The Co-operative Bank plc
Additional Regulatory Disclosures – Interim 2013

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1. Overview and context

For the period ended 30 June 2013

All amounts are stated in £m unless otherwise indicated

1.1 Introduction

These Additional Regulatory Disclosures are in accordance with requirements defined by the Prudential Regulation Authority (PRA), and provide interim Basel III CRD IV capital resources and leverage ratio disclosures.

These disclosures have been completed according to the final Capital Requirements Directive (CRD IV) published within the Official Journal of the European Union on 26 June 2013, along with the FSA's public statement 'CRD IV transitional provisions on capital resources'.

1.2 Frequency

This interim regulatory disclosure will be published on an annual basis for the period ended 30 June to facilitate interim reporting of Basel III CRD IV capital and leverage ratio. Full year disclosures are expected to be published within the Pillar 3 disclosures for the year ended 31 December 2013, in line with the financial statements announcement.

1.3 Media and location

The report will be published on The Co-operative Banking Group website: www.co-operativebankinggroup.co.uk.

1.4 Verification

These disclosures have been internally reviewed and verified. They will be externally verified only to the extent they are equivalent to those made under accounting requirements.

1.5 Scope of application

These disclosures are based on the Bank. The Bank is defined as The Co-operative Bank consolidated with its subsidiaries. Basel II capital disclosures are included within this disclosure for comparative purposes and are in line with BIPRU requirements.

2. Capital resources and leverage ratio

For the period ended 30 June 2013
All amounts are stated in £m unless otherwise indicated

On 17 June 2013, the Bank announced a recapitalisation plan ('the Plan') which has been discussed with the relevant regulatory bodies. The Plan is intended to raise an additional £1.5bn of Common Equity Tier 1 capital from a combination of a capital injection from The Co-operative Group and an Exchange Offer. The Plan is discussed more fully in the 2013 interim financial statements.

The capital position disclosed below is prior to recognising the anticipated impact of this Plan.

The Bank currently reports its regulatory capital under the prevailing Basel II approach. However, from 1 January 2014 the Bank will be subject to the final Basel III CRD IV including transitional provisions where applicable.

2.1 Capital resources under Basel II

The Bank's regulatory capital is analysed into two tiers, which are then subject to regulatory adjustments as applicable.

Tier 1 capital:
Tier 1 capital includes share capital, retained earnings, and non-cumulative irredeemable preference shares. Retained earnings exclude gains or losses on cashflow hedges and available for sale assets.

Tier 2 capital:
Tier 2 capital includes subordinated debt issues and perpetual subordinated bonds (PSBs). The rights of payment to the holders of this debt are subordinated to the claims of depositors and other creditors of the Bank. More information on these can be found in the 2012 financial statements.

Revaluation reserves relating to net gains on equity held in the available for sale financial assets category are included in Tier 2 capital.

Regulatory adjustments
Intangible assets are deducted from Tier 1 capital. Under the Internal Ratings Based (IRB) approach, a deduction is made for expected losses in excess of impairment. Of this, 50% is deducted from Core Tier 1 net of tax and 50% from Tier 2 capital gross of tax. Other Tier 1 capital is adjusted by the remaining 50% tax on the excess of expected losses over impairment. Further adjustments are explained within the appropriate footnote to Table 2.

2. Capital resources and leverage ratio continued

For the period ended 30 June 2013

All amounts are stated in £m unless otherwise indicated

Table 1 – Basel II capital ratios and risk-weighted assets

	30 June 2013	31 December 2012
Capital Ratios		
Core Tier 1 ratio	**4.9%**	8.8%
Tier 1 ratio	**5.3%**	9.4%
Total capital ratio	**9.4%**	14.4%
Risk-weighted assets		
Credit risk	**14,758.0**	15,974.8
Market and counterparty risk	**2.1**	492.6
Operational risk	**1,255.2**	1,441.3
Total risk-weighted assets	**16,015.3**	17,908.7

Core Tier 1 ratio has reduced by 3.9% to 4.9% as at 30 June 2013. This is due to a 50% (£789.0m) decrease in Core Tier 1 after deductions offset by a 11% (£1,893.4m) decrease in risk-weighted assets.

The reduction in risk-weighted assets is primarily due to a 12% (£894.7m) reduction in corporate risk-weighted assets. The change is driven by asset sales and the reassessment of the carrying value of corporate real estate exposures together with an ongoing review of regulatory capital requirements. Slotting models are used to analyse and monitor specialised lending exposures to property which are assigned to PRA supervisory categories with predefined risk-weights. A significant proportion of loans have been downgraded with many moving into default. Loans in default have a zero risk-weight (but a 50% Expected Loss). Movement to default is the primary reason for the reduction in corporate risk-weighted assets.

Market and counterparty risk capital requirements have also decreased, by £490.5m due to the sale of the Bank's held for trading assets.

2. Capital resources and leverage ratio continued

For the period ended 30 June 2013

All amounts are stated in £m unless otherwise indicated

2.1 Capital resources under Basel II continued

The following table shows the capital resources of the Bank as at 30 June 2013.

Table 2 – Basel II capital resources

	30 June 2013	31 December 2012
Core Tier 1 capital before regulatory adjustments:		
Permanent share capital	**410.0**	410.0
Retained earnings	**1,304.1**	1,813.4
Minority interests (1)	**32.8**	32.0
Losses for the period	**(781.5)**	(508.1)
Share premium account	**8.8**	8.8
Total Core Tier 1 capital before regulatory adjustments	**974.2**	1,756.1
Regulatory adjustments from Core Tier 1 capital:		
Intangible assets (2)	**(115.6)**	(27.9)
50% of excess of expected losses over impairment (net of tax) (3)	**(58.8)**	(159.7)
50% of securitisation positions (3)	**(21.0)**	(0.7)
Total Core Tier 1 capital after regulatory adjustments	**778.8**	1,567.8
Other Tier 1 capital:		
Non-cumulative irredeemable preference shares	**60.0**	60.0
Regulatory adjustments from Other Tier 1 capital:		
50% of tax on excess of expected losses over impairment (3)	**17.8**	51.8
50% of material holdings	**(2.2)**	(2.0)
Total Tier 1 capital after regulatory adjustments	**854.4**	1,677.6
Tier 2 capital before regulatory adjustments:		
Revaluation reserves	**2.0**	2.0
Collective provisions	**0.9**	0.7
Subordinated notes and perpetual subordinated bonds (4)	**1,116.8**	1,112.1
Excess on limits for lower Tier 2 capital (5)	**(366.4)**	–
Total Tier 2 capital before regulatory adjustments	**753.3**	1,114.8
Regulatory adjustments from Tier 2 capital:		
50% of excess of expected losses over impairment (gross of tax) (3)	**(76.6)**	(211.5)
50% of securitisation positions (3)	**(21.0)**	(0.7)
50% of material holdings	**(2.2)**	(2.0)
Total Tier 2 capital after regulatory adjustments	**653.5**	900.6
Total capital resources	**1,507.9**	2,578.2

(1) Minority interests represent the interests of shareholders, other than the Bank, in the equity of Unity Trust Bank.

(2) Intangible assets are excluded from capital for regulatory purposes.

(3) Under IRB rules both the excess of expected losses over impairment and securitisation positions with an external credit rating below BB- are deducted 50% from Tier 1 and 50% from Tier 2 capital.

(4) Subordinated notes and perpetual subordinated bonds include Permanent Interest Bearing Shares (PIBS) of Britannia Building Society which converted to perpetual subordinated debt on merger. For regulatory purpose, these are included net of any unamortised issue costs and fair value adjustments arising from the merger with Britannia. Tier 2 instruments with less than five years to maturity are subject to amortisation per regulatory rules. More information regarding these instruments can be found in the Bank's 2012 financial statements.

(5) Under regulatory gearing rules, lower Tier 2 capital cannot exceed 50% of Tier 1 capital after deduction of intangible assets.

2. Capital resources and leverage ratio continued

For the period ended 30 June 2013

All amounts are stated in £m unless otherwise indicated

2.1 Capital resources under Basel II continued

The following table shows the movement in capital resources of the Bank between 31 December 2012 and 30 June 2013.

Table 3 – Basel II capital resources movements

Core Tier 1 capital as at 31 December 2012:	1,567.8
Retained earnings	(1.2)
Minority interests	0.8
Losses for the period	(781.5)
Intangible assets	(87.7)
50% of excess of expected losses over impairment (net of tax)	100.9
50% of securitisation positions	(20.3)
Core Tier 1 capital as at 30 June 2013	**778.8**
Other Tier 1 capital as at 31 December 2012:	109.8
50% of tax on excess of expected losses over impairment	(34.0)
50% of material holdings	(0.2)
Other Tier 1 capital as at 30 June 2013	**75.6**
Total Tier 1 capital as at 30 June 2013	**854.4**
Tier 2 capital as at 31 December 2012:	900.6
Collective provisions	0.2
Subordinated notes and perpetual subordinated bonds	4.7
Excess on limits for lower Tier 2 capital	(366.4)
50% of excess of expected losses over impairment (gross of tax)	134.9
50% of securitisation positions	(20.3)
50% of material holdings	(0.2)
Tier 2 capital as at 30 June 2013	**653.5**
Total capital resources as at 30 June 2013	**1,507.9**

Total capital resources decreased by £1,070.3m over the period to £1,507.9m at 30 June 2013. Core Tier 1 capital fell by £789.0m primarily due to the statutory loss of £709.4m before tax and £781.5m after tax.

Total excess expected loss over impairment provisions deduction (gross of tax) decreased by £269.8m, primarily driven by an additional £225.6m of provisions within the period. The Bank contracts with CFS Management Services Ltd (CFSMS), a fellow subsidiary of the Banking Group, to build certain assets, including IT developments. Whilst these intangible assets are on the balance sheet of CFSMS, at 30 June 2013 the share attributable to the Bank has been deducted from the Bank's capital resources. The £115.6m includes £91.8m of intangibles included on the CFSMS balance sheet. This is in line with the Bank's regulatory reporting to the PRA.

The £40.6m increase in the securitisation deduction (net of provisions) was primarily due to the completion of the Calico synthetic securitisation in January 2013.

£366.4m of lower Tier 2 capital is currently ineligible due to gearing rules as lower Tier 2 capital cannot exceed 50% of Tier 1 capital after deductions.

2. Capital resources and leverage ratio continued

For the period ended 30 June 2013

All amounts are stated in £m unless otherwise indicated

2.2 Capital resources under Basel III

The Bank also monitors its capital position under forthcoming Basel III regulations. These regulations are not yet in force within the European Union. Basel III rules within the EU (collectively known as CRD IV) will be implemented on a transitional basis from 1 January 2014 to full implementation in 2022 (at the earliest). The PRA released its consultation to implement CRD IV on 2 August 2013. We note that the PRA's consultation proposes that the definition of Common Equity Tier 1 (CET1) capital will require capital deductions and amendments to prudential filters to apply fully from 1 January 2014, rather than on a transitional basis. However, these disclosures are produced in-line with PRA requirements issued before the consultation on CRD IV and do not include these proposed amendments to the transitional period.

Table 4 – Basel III capital ratios and risk-weighted assets

The table below shows the capital ratios and risk-weighted assets of the Bank as at 30 June 2013 on a final Basel III basis.

	30 June 2013	31 December 2012
Capital Ratios		
Common Equity Tier 1 ratio	**3.2%**	6.3%
Tier 1 ratio	**3.2%**	6.3%
Total capital ratio	**7.6%**	10.3%
Basel II risk-weighted assets	**16,015.3**	17,908.7
Securitisations risk-weighted at 1250%	**525.8**	17.2
Credit Valuation Adjustment	**431.0**	397.5
Asset Valuation Correlation	**379.1**	431.5
Deferred Tax Assets	**–**	77.5
Other	**10.7**	9.9
Basel III risk-weighted assets	**17,361.9**	18,842.3

2. Capital resources and leverage ratio continued

For the period ended 30 June 2013

All amounts are stated in £m unless otherwise indicated

2.2 Capital resources under Basel III continued

The table below shows the capital resources of the Bank as at 30 June 2013 using transitional and final Basel III rules. For June 2013, year 1 transitional rules are based on 2014 percentages. For December 2012, year 1 transitional rules are based on 2013 percentages. As a result, grandfathering percentages applied to Additional Tier 1 (AT1) and Tier 2 (T2) capital instruments are 80% in June 2013 and 90% in December 2012. In addition transitional percentages applied to regulatory adjustments are 20% in June 2013 and 0% in December 2012. Tier 2 capital as at 31 December 2012 has been restated such that those instruments which do not have an incentive to redeem remain eligible under Basel III.

Table 5 – Basel III capital resources

	30 June 2013		31 December 2012	
	Year 1 Basel III transitional rules £m	**Basel III final rules £m**	Year 1 Basel III transitional rules £m	Basel III final rules £m
Common Equity Tier 1 capital: instruments and reserves				
Permanent share capital and the related share premium account	**418.8**	**418.8**	418.8	418.8
Retained earnings	**1,304.1**	**1,304.1**	1,813.4	1,813.4
Available for sale and cash flow hedge reserves	**30.8**	**30.8**	93.7	93.7
Minority Interests (1)	**28.7**	**12.2**	32.0	11.5
Independently reviewed interim profits net of any foreseeable charge or dividend	**–**	**–**	–	–
Common Equity Tier 1 (CET1) capital before regulatory adjustments	**1,782.4**	**1,765.9**	2,357.9	2,337.4
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
Prudential valuation in trading book	**(5.0)**	**(5.0)**	(7.0)	(7.0)
Intangible assets (net of related tax liability) (2)	**(23.1)**	**(115.6)**	–	(27.9)
Deferred tax assets not arising from temporary differences (3)	**–**	**–**	(1.4)	(14.1)
Cashflow hedge reserves	**(24.9)**	**(24.9)**	(63.7)	(63.7)
Expected loss shortfall (4)	**(55.9)**	**(279.5)**	–	(537.4)
Securitisation positions treated as deduction (5)	**–**	**–**	–	–
Losses for the period	**(781.5)**	**(781.5)**	(508.1)	(508.1)
Filter for unrealised gains on debt instruments held in the available for sale category (6)	**(3.9)**	**–**	(27.9)	–
Unrealised gains or losses on available for sale assets (revaluation reserve) (6)	**(2.0)**	**–**	(2.0)	–
Qualifying AT1 deductions that exceed AT1 capital (7)	**(155.8)**	**–**	(242.6)	–
Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(1,052.1)**	**(1,206.5)**	(852.7)	(1,158.2)
Common Equity Tier 1 (CET1) capital	**730.3**	**559.4**	1,505.2	1,179.2

2. Capital resources and leverage ratio continued

For the period ended 30 June 2013

All amounts are stated in £m unless otherwise indicated

2.2 Capital resources under Basel III continued

Table 5 – Basel III capital resources continued

	30 June 2013		31 December 2012	
	Year 1 Basel III transitional rules £m	Basel III final rules £m	Year 1 Basel III transitional rules £m	Basel III final rules £m
Additional Tier 1 capital: instruments				
Perpetual non-cumulative preference shares (8)	**48.0**	**–**	54.0	–
Minority interest (1)	**0.5**	**2.6**	–	2.5
Additional Tier 1 capital before regulatory adjustments	**48.5**	**2.6**	54.0	2.5
Additional Tier 1 capital: regulatory adjustments				
Intangible assets (2)	**(92.5)**	**–**	(27.9)	–
Expected loss shortfall (4)	**(111.8)**	**–**	(268.7)	–
Total regulatory adjustments to Additional Tier 1 (AT1) capital	**(204.3)**	**–**	(296.6)	–
AT1 adjustments in excess of AT1 capital (7)	**155.8**	**–**	242.6	–
Additional Tier 1 capital	**–**	**2.6**	–	2.5
Tier 1 capital	**730.3**	**562.0**	1,505.2	1,181.7
Tier 2 capital: instruments and provisions				
Capital instruments (9)	**1,120.4**	**747.2**	1,119.8	747.3
Minority interests (1)	**0.7**	**3.5**	–	3.4
Collective provisions	**0.9**	**0.9**	0.7	0.7
Tier 2 capital before regulatory adjustments	**1,122.0**	**751.6**	1,120.5	751.4
Tier 2 capital: regulatory adjustments				
Expected loss shortfall (4)	**(111.8)**	**–**	(268.7)	–
Revaluation reserves (6)	**2.0**	**–**	2.0	–
Total regulatory adjustments to Tier 2 capital	**(109.8)**	**–**	(266.7)	–
Tier 2 capital	**1,012.2**	**751.6**	853.8	751.4
Total capital	**1,742.5**	**1,313.6**	2,359.0	1,933.1

(1) Under Basel III the amount of minority interest which can be recognised is reduced over the transitional period and allocated between the different tiers of capital.

(2) Intangible assets change from being a deduction from Tier 1 under Basel II to a deduction from CET1 under Basel III.

(3) Deferred tax assets not arising from temporary differences move from being risk-weighted to being a deduction from CET1.

(4) Expected loss shortfall changes from being deducted half from Tier 1 and half from Tier 2 to a full deduction from CET1. Under Basel II rules the deduction is net of tax, whereas under Basel III they are gross with the full change applying immediately. Under Basel III provisions for default accounts can only be recognised up to the value of the expected loss.

(5) Securitisation positions with an external credit rating below BB- are no longer shown as a deduction, and are risk-weighted instead.

(6) Some regulatory adjustments under Basel II do not apply under Basel III.

(7) The amount of qualifying deductions allowed against Additional Tier 1 exceeds the Bank's Additional Tier 1 resources and so is shown as a deduction against CET1. Under full implementation, deductions are applied entirely from CET1.

(8) Perpetual non-cumulative preference shares have a cap of 80% of the nominal value applied (£48m) under Year 1 transitional rules. The remaining £12m is included in Tier 2 capital prior to the application of the Tier 2 cap.

(9) The year one transitional cap has a small impact on the recognised value of Tier 2 instruments. The cap is based on the nominal value of the underlying instruments at 31 December 2012. As a result of the merger with Britannia Building Society in 2009, some of the Bank's Tier 2 instruments are reported net of fair value adjustments and so the total value of the Tier 2 instruments only just exceeds the year one cap.

2. Capital resources and leverage ratio continued

For the period ended 30 June 2013

All amounts are stated in £m unless otherwise indicated

2.2 Capital resources under Basel III continued

The previous table is based on the reporting template in Annex VI of the EBA Consultation Paper on Draft Implementing Technical Standards on Disclosure for Own Funds by institutions (EBA/CP/2012/04), 7 June 2012. It has been completed according to the final CRR regulations published within the Official Journal of the European Union on 26 June 2013, along with the PRA's public statement 'CRD IV transitional provisions on capital resources'. For clarity, only those parts of the table with relevance to the Bank are shown.

In addition to changes to capital resources and deductions highlighted under Basel II capital resources, the following changes impact Basel III capital resources:

Deferred tax assets are treated under Basel III net of deferred tax liabilities. In June 2013 the Bank had a net deferred tax liability so there is no capital impact of deferred tax.

Note that the capital instruments included in Table 5 above are subject to the Exchange Offer discussed in the opening paragraph to Section 2. The Plan will enable the Bank to improve its capital position and generate additional Common Equity Tier 1 capital. Further information on The Plan can be found in the Bank's interim financial statements.

2.3 Leverage ratio

Under final Basel III rules, the leverage ratio as at 30 June 2013, is 1.15% (31 December 2012: 2.24%). If ineligible Tier 1 capital instruments are included (perpetual preference shares) then the leverage ratio is 1.25% (31 December 2012: 2.35%).

The leverage ratio is calculated as Basel III Tier 1 capital after deductions divided by adjusted balance sheet exposure. Exposures are calculated using instructions for Basel III Quantitative Impact Studies and related FAQs. Derivative balances are adjusted to reflect the exposure used for capital purposes, off-balance sheet commitments are added and some deductions from Tier 1 are also deducted from the exposure.

3. Glossary

For the period ended 30 June 2013

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

Item	Description
Basel II	A statement of best practice issued by the Basel Committee on Banking Supervision, that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the FSA Handbook.
Basel III	A strengthening of the requirements laid out in Basel II, with phased implementation from 2014, ahead of full implementation by 2023. Basel III disclosures within this document are reported on a CRD IV basis which implements Basel III within the European Union. The PRA released its consultation to implement CRD IV on 2 August 2013. We note that the PRA's consultation proposes that the definition of Common Equity Tier 1 capital will require capital deductions and amendments to prudential filters to apply fully from 1 January 2014, rather than on a transitional basis. However these disclosures are produced in-line with PRA requirements issued before the consultation on CRD IV and do not include these proposed amendments to the transitional period.
Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)	Part of the Prudential Regulation Authority (PRA) handbook setting out prudential requirements: The Prudential Sourcebook for Banks, Building Societies and Investment Firms. Available to view on www.fshandbook.info/FS/.
CFS Management Services (CFSMS)	A subsidiary of The Co-operative Banking Group that provides facilities and services to all Banking Group companies.
Capital Requirements Directive (CRD IV)	The package of regulation (CRR) and directive (CRD IV) that implement Basel III within the European Union.
Capital Requirements Regulation (CRR)	European regulation that along with the Capital Requirements Directive (CRD IV) implements Basel III within the European Union.
Expected Loss (EL)	A Basel II Pillar 1 calculation – The amount estimated under the IRB approach to be lost on current exposures due to potential defaults on existing and committed lending over a one year time horizon.
Prudential Regulation Authority (PRA)	An independent body that, along with the Financial Conduct Authority (FCA), regulates the financial services industry in the UK. The PRA is part of the Bank of England and is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms.
Perpetual Subordinated Bonds (PSBs)	Bonds with no maturity date that do not require the issuer to redeem.
The Bank	The Co-operative Bank consolidated with its subsidiaries.
The Co-operative Banking Group	A consolidation of the following entities: CFS Management Services Ltd, CFS Services Ltd, CIS General Insurance Ltd, Co-operative Insurance Society Ltd, Co-operative Asset Management Ltd and Co-operative Bank plc. Following the sale of the Life and Savings business on 1 August 2013, Co-operative Insurance Society Ltd and Co-operative Asset Management Ltd are no longer part of The Co-operative Banking Group.

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