on normal commercial terms.

## 12. Risk analysis

The Bank's principal risks relating to financial instruments are considered to be consistent with those reported in the 2009 financial statements. Further analysis is provided in the principal risks section of this report.

# Responsibility statement

We confirm that to the best of our knowledge:

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

By Order of the Board, 25 August 2010

Neville Richardson  
Chief executive

The Co-operative Bank plc board of directors:

## **Executive directors:**

Neville Richardson	Chief executive
Rod Bulmer	
Tim Franklin	
Phil Lee	
John Reizenstein	
Barry Tootell	

## **Non-executive directors:**

Bob Burlton	Chair	(Resigned 15 April 2010)
Paul Flowers	Chair	(Appointed 15 April 2010)
Rodney Baker-Bates		
Duncan Bowdler		
David Davies		
Peter Harvey		
Paul Hewitt		
Chris Jones		
Stephen Kingsley		
Peter Marks		
Bob Newton		
Ben Reid		
Len Wardle		
Martyn Wates		
Steve Watts		
Piers Williamson		

The half-yearly dividend to Preference shareholders of 4.625p per £1 preference share, amounting to £2,775,000 will be paid on 30 November 2010 to holders on the register at 29 October 2010.

Registered Office:  
1 Balloon Street  
Manchester  
M60 4EP

Reg. No. 990937 (England)

Registrar:  
Computershare Investor Services PLC  
P.O. Box 82  
The Pavillions  
Bridgwater Road  
Bristol  
BS99 7NH

Tel: 0870 702 0003

25 August 2010





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